Real Estate Tax Newsletter

2nd Version 2024

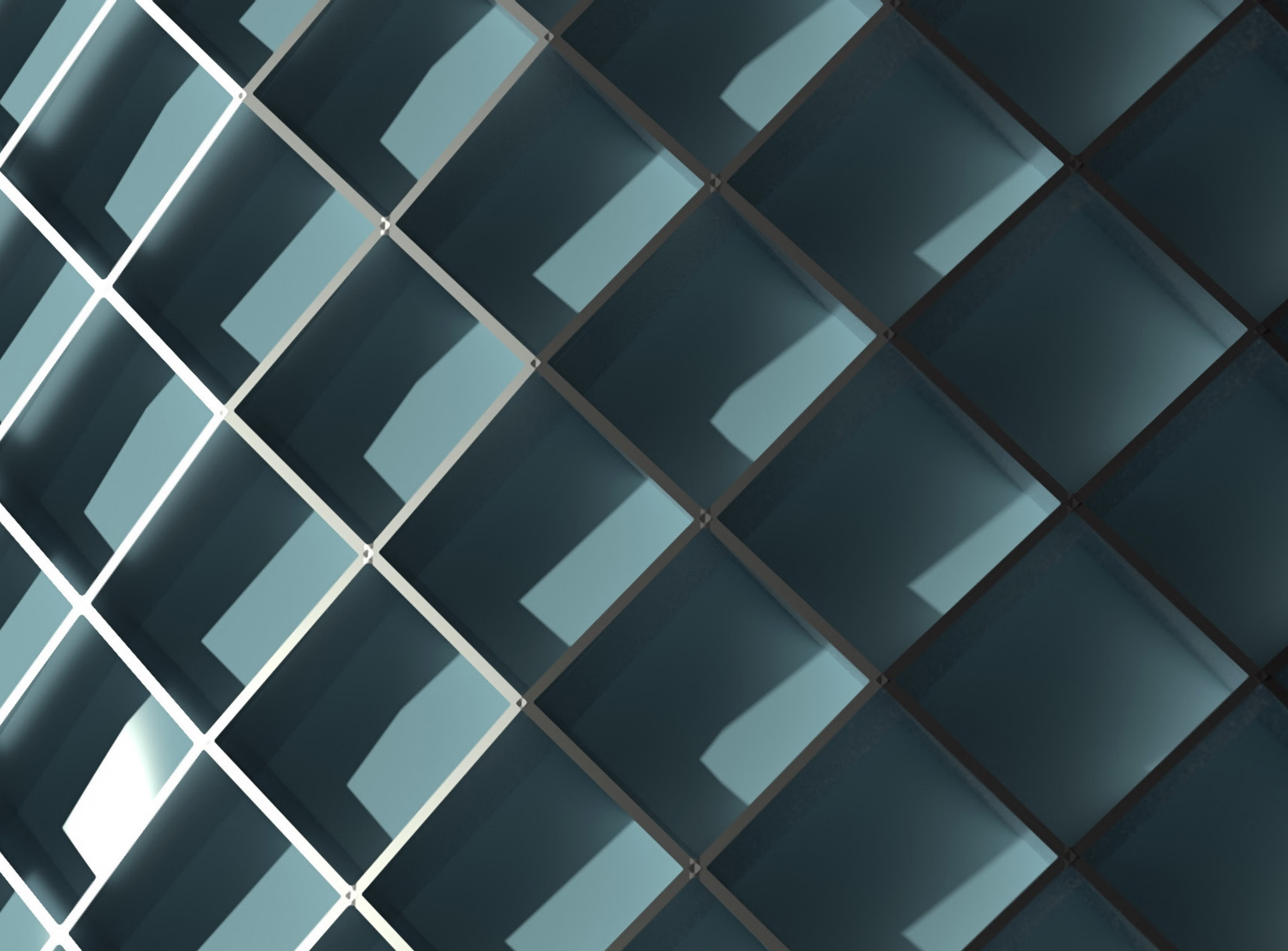
Inhalt

Dear Real Estate Community,

welcome to the latest edition of our Real Estate Tax Newsletter, in which we present news and updates on selected tax aspects related to real estate investments. We hope you enjoy reading.

With kind regards,

KPMG RE Tax Team



01

Second Future Financing Act - measures to promote investment in infrastructure and renewable energies

New tax framework for investments by (special) investment funds

The signs are green - the draft bill for a Second Future Financing Act contains numerous regulations that shall enable the fund industry to participate more strongly in infrastructure projects and renewable energies.

