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Fiscal Court on Sec. 6a RETT Act: Broad interpretation due to national law but potential state aid

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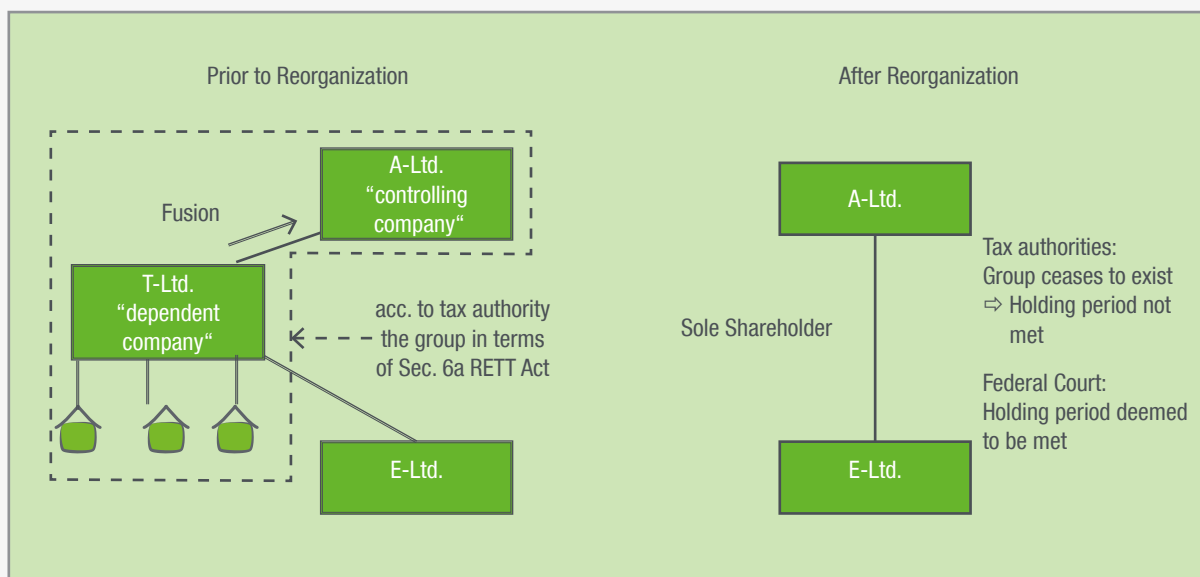
With its decision dated 30 May, 2017, the German Federal Fiscal Court referred several questions as to a potential state aid qualification of the tax exemption according to Sec. 6a of the German Real Estate Transfer Tax Act to the European Court of Justice (“ECJ”). This provision – under specific circumstances – exempts group restructurings involving property holding companies, which as such generally qualify as a taxable acquisition under the German Real Estate Transfer Tax Act, from taxation.

The present tax dispute initially aimed at the requirements for fulfilling the holding period specified in Sec. 6a of the Real Estate Transfer Tax Act. Relevant in this context is the definition of the term “controlling company” (herrschendes Unternehmen) and “dependent companies” (abhängige Unternehmen) as well as the holding period.

Federal Fiscal Court approves tax relief due to national law even if the dependent company ceases to exist...

To avoid misuse, the legislator has implemented a strict minimum holding period of five years to be fulfilled prior and subsequent to the exempted restructuring of a group of companies. During this holding period the controlling company must have a direct or indirect holding of at least 95 % in the dependent companies. Questionable in this regard was the fact whether such holding period is assumed to be fulfilled if the group of companies, prior to the restructuring, consist of only one controlling and one dependent company. In this constellation, obviously, the subsequent holding period requirement practically cannot be met in case that the dependent company ceases to exist in the course of the restructuring.

The prevailing opinion in literature is that in such a case the subsequent holding period should be assumed as fulfilled. The tax authorities, however, disagree and deny the tax exemption on the basis of Sec. 6a of the Real Estate Transfer Tax Act in this context.





In line with the lower court's ruling, the Federal Fiscal Court, in substance, confirmed the prevailing opinion set forth in the tax literature. The Federal Fiscal Court applies a wide interpretation of Sec. 6a of the Real Estate Transfer Tax Act and states that due to national law, the tax exemption should be applied in the case at hand.

..., however, submits the question as to whether Sec. 6a of the Real Estate Transfer Tax Act constitutes a prohibited state aid under EU law to the ECJ

However, the Federal Ministry of Finance joined the trial and notified the parties involved that the formal review proceeding by the European Commission according to Art. 108 3) of the Treaty on the Functioning of the European Union ("TFEU"), which is generally applicable in regard to the intended implementation of a state aid into national law, was not conducted upon implementation of the tax relief provision set forth in Sec. 6a of the Real Estate Transfer Tax Act.

In the context of legal disputes, the national courts are responsible for verifying a potential state aid. In the event provisions were implemented without undergoing the advance formal review proceeding with the Commission, the national courts have to decide whether such proceeding should have been applied. If there is doubt whether a newly implemented tax relief provision qualifies as state aid, the Federal Fiscal Court has to submit the issue to the ECJ.

