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German Tax and Legal News

MOF publishes decree on exit tax consequences where Germany’s taxing rights are restricted

The decree specifically refers to the tax treaties with Spain and Luxembourg

On 26 October 2018, Germany’s Ministry of Finance (MOF) issued a decree confirming that the exit tax rules may be triggered by a change in the applicable tax rules even in a situation where a taxpayer does not undertake an exit tax-triggering transaction (e.g. “passive triggering event”).

German tax law allows the taxation of unrealized capital gains when Germany’s right to tax the gains on the sale or use of an asset is restricted or excluded as a result of the transaction (i.e. exit taxation). This typically is the case if a taxpayer relocates to a foreign country or if an asset is transferred out of Germany (“active triggering event”). Germany’s right to tax capital gains arising from the disposal of an asset also may be restricted or excluded where Germany concludes a new tax treaty (or amends an existing treaty), and the treaty provisions limit Germany’s taxing rights (“passive triggering event”). There is some controversy in the tax literature as to whether a passive triggering event is sufficient to trigger capital gains taxation or whether the taxpayer actually must undertake a transaction to trigger exit taxation.

The MOF decree confirms that a passive triggering event can result in capital gains taxation and refers specifically to Germany’s treaties with Spain (effective as from 1 January 2013) and Luxembourg (effective as from 1 January 2014). Both treaties include a provision on real estate-rich entities, allocating taxing rights on gains from the sale of shares in the real estate-rich entity to the country where the property is located (see also article 13(4) of the OECD model treaty). Both the Spain and the Luxembourg treaties restricted Germany’s right to tax capital gains derived from the sale of the shares in real estate-rich entities. According to the MOF, the change effected by the treaties is sufficient to allow capital gains/exit taxation by Germany. The gains subject to taxation in Germany should be calculated as the difference between the acquisition costs of the shares of the real estate-rich company and their fair market value on the date the relevant treaty became effective (i.e. 1 January 2013 in the case of Spain and 1 January 2014 in the case of Luxembourg).

The MOF decree confirms the position of the tax authorities; to date there is no jurisprudence on taxation in the case of a passive triggering event. The conclusion/amendment of a tax treaty is one example of a passive triggering event--other law changes or more general changes in the legal environment (e.g. Brexit, see GTLN dated 11/10/18 that describes planned law changes to mitigate the effects of Brexit) also could trigger the exit tax rules.

For German resident individuals, the capital gains/exit tax resulting from a passive triggering event may be deferred in certain cases (e.g. section 6(5) No. 4 of the Foreign Tax Act). Germany’s treaty with Liechtenstein is the only treaty that includes a specific deferral provision to mitigate the consequences of a passive triggering event for all taxpayers.

Taxpayers should analyze whether they were affected by a passive triggering event in the past and consider legal actions if the tax authorities are assessing exit tax based on the MOF decree.

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