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German Tax and Legal News

Compatibility of RETT intragroup exemption with EU state aid rules referred to CJEU

If CJEU concludes unlawful state aid is involved, the European Commission then will need to make a determination

On 30 May 2017, Germany's Federal Tax Court (BFH) referred a case to the Court of Justice of the European Union (CJEU) requesting a preliminary ruling on the compatibility of the German real estate transfer tax (RETT) intragroup restructuring exemption with the EU state aid rules.

The case before the BFH is based on an appeal by the tax authorities following a 2015 decision by the lower tax court of Nuremberg in favor of the taxpayer, a decision that was contrary to the tax authorities' guidance on the exemption ([see GTLN dated 25 March 2015](#)). Due to the complexity of the rules, in 2015, the BFH asked the Federal Ministry of Finance (MOF) to opine on whether the RETT intragroup exemption constitutes state aid ([see GTLN dated 29 February 2016](#)). The MOF confirmed that the exemption was not formally notified to the European Commission (EC) as potential state aid when the exemption was introduced in 2009 (with effect as from 1 January 2010).

Under the RETT intragroup restructuring exemption, certain direct or indirect transfers of real estate or shares in real estate-owning entities are exempt from RETT. One condition for the exemption to apply is that the restructuring transaction must involve one controlling company and one or more controlled entities, and a direct or indirect shareholding of at least 95% must exist between the entities for the five years immediately before and after the transaction. If this criterion is interpreted based on the literal wording of the statute, the criterion cannot be met where the transaction involves a merger (where the controlled entity is eliminated) or a demerger (where the controlled entity is newly created), because the 95% shareholding either would not survive the transaction or would not exist prior to the transaction, respectively.

In the case brought 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 a 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 in terms of article 107 of the Treaty on the Functioning of the EU. 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 of the domestic provision. The BFH considers the RETT intragroup restructuring exemption to be an integral and necessary part of the RETT rules and the conditions for its application are required to limit the number of beneficiaries, so the exemption should not constitute a selective measure under the state aid rules. Nevertheless, the BFH acknowledged there is some uncertainty in this area (referring to the 21 December 2016 decision of the CJEU in the World Duty Free Group case), and referred the issue to the CJEU.

If the CJEU concludes that the RETT intragroup restructuring exemption is selective and, therefore, constitutes unlawful state aid, the European Commission will have to make a final decision on whether the measure is compatible with the principles of the EU free market.

Taxpayers should carefully consider the potential risk associated with relying on the RETT

intragroup restructuring exemption and closely monitor the outcome of the CJEU proceedings.

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