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German Tax and Legal News

Local Tax Court rules on RETT intragroup restructuring exemption in upstream merger

The Local Tax Court of Nürnberg has ruled that the RETT intragroup restructuring exemption applies where an entity owning real estate is merged upstream into its 100% parent company. The decision is contrary to the tax authorities' guidance on the RETT intragroup restructuring exemption.

The Local Tax Court of Nürnberg ruled on October 16, 2014 that the real estate transfer tax (RETT) intragroup restructuring exemption applies where an entity owning real estate is merged upstream into its 100% shareholder.

RETT is triggered, inter alia, with respect to real estate owned by a corporation or partnership if the property is transferred to another entity either by way of a sale or through a merger of the real estate-owning entity into another entity. RETT also is triggered by upstream mergers if the ceding entity owned real estate.

Certain intragroup restructurings, however, can benefit from an exemption from RETT if the following conditions are satisfied:

- The transaction is carried out under specific provisions in Germany's Reorganization Tax Code (e.g. mergers, de-mergers, spin-offs) or comparable rules in other EU/EEA countries, or the transaction is based on company law (e.g. a contribution of shares) or comparable rules in other EU/EEA countries. Other transactions (e.g. straightforward intragroup sales of shares) do not qualify;
- The reorganization involves a controlling entity and subsidiaries in which the controlling entity holds, directly or indirectly, at least a 95% interest ("corporate group for RETT purposes"); and
- At the time the reorganization is carried out, the direct or indirect 95% shareholding was held for the previous five years and will continue to be held for five years after the reorganization.

As a result of the five-year pre- and post-reorganization holding periods and the German tax authorities' restrictive interpretation of the applicability of the intragroup exemption, the exemption is applied only in rare instances.

The case before the Local Tax Court of Nürnberg involved a situation where a company ("A-AG") owned 100% shareholdings in several subsidiaries. One of those subsidiaries ("B-GmbH") that owned German real estate was merged upstream into A-AG.

The tax authorities assessed RETT with respect to the real estate that was transferred in the course of the merger to A-AG. The RETT intragroup restructuring exemption was denied on the basis that the corporate group for RETT purposes, which previously consisted of the entities being subject to the merger (i.e. A-AG as the controlling entity and B-GmbH as the subsidiary; the other entities not subject to the merger were disregarded) no longer existed after the merger because only A-AG survived the merger. This assessment is in line with official guidance published by the tax authorities according to which reorganizations (e.g. mergers) that result in a dissolution of a corporate group for RETT purposes cannot benefit from the RETT intragroup restructuring exemption.

The case illustrates the difficulties that can arise when applying the RETT intragroup restructuring exemption. There have been controversial discussions in tax literature whether mergers, which are specifically included in the wording of the RETT law, can benefit from the RETT intragroup restructuring exemption given that the five-year post-reorganization holding period with respect to the shares in the concerned entities can never be met since the shares in the transferring entity cease to exist.

The tax court rejected the position of the tax authorities and ruled that the RETT intragroup restructuring exemption generally covers cases where the real estate-owning entity is merged upstream into its parent entity and that consequently lead to a dissolution of the corporate group for RETT purposes since only one entity survives.

Several local tax courts have issued decisions that illustrate the complexity of interpreting the RETT intragroup restructuring exemption rule and its restrictive interpretation by the tax authorities (see Deloitte Tax News: Local Tax Court rules on RETT intragroup restructuring exemption; Local tax court rules on RETT intragroup restructuring exemption rule ; Local Tax Court rules on tax authorities interpretation of RETT intragroup restructuring exemption). The case decided by the tax court of Nürnberg may allow for more flexibility in the case of certain corporate reorganizations, in particular, mergers. The German tax authorities are expected to appeal the case to the Federal Tax Court which will issue a final decision.
