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URL: http://www.deloitte-tax-news.de/german-tax-legal-news/bfh-rules-on-rett-intragroup-restructuring.html

16.12.2022

German Tax and Legal News

BFH rules on RETT intragroup restructuring

BFH clarifies conditions of RETT intragroup restructuring exemption in upstream merger case.

In a decision dated 28 September 2022 and published on 1 December 2022, Germany's federal tax court (BFH) ruled on the application of the real estate transfer tax (RETT) intragroup restructuring exemption and the determination of the controlling parent entity in the case of an upstream merger. As in several other court cases, the BFH interpreted the exemption broadly and confirmed that the required five-year minimum holding period is not of relevance where a controlled subsidiary is merged into its controlling parent entity.

Background
The case decided by the BFH involved a multi-tier structure of German entities, which included a bottom-tier German company that owned German real estate. The company was merged into its controlling parent entity and, for RETT purposes, the merger was treated as being exempt from RETT based on the intragroup restructuring exemption. Shortly after the merger, the ultimate parent entity indirectly sold some of its shares in the surviving merger entity that now held the German real estate.

The tax authorities treated the ultimate parent entity as the controlling parent entity for purposes of the exemption and determined that the indirect sale of the shares in the surviving merger entity was a harmful tax practice for purposes of the RETT exemption, because the required five-year retention period at the level of the ultimate parent entity was not met. The taxpayer argued that the surviving entity in the merger for purposes of the exemption was the surviving merger entity. The required five-year retention period, therefore, would not be of relevance with regard to shareholdings above the surviving merger entity. The lower tax court agreed with the taxpayer.

RETT intragroup restructuring exemption
Restructurings leading to a direct or indirect transfer of shares in a German real estate owning entity or the unification of such entity's shares in the hands of one shareholder generally should trigger RETT if the applicable threshold of 90% is reached (95% prior to 1 July 2021).

According to the intragroup restructuring exemption (section 6a of the RETT Act), certain direct or indirect transfers of real estate owning entities are exempt from RETT. Among other conditions for the exemption to apply, the restructuring transaction must involve one controlling parent entity and one or more controlled entities (i.e., a 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 the transaction (minimum holding period) and after the transaction (retention period). The 95% threshold for purposes of the exemption was not amended in the 2021 RETT reform.

There has been a long-standing controversy in German tax literature as to how the conditions for the exemption must be interpreted; in particular, how the RETT group must be determined and whether transactions where the conditions could not be fulfilled because of the nature of the transaction (e.g., where the controlled entity is eliminated by way of a merger transaction or newly created because of a demerger or hive down transaction) are considered a harmful tax practice for purposes of the exemption.

BFH decision
In line with previous decisions, the BFH upheld its view that the five-year minimum shareholding period of a 95% (direct or indirect) shareholding following a restructuring does not apply if the nature of the qualifying restructuring transaction does not allow this requirement to be met. The BFH once again confirmed that where the controlled entity is eliminated through an upstream merger into its controlling parent entity and, as a result, the five-year minimum retention period for a minimum shareholding of at least 95% could

not be met, the exemption should, nevertheless, be applicable.

The BFH confirmed that, for purposes of the retention period only, the relationship between the entities involved in the transaction subject to the exemption would be of relevance. In the case at hand, the merger took place between the real estate owning company and its controlling parent entity; however, the shareholder of such parent entity (or other shareholders further up the chain) was not involved and, therefore, neither qualified as a controlling parent entity nor were their direct or indirect shareholdings subject to the required five-year retention period. As a consequence, since the RETT group ceased to exist as a result of the merger of the real estate owning company into its controlling parent entity, a sale of the shares in the surviving merger entity by its shareholder (or indirectly by a shareholder further up the chain) would not cause the merger transaction to be become taxable for RETT purposes on a retroactive basis.

The decision of the BFH is a welcome clarification with respect to the determination of the controlling parent entity for purposes of the RETT intragroup restructuring exemption.

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