

BFH rules on applicability of trade tax exemption for partner in real estate managing partnership

Partner was eligible for exemption relating to its share of rental income from real estate managing partnership.

In a 25 September 2018 decision published on 27 March 2019, the Grand Senate of the German federal tax court (BFH) concluded that a holding company that was subject to German trade tax due solely to its legal form was not prevented from benefitting from the trade tax exemption rules relating to real estate in a situation where it held real estate in Germany indirectly through its participation in a German asset-managing partnership (which was not carrying on a trade or business).

For German trade tax purposes, a company subject to trade tax but that is exclusively (or almost exclusively) engaged in the administration of its own real property is allowed to benefit from an “extended trade tax deduction”, i.e. a trade tax exemption where the income derived from the management of its own real estate (such as rental income) is exempt from trade tax.

An asset-managing partnership is not subject to trade tax if it does not pursue any commercial or trade activities and its activities are limited to the acquisition and long-term administration of property, such as real estate held in Germany. However, if its general partner is a corporation, the asset-managing partnership needs to ensure that it is not considered as a partnership carrying on a trade or business by appointing at least one (corporate or individual) limited partner as a managing director. For income tax purposes, the assets and liabilities of an asset-managing partnership are deemed to be allocated to its partner(s) in accordance with their participation in the partnership.

In the case, a partnership liable to trade tax due to its legal form (GmbH & Co. KG) held a partial participation in an asset-managing partnership (GbR) that owned real estate in Germany. The GmbH & Co. KG applied for a trade tax exemption for its partial share of income derived from the rental income earned by the GbR, which was allocated to the GmbH & Co. KG for income tax purposes because the GbR was a transparent entity for tax purposes.

The tax office did not grant the trade tax exemption, as it considered that the real estate was not directly owned by the GmbH & Co. KG, but by the GbR. The case was brought before the Fourth Senate of the BFH, which generally considers certain cases involving partnerships and intended to rule in favor of the GmbH & Co. KG. However, this would have conflicted with a previous opinion of the First Senate (which generally considers certain cases involving corporations), so the Fourth Senate asked the Grand Senate (comprising the president of the BFH and one judge from all BFH senates not chaired by the president) for its decision on the issue.

The Grand Senate held that the allocation of the asset-managing partnership's real estate for purposes of the trade tax exemption must be made based on the general principles of income taxation, as well as the purpose of the provision. Therefore, real estate that qualifies as a business asset of the relevant entity must be taken into account for purposes of the trade tax exemption. From a tax perspective, all assets and liabilities are allocated to the partner(s) of an asset-managing partnership in accordance with their participations. Therefore, in the case, the real estate legally owned by the GbR was deemed to be partially owned by the GmbH & Co. KG for purposes of the application of the trade tax exemption, since the GmbH & Co. KG was a partner in the GbR. Accordingly, the GmbH & Co. KG was not prevented from benefitting from the trade tax exemption with regards to its partial share of income derived from the rental income earned by the GbR.

The decision clarifies a long-disputed question in favor of the taxpayer. Nevertheless, there are still several open questions relating to the trade tax exemption (e.g. whether and to what extent the inclusion of operating facilities in the rental agreement constitutes a

harmful activity that prevents the granting of the trade tax exemption), so care should be taken in structuring investments into German real estate.

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