The successful interconnection of supervisory and investment tax law is particularly positive for the real estate fund industry. Legislators have recognised that a strong fund market can make an important contribution to financing infrastructure and transforming the economy. The Second Future Financing Act is intended to largely remove obstacles to urgently needed investments in infrastructure projects and renewable energies and create a legally secure framework for investment decisions in order to accelerate the transformation.

Background and aim of the draft law

On 27 August 2024, the Federal Ministry of Finance published a draft bill for a second law on the financing of future-proof investments (Second Future Financing Act - „ZuFinG II").

According to the explanatory memorandum, stable, efficient and deep capital markets are of crucial importance for innovation, private investment and growth. The law therefore aims to „provide positive impulse for the mobilisation of private financial resources and the growth of the German economy".

With the First Future Financing Act (Federal Law Gazette 2023 I no. 354 of 14 December 2023), numerous measures have already been taken to improve the framework conditions for the capital market and start-ups.

The draft law serves, among other things, to implement the growth initiative adopted by the Federal Cabinet on 17 July 2024. It contains a total of 58 articles amending various laws and ordinances. Building on the Future Financing Act, the aim is to further strengthen the competitiveness and attractiveness of Germany as a financial centre and, in particular, to improve financing options for young, dynamic companies. In order to achieve this goal, the legislator is creating a more secure framework for future investment decisions through numerous (tax) law amendments.

Until now, (special) investment funds have been reluctant to invest in infrastructure projects and renewable energies due to regulatory and tax hurdles.

The risk of generating harmful income from active entrepreneurial management („auB") and the associated risk of loss of status as well as the strict requirements of the tax investment regulations for special investment funds largely restricted investment opportunities in infrastructure projects or renewable energies.

Legislators have therefore already gradually relaxed the rules in recent years.

With the Annual Tax Act 2022[1], Section 26 InvStG was amended in a first step and (i) the fulfilment of the requirements for a trade tax exemption pursuant to Section 15 (2) and (3) InvStG as a prerequisite for a special investment fund was removed from Section 26 sentence 1 InvStG and (ii) a new no. 7a was added (see also our RE Tax News 2nd edition 2023 on the new no. 7a).

In Section 26 no. 7a InvStG, among other things, a new 10% limit was introduced from 1 January 2023 for income from the generation or supply of electricity from renewable energies in connection with the letting and leasing of real estate.

In a second step, this new 10% limit was raised to 20% with effect from 1 January 2024 by the Growth Opportunities Act.[2]

While these first two steps were welcome, uncertainties remained that slowed down the necessary investments in infrastructure and renewable energies.

1 *Annual Tax Act 2022 of 16 December 2022, promulgated in Federal Law Gazette I 2022, p. 2294.*
2 *Growth Opportunities Act of 27 March 2024, promulgated in Federal Law Gazette 2024 I no. 108*

The current draft of ZuFinG II is intended to remove these (tax) legal uncertainties and contains a number of positive changes.