The German Federal Fiscal Court sees significant arguments substantiating the view that Sec. 6a of the Real Estate Transfer Tax Act does not qualify as incompatible state aid. According to the Court, the tax relief appears to be a justifiable adjustment to the general rule for taxable acquisitions within the Real Estate Transfer Tax Act. Nevertheless, reasonable doubts exist regarding the fact whether the tax relief might indeed grant a tax benefit in favor of certain companies or industrial sectors only and as such is at least potentially able to distort the competition between the EU Member States. In the event such doubts regarding the potential qualification of a tax relief provision as state aid exist, the Federal Fiscal Court is obliged, according to Art. 267 para. 3 TFEU, to request the ECJ on the interpretation of the relevant Union legislation.

The ECJ decides on the formal legal decision whether a state aid does or does not exist.

The qualification of a national provision as state aid requires four criteria to be fulfilled:

- governmental action or the use of public funds
- selective benefit
- potential impact on the trade between the Member States
- potential distortion of competition

Federal Fiscal Court doubts provision qualifies as prohibited state aid

The tax relief granted by Sec. 6a of the Real Estate Transfer Tax Act is applicable to restructurings (merger, split-up or transfer of assets) on the basis of Sec. 1 para. 1 no. 1 to 3 of the German Reorganization of Companies Act and corresponding reorganizations on the basis of the law of any EU and EEA Member State, provided such restructuring and reorganizations are undertaken within a group of companies. Further requirements, which have to be met, are in particular (i) the qualified holding in the dependent company of not less than 95 % and (ii) the minimum holding period of 5 years prior and subsequent to the exempted restructuring. Thereby, the tax relief is not restricted to certain companies or industrial sectors. Nevertheless, as there is no clear distinction between requirements, which do give rise to a state aid review and which do not, doubts exist whether such requirements might constitute a selective advantage.

In addition and independent thereof, the German Federal Fiscal Court sees considerable arguments that potentially justify the tax relief. An advantageous tax provision might be justifiable against the background of the nature or the general structure of the system in which it is integrated. As such, an exemption to the general system of taxation might be justified if verifiably based on the basic or guiding principles of its system. Furthermore, the fact that the general rule (in this regard, the general taxation of the change in ownership of a property) is defined too broadly, can be a justification to establish an appropriate exemption. In this regard, the German Federal Fiscal Court states that Sec. 6a of the Real Estate Transfer Tax Act, under the additional conditions defined therein, is supposed to grant an exemption only for changes in ownership that the German legislator did not see the need to tax.

In the view of the German Federal Fiscal Court, the requirements regarding the controlling entity and the holding period are supposed to appropriately restrict the scope of application of Sec. 6a of the Real Estate Transfer Tax Act while taking the objectives of the norm into account.

Decision of the ECJ with potentially far-reaching implications awaited

The argumentation in the order for reference, however, at least gives reason to hope that the ECJ will reach the conclusion that Sec. 6a of the Real Estate Transfer Tax Act should not qualify as state aid. If the ECJ rules that the tax provision does qualify as state aid nonetheless, the application of Sec. 6a of the Real Estate Transfer Tax Act would be suspended until the European Commission decides whether such state aid is incompatible with the European Market. If the Commission then qualifies the rule as incompatible, which is more



likely than not once the ECJ has identified an instance of state aid, it can be expected that Germany will be ordered to claw back the unlawful tax benefits or find a solution to effectively adjust the provision retroactively.

In such event, the principle of legitimate expectations, which is usually granted under tax law and on which taxpayers rely, would be overridden by Union law. This highlights the explosive nature of the prohibition of fiscal state aids according to Art. 107 (1) TFEU. Upon a negative decision of the Commission, the Member States are obligated to claw back unapproved state aid even if the statute of limitation has expired under national procedural rules.

Apart from that, in case that the tax relief according to Sec. 6a of the Real Estate Transfer Tax Act qualifies as selective and is also seen as having a potential impact on trade between the Member States and distorting the competition, it would have to be assumed that such characteristics in principle are inherent in almost any tax benefits granted under national law. Therefore, a potential qualification by the ECJ as state aid accompanied by a classification of the norm as incompatible with the European Market by the Commission would have a major impact on the challenging of further tax benefits as well. The process all the way to a final decision of the Commission is expected to take at least two years.

be in touch: If you have any questions, please do not hesitate to contact us!



Dr. Carsten Bödecker
Partner . Steuerberater . Rechtsanwalt
Tel. +49 211 946847-51
Fax +49 211 946847-01
carsten.boedecker@bepartners.pro



Carsten Ernst
Partner . Steuerberater
Tel. +49 211 946847-52
Fax +49 211 946847-01
carsten.ernst@bepartners.pro



Nathalie Grenewitz
US-Attorney at Law
Tel. +49 211 946847-57
Fax +49 211 946847-01
nathalie.grenewitz@bepartners.pro



Silvan Hussien
Steuerberater
Tel. +49 211 946847-58
Fax +49 211 946847-01
silvan.hussien@bepartners.pro