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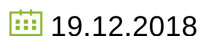 19.12.2018

German Tax and Legal News

CJEU rules German RETT intragroup exemption in line with EU state aid rules

RETT intragroup exemption does not constitute state aid because it prevents excessive taxation and relies on objective criteria in line with objective and purpose of the RETT law.

The Court of Justice of the European Union (CJEU) issued a decision (case C-374/17) on 19 December 2018, concluding that the intragroup restructuring clause in Germany's Real Estate Transfer Tax (RETT) does not constitute unlawful state aid under EU principles. The CJEU followed the 19 September 2018 opinion of the Advocate General (AG).

Background
Under current rules, RETT is triggered on direct transfers of real estate and where 95% or more of the shares in a German real estate-owning company are directly or indirectly transferred to a new owner, or where 95% or more of such shares are directly or indirectly combined for the first time in the hands of a new shareholder or if there is a 95% or greater direct or indirect change of the partners in a partnership. (It should be noted that changes have been proposed to the RETT rules.)

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

If these conditions are interpreted based on the literal wording of the statutory language, the conditions cannot be met where the transaction involves a merger (i.e. where the controlled entity is eliminated) or a demerger (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, respectively.

In a case first discussing the domestic interpretation of the RETT intragroup restructuring exemption, Germany's Federal Tax Court (BFH) raised the question whether the rule could constitute state aid by favoring certain undertakings (with a 95% ownership and a transaction by way of merger versus a regular sale).
In the case before the BFH, the controlled entity owning real estate was eliminated through an upstream merger, and the German tax authorities denied the intragroup restructuring exemption and assessed RETT. The lower tax court rejected the position of the tax authorities and held that the exemption generally covers cases where the real estate-owning entity is merged upstream into its parent entity, even though the merger leads to the dissolution of the corporate group for RETT purposes (since only one entity survives). Therefore, the requirement that a 95% shareholding be maintained for five years after the transaction is not met.

On appeal, the BFH agreed with the technical analysis of the lower court and rejected the arguments of the tax authorities. However, the BFH also concluded that, because the exemption is available only for certain restructuring transactions, requires an ownership threshold and a minimum holding period, it could be interpreted as being selective aid under article 107 of the Treaty on the Functioning of the European Union. If there is a question whether a measure is "selective" or a "permitted restriction" of a general tax benefit, the issue must be referred to the CJEU for guidance and interpretation. The BFH considered the RETT intragroup restructuring exemption to be an integral and necessary part of the RETT rules and the conditions for its application are designed to limit the number of beneficiaries, so the

exemption should not constitute a selective measure under the state aid rules.

On 30 May 2017, the BFH referred the case to the CJEU requesting a preliminary ruling on the compatibility of the RETT intragroup restructuring exemption with the EU state aid rules. In the wake of the CJEU's 21 December 2016 decision in another case (C-20/15 P), there was some uncertainty about the scope of state aid rules where tax law refers to objective criteria to determine eligibility for tax benefits, such as an exemption from a transactional tax.

Further, there could be detrimental consequences if the restructuring exemption constitutes state aid. Where a member state implements a measure without first notifying the European Commission and it later is determined that the measure constitutes state aid incompatible with EU law, the member state may be required to recover the aid on a retroactive basis from taxpayers that benefitted from the measure. Final tax assessment notices issued during the previous 10 years could be affected. A member state's domestic law (including binding rulings on the relevant issue) does not permit taxpayers to rely on measures that contravene controlling EU law.

Decision of the CJEU
The AG concluded in his opinion that the RETT intragroup restructuring exception does not constitute state aid and the CJEU agreed.

In reaching its conclusion, the CJEU reviewed the main conditions for a domestic measure to constitute state aid under EU rules:

- There must be an "intervention" by the state or through state resources;
- The intervention potentially can affect trade between EU member states;
- The intervention confers a "selective advantage" on the recipient; and
- The intervention must distort or threaten to distort competition in the EU.

The court devoted several paragraphs of its decision to a discussion of the selective advantage condition. It first stated that national measures applicable to all economic operators in the relevant member state without distinction constitute general measures and, therefore, are not selective. The CJEU reiterated that the fact that only taxpayers fulfilling the conditions to benefit from a measure cannot, in and of itself, turn that measure into a selective measure. The RETT intragroup restructuring exemption was included in German law during the 2008 financial crisis as a derogation from the normal rules to facilitate the restructuring of undertakings and, in particular, the structural changes involving the transfer of property between companies, to make them more competitive.

The exemption is restricted to certain groups of companies (i.e. controlling / dependent companies) that meet the participation and holding period requirement and that participate in a restructuring. A measure that creates an exception to the application of the general tax rules can be justified by the nature and overall structure of the tax system if the member state concerned can show that the "measure results directly from the basic or guiding principles of its tax system."

The CJEU concluded that the intragroup restructuring exemption is an integral and necessary part of the German RETT rules and the conditions for its application are required to limit the number of beneficiaries, so the exemption does not constitute a selective measure under the state aid rules. The court stated that the rule is intended to prevent excessive taxation in situations where there are multiple RETT-triggering events and the ultimate ownership of the real estate stays within a 95% ownership group. Thus, the exemption from RETT can be justified by the nature or general structure of the system of which it forms part.

The CJEU concluded that the RETT intragroup restructuring exemption, which grants a tax exemption for a reorganization within a group of companies (a merger in the present case), in which a controlling undertaking and a dependent company are involved, it being understood that the controlling undertaking must hold a stake of at least 95% in the dependent company in the five years preceding the procedure and, in principle, in the five years following that procedure, is not a selective measure and, thus, does not constitute state aid.

Comments
The fact that the decision was delivered by the Grand Chamber indicates the importance of the case for the further development of the concept of state aid in the tax area. In comparison to the CJEU's decision in 2016, the risk that a tax measure that provides benefits based on objective criteria would qualify as state aid has been diminished, provided the rule fits into the overall system. Nevertheless, the discussion on the application of state aid rules to direct tax

measures likely will continue.

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