Changes to the Investment Tax Act as a result of ZuFinG II

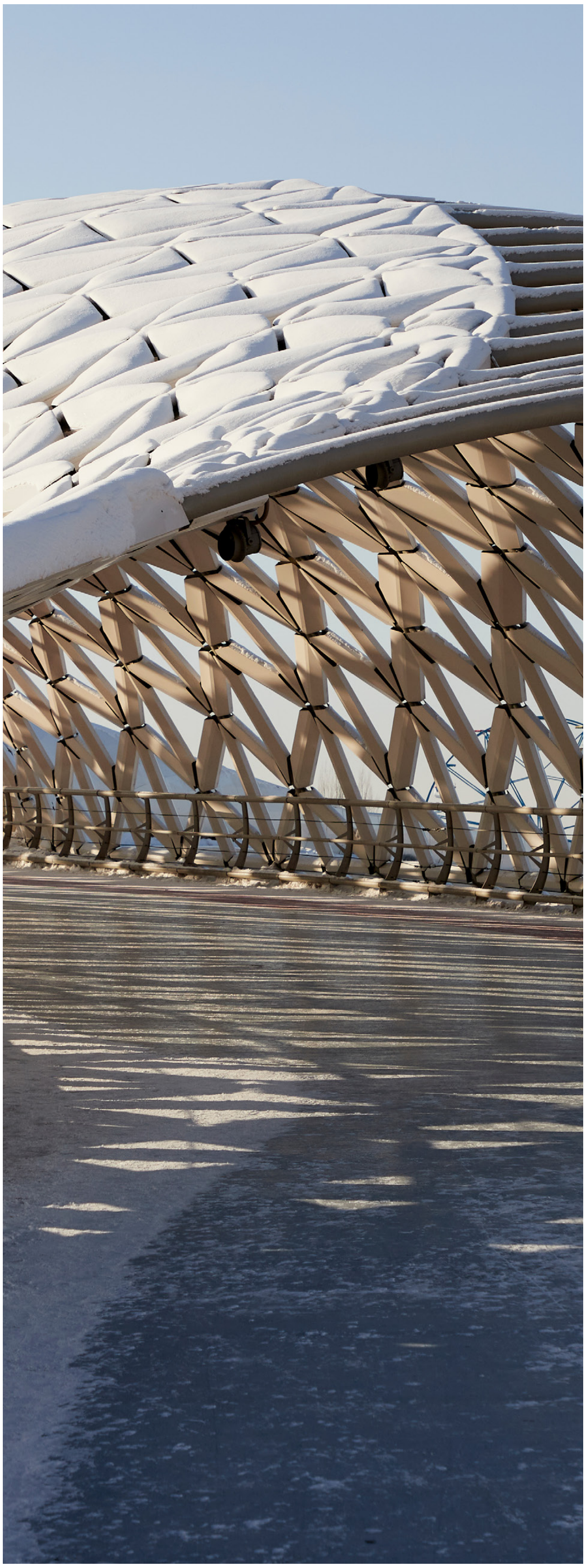
Below we present the main changes to the Investment Tax Act for the fund industry:

- **General harmlessness of commercial activities**

In general, Section 1 (2) sentence 2 InvStG-E adds that it is not detrimental to the qualification as an investment fund if an investment fund that fulfils the requirements of Section 1 (1) of the German Investment Code („KAGB") actively manages all or some of its assets on a commercial basis.

With this regulation, investment funds will generally be permitted to engage in commercial activities themselves (such as the operation of a photovoltaic system on a rented property) or to participate in commercially active co-entrepreneurships within the framework permitted by supervisory law. Due to the planned amendment, an investment fund under supervisory law will also qualify as an investment fund for tax purposes if it operates exclusively as a co-entrepreneur or is otherwise commercially active.

In order to avoid distortions of competition compared to companies subject to corporate income tax, ZuFinG II contains further consequential amendments that are intended to ensure taxation with corporate income tax at fund level.



- **Qualification of income as domestic investment income, domestic real estate income or other domestic income**

Section 6 InvStG-E contains far-reaching changes to ensure correct taxation at fund level. The qualification and allocation of income as domestic investment income (Section 6(3) InvStG), domestic real estate income (Section 6(4) InvStG) and other domestic income (Section 6(5) InvStG) has had little practical relevance to date, as the same taxation consequences have generally occurred at fund level. Due to the abolition of tax exemption options under ZuFinG II for other domestic income, the allocation of income will be of decisive importance in future.

Insofar as domestic investment income and domestic real estate income is generated via commercially infected or commercially characterised partnerships, the investment fund can provide evidence that this income originates from asset management activities. If such proof is provided, this income will in future be subject to Section 6 (3) and Section 6 (4) InvStG-E and will not qualify as other domestic income.

Domestic investment income and domestic real estate income generated via a domestic permanent establishment of an originally commercial partnership, on the other hand, qualify as other domestic income and are therefore generally subject to corporate income tax at fund level.

The Growth Opportunities Act introduced an additional taxable event for the sale of certain shares in corporations in Section 6 (5) sentence 1 no. 1 InvStG. This affects shares in corporations whose share value was directly or indirectly based on more than 50% of domestic immovable assets at any time during the 365 days prior to the sale.

Under ZuFinG II, this income will no longer qualify as other domestic income in future, but as domestic property income. This is also intended to enable tax exemption of this income in the context of fund investments. The prerequisite is that the investment fund does not actively manage the assets as a business. According to the explanatory memorandum to the law, the holding of investments in corporations is only deemed to be an entrepreneurial activity if they are acquired exclusively or predominantly for the purpose of short-term sale.

The new provision in Ssection 6 (5a) sentence 2 InvStG-E is particularly relevant with regard to future investments in renewable energies and infrastructure, as these are often structured via commercial partnerships/co-entrepreneurships. It would now be clearly regulated that active entrepreneurial management is always to be assumed for participations in co-entrepreneurships, insofar as the company generates commercial income within the meaning of Section 15 (1) EStG. However, the income of the co-entrepreneurship is only subject to taxation as other domestic income if the co-entrepreneurship maintains a permanent establishment in Germany or if another circumstance of Section 49 para. 1 no. 2 EStG exists. A domestic nexus is therefore generally necessary.

- **Restriction of transparency options and tax exemptions**

In order to ensure that investment via an investment fund is largely treated equally to direct investment, the tax exemption options and transparency options in Sections 8, 10, 30 and 33 InvStG are adapted and restricted so that they do not include commercial income as other domestic income (see above).

In future, other domestic income will therefore be subject to a definitive corporate income tax charge at fund level. For domestic investment income and domestic real estate income, too, no transparency option or tax exemption would be possible if it is received via a domestic permanent establishment of a partnership that is originally commercially active , and the consequence would be a definitive charge to corporate income tax. This would be accompanied by correspondingly extended declaration obligations for special investment funds.

- **Extension of exemptions and trade tax liability**

The „auB exemption" for real estate companies contained in Section 15 (2) sentence 2 InvStG will be extended to

i. companies whose corporate purpose is the management of renewable energies,

ii. infrastructure project companies and

iii. PPP project companies.

With this regulation, the legislator is making it easier for (special) investment funds to invest in the infrastructure sector. However, this is only an administrative relief and does not reduce trade tax revenue, as these companies are generally subject to trade tax themselves. In order to avoid double taxation with trade tax, Section 9 no. 2 GewStG stipulates that the partners' trade tax assessment base must be reduced by the profit shares from partnerships engaged in commercial activities.

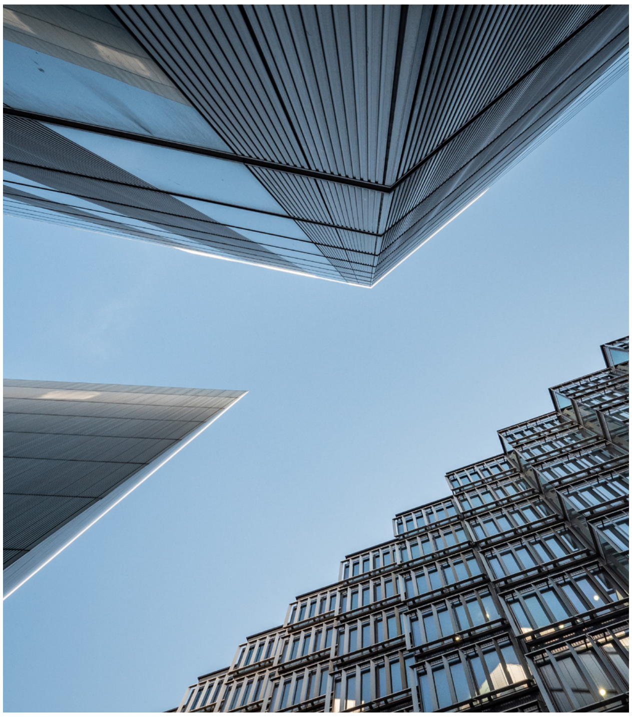
However, the new regulation and the inclusion of the above-mentioned companies also means that the income from the companies is not included in the 5% de minimis limit for (special) investment funds and therefore does not prevent the trade tax exemption of (special) investment funds.

Special features for special investment funds

Another positive and long-requested amendment is contained in Section 26 no. 7a InvStG-E, which should now enable legally secure investments by special investment funds in the production of renewable energies without risking a loss of status.

For special investment funds, the recently introduced limits of Ssection 26 no. 7a InvStG for income from the generation or supply of electricity in connection with the letting and leasing of real estate are to be completely abolished.

This is intended to enable special investment funds to invest in plants for the generation of electricity from renewable energies with legal certainty. The investment must take place in connection with the letting and leasing of real estate. This connection should be given, for example for photovoltaic systems on the roof of rented properties, on the façade or a covered car park, but also for systems that are installed in close proximity to the property. Furthermore, the connection should only depend on the type of energy generation and not on the subsequent use of the energy by the tenants of the property. It would also be permissible for the electricity to be fed into the public grid or sold to third parties.



In future, income „from the management of renewable energies" is to be disregarded for the purposes of the 5% de minimis threshold.

The draft bill does not yet include income from the supply of energy via charging infrastructure for electromobility. This income would therefore continue to be included in the 5% limit. In our view, an expansion of the wording of the law would be desirable.

- **Extension of the investment regulations for special investment funds**

