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German Tax and Legal News

BFH rules on application of RETT intragroup exemption clause

Court interprets clause broadly and rejects literal reading of statutory language.

In a series of seven decisions from August 2019 that were published on 13 February 2020, Germany's federal tax court (BFH) ruled on the application of the real estate transfer tax (RETT) intragroup restructuring exemption clause. The BFH generally interpreted the clause broadly and rejected a literal reading of the statutory language, and its interpretation could allow more taxpayers to qualify for the exemption.
Under the current rules, RETT generally is triggered under the following circumstances:

- Direct transfers of real estate located in Germany;
- Where 95% or more of the shares in a German real estate-owning company are directly or indirectly transferred to a new owner;
- Where 95% or more of the shares in a German real estate-owning company are directly or indirectly combined for the first time in the hands of a new shareholder; or
- Where there is a 95% or greater direct or indirect change of the partners in a German real estate-owing partnership.

It should be noted that changes have been proposed to the RETT rules and that the rules are likely to change with effect from 1 January 2021, or possibly sooner.

Under the existing RETT intragroup restructuring exemption, certain direct or indirect transfers of real estate or shares in real estate-owning entities are exempt from RETT. Among other conditions for the exemption to apply, the restructuring transaction must involve one controlling entity and one or more controlled entities (RETT group), and a direct or an indirect shareholding of at least 95% must exist between the RETT group members for the five years immediately before and after the transaction.

There has been controversy in the German tax literature over whether the conditions for the exemption must be interpreted based on the literal wording of the statutory language. Taken literally, the conditions could not be fulfilled where the transaction involves a merger (i.e., where the controlled entity is eliminated by way of an "upstream" or "side-stream" merger) or a demerger or "hive down" transaction (i.e., where the controlled entity is newly created) because the 95% shareholding either would not survive the transaction or would not exist before the transaction.

The BFH has now ruled on the application of the RETT intragroup exemption clause in a series of cases involving upstream mergers, a side-stream merger, a demerger, and a hive-down transaction. In its decisions, the BFH generally came to the conclusion that the RETT intragroup restructuring exemption must be applied broadly.

The cases in the series were linked and pending together because, in one case involving an upstream merger of a controlled entity into its parent entity (see GTLN dated 06/16/2017), the BFH had raised the question whether the intragroup restructuring exemption could constitute state aid by favoring certain undertakings (where there is 95% ownership and a merger transaction, compared to a regular sale). The BFH referred the case to the Court of Justice of the European Union (CJEU), requesting a preliminary ruling on the compatibility of the German RETT intragroup restructuring exemption clause with the EU state aid rules (see GTLN dated 06/16/2017). On 19 December 2018, the CJEU issued a decision confirming that the intragroup restructuring exemption does not constitute state aid because it prevents excessive taxation and relies on objective criteria in line with the objective and purpose of the German RETT law (see GTLN dated 12/19/2018).

Following the CJEU's decision, the BFH resumed consideration of the cases in the series, including whether the conditions to qualify for the intragroup restructuring exemption must be interpreted based on a literal reading of the statutory language. The following observations can be made from the series of rulings issued by the BFH:

- The BFH ruled (in favor of the taxpayers) that the five-year minimum shareholding

period for a 95% (direct or indirect) shareholding percentage following a restructuring does not apply if the nature of the qualifying restructuring transaction does not allow this requirement to be met. In cases where the controlled entity is eliminated through an upstream or side-stream merger transaction, the 95% minimum shareholding of the controlling parent in the entity that is merged out of existence does not survive the transaction, due to the nature of the restructuring. Accordingly, the requirement that a 95% shareholding must be maintained for five years after the transaction cannot be met. In line with the decisions of the lower tax courts (see GTLN dated 06/16/2017), the BFH rejected the tax authorities' position and held that the group exemption also applies in a scenario where the real estate-owning entity is merged upstream into its parent entity/shareholder, even though the merger leads to the elimination of the controlled entity and, hence, the dissolution of the RETT group (since only one entity survives).

- Similarly, the BFH ruled (in favor of the taxpayers) that the five-year minimum shareholding period before a restructuring does not apply if the nature of the qualifying restructuring transaction does not allow this requirement to be fulfilled. In cases where the controlled entity is newly incorporated as a result of a side-stream merger (or a demerger or a hive-down transaction), the required shareholding of the controlling parent in the newly established entity does not exist prior to the transaction, due to the nature of the restructuring. Accordingly, the five-year pre-restructuring holding period cannot be fulfilled. In line with the lower tax courts' decisions, the BFH rejected the tax authorities' position and held that the group exemption also covers cases where the 95% shareholding in a controlling entity that is part of the restructuring is established through the qualifying transaction and does not exist prior to the transaction. However, this does not mean that the five-year minimum pre-restructuring holding period does not apply to any newly incorporated entities; the intragroup restructuring exemption may apply only if the entity was incorporated through a qualifying restructuring.
- The BFH opined (in favor of the taxpayers) that a controlling parent may include an individual. To be a qualifying parent, a person must carry out business activities, but does not necessarily need to meet the strict requirements that would apply to qualify as an entrepreneur within the meaning of the German VAT Act. In line with the decisions of the lower tax courts, the BFH rejected the tax authorities' position and ruled that entities or individuals carrying out business activities may qualify as controlling entities within the meaning of the RETT intragroup restructuring exemption clause.
- The BFH ruled (in favor of the tax authorities) that in a side-stream merger transaction where a controlled entity is being merged into another controlled entity, the five-year minimum shareholding period for a shareholding of at least 95% not only must be fulfilled with respect to the shareholding in the (controlled) transferring entity, but also with respect to the shares in the (controlled) receiving entity. In line with the decision of the lower tax court that dealt with a side-stream merger of a controlled entity into another controlled entity that was acquired by the common controlling parent only two years prior to the effective date of the merger, the BFH held that it is not sufficient for the pre-restructuring shareholding period to be met for the shares in the transferring entity; the same holding period also applies for the shares in the receiving entity. Since the shareholding was acquired (as opposed to being established through incorporation as a result of the merger transaction) two years before the merger and, hence, did not exist within the mandatory five-year minimum shareholding period prior to the restructuring, the BFH rejected the position of the taxpayer that claimed that the RETT intragroup exemption should apply.

Affected taxpayers that have been subject to German RETT because the RETT intragroup restructuring exemption either was not applied or was denied by the German tax authorities should carefully reconsider the facts of their case. Based on the BFH's decisions, taxpayers may consider filing an objection against the relevant assessments and claiming an exemption from RETT for any such restructurings, if they have not already done so.

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