Deloitte.

URL: http://www.deloitte-tax-news.de/german-tax-legal-news/court-decisions-clarify-interpretation-of-trade-tax-exemption-for-real-property.html

17.03.2020

German Tax and Legal News

Court decisions clarify interpretation of trade tax exemption for real property

Certain issues clarified that have been disputed between German tax authorities and taxpayers.

The German federal tax court (BFH) and lower regional tax courts issued a number of decisions in 2019 that clarify some issues that have been disputed between the tax authorities and taxpayers regarding the interpretation of the trade tax exemption for certain entities managing their own real property.

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., income derived from the management of a company's own real estate (such as rental income) is exempt from trade tax. For further details, see our newsletter dated 15 April 2019.

The cases described below clarify certain points relating to the trade tax exemption, including the effect of various circumstances on eligibility for the exemption.

Rental of operating facilities

In three decisions dated 11 April 2019 (III R 36/15, III R 5/18 and III R 6/18), the BFH considered whether the rental of operating facilities together with the rental of real property was a "harmful" activity, i.e., an activity that prevents an entity from qualifying for the trade tax exemption. The BFH denied the trade tax exemption in all three cases. In the first case, hotel equipment (a beer cooling system, cold storage rooms, refrigerating units for counters and buffets) was rented out along with the hotel building. In the other cases, car dealership buildings were rented together with certain equipment (paint booths, a portal washing system, lifting platforms, a compressed air refrigeration dryer, and an advertising tower).

In line with the BFH's previous decisions, it ruled again that machines and other devices of any kind that serve trade or business operations ("operating facilities") do not qualify as real property. To distinguish between operating facilities and real property, the determinative factor is whether the relevant equipment serves the general use of the building or whether it is used for trade or business operations. In the three April 2019 cases, the BFH concluded that the equipment rented out in addition to the real property qualified as operating facilities, since the real property could have been rented to the tenants without the rental of the equipment.

The BFH also stated that even a portion of 0.3% of the total rental income that relates to the rental of the operating facilities is sufficient to constitute a harmful activity that prevents an entity from qualifying for the trade tax exemption, as there is no de minimis threshold included in the trade tax law. Thus, the fact that operating facilities may have an insignificant value compared to the real property value or may account for only a marginal portion of the total annual rental income does not allow an entity to benefit from the exemption from trade tax. The BFH's decisions in these cases are final.

Participation in asset-managing partnership that is commercial by definition

In two decisions dated 27 June 2019 (IV R 44/16 and IV R 45/16), the BFH considered situations where an asset-managing German partnership (GmbH & Co. KG) was holding a participation in another type of asset-managing partnership (GbR). An asset-managing partnership generally 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 in Germany.

All partnerships considered in the cases were "commercial" by definition, i.e., they were deemed to be partnerships carrying on commercial activities due to their legal form. The holding partnerships claimed an exemption from trade tax with regard to the real estate

held on their own account and attributable to their business assets.

The BFH ruled that participation in an asset-managing partnership that is commercial by definition qualifies as a harmful commercial activity that prevents an entity from benefitting from the exemption from trade tax. This differs from a decision of the Grand Senate of the BFH dated 25 September 2018, in which the Grand Senate stated that the exemption from trade tax can be granted to a partnership holding a participation in an asset-managing partnership that is not deemed to carry on commercial activities. The Grand Senate ruled that the exemption was allowed because all assets and liabilities of an asset-managing partnership are deemed to be allocated to its partner(s) in accordance with their participation and, thus, the asset-managing activity of the entity (in which the participation is held) is allocated to its partner(s). However, the BFH ruled in the June 2019 cases that because a participation held in an asset-managing partnership that is deemed to carry on commercial activities does not lead to such an allocation, the holding of the participation is deemed to be a harmful commercial activity. The taxpayer has raised an objection to the ruling that is awaiting consideration by the German constitutional court (1 BvR 2331/19).

Identity-preserving change of legal form

In a decision dated 11 July 2019 (13 K 2469/17A), the lower tax court of Cologne considered a situation where a German partnership (GmbH & Co. KG) changed its legal form into a German GmbH with retroactive effect in a tax-neutral manner, carrying over the tax book values of its assets. In the retroactivity period (i.e., between the date the change of legal form was carried out and its effective date), the entity derived a taxable gain from the sale of real estate.

The tax authorities considered that the change of legal form constituted a transfer of the real estate at below the going concern value and denied an exemption from trade tax for the gain from the sale. The tax authorities based their position on a provision of the trade tax act (article 9, number 1, sentence 5) that denies an exemption from trade tax for income that is derived from unrealized gains from real estate transferred to the entity in the preceding three business years at below the going concern value, to the extent that the income is related to unrealized gains accrued before the transfer.

The lower tax court disagreed with the tax authorities, stating that a change of legal form does not constitute a transfer within the meaning of the general principles of the income tax law. For income tax law purposes, a transfer requires a change of the assignment of current assets from the property of one business to another business, without the alternation of the form of the legal entity holding the assets. The fiction of a transfer that is respected under the reorganization law does not apply for income tax purposes. As a result, the lower tax court of Cologne granted the exemption from trade tax for the gain from the sale of real property. The tax authorities have raised an objection, and the case is pending before the BFH for review (BFH I R 39/19).

Interruption in holding of real property

In two decisions from the lower tax court of Berlin-Brandenburg dated 13 August 2019 (8 K 8310/15) and 5 November 2019 (6 K 6276/17), the sole real property owned by a German entity was transferred to another investor during the calendar year. After a period, the German entities acquired new real property. In the interim period, the German entities did not own any real property, but derived interest income from the sales proceeds received from the previously owned property and prepared for the acquisition of a new real property.

The lower tax court of Berlin-Brandenburg denied an exemption from trade tax for the German entities, stating that the requirement that an entity be exclusively (or almost exclusively) engaged in the administration of its own real property must be interpreted to include a timing aspect that requires the uninterrupted holding of real property during the entire assessment period. Both cases decided by the court are final.

Income derived from cancellation of lease agreement

In a decision from the lower tax court of Berlin-Brandenburg dated 5 November 2019 (6 K 6170/18), the tenant and the landlord concluded a 15-year lease agreement for real property in commercial use. The landlord also was obliged to renovate the real property for the particular needs of the tenant's business. However, due to disputes between the tenant and the landlord, the lease agreement was mutually terminated before the tenant started to use the real property. The tenant made a "compensation payment" (final lease payment) to the landlord to settle all claims and receivables arising from the termination of the lease

agreement.

It was disputed between the taxpayer and the tax authorities whether the compensation payment qualified for an exemption from trade tax and whether the mere existence of operating facilities in the real property resulted in a harmful activity. The lower tax court of Berlin-Brandenburg held that the compensation payment qualified for the exemption from trade tax. The court also decided that the mere existence of operating facilities in the real property did not prevent the landlord from qualifying for the trade tax exemption, since the operating facilities never actually were used by the tenant for its business operations. The decision is pending review at the BFH (BFH IV R 33/19).

Your Contacts

Alexander Vincenc
Director
avincenc@deloitte.de
Tel.: +49 89 29036-8337

Maria de Orofino
Senior Manager
mdeorofino@deloitte.de
Tel.: +49 89 29036 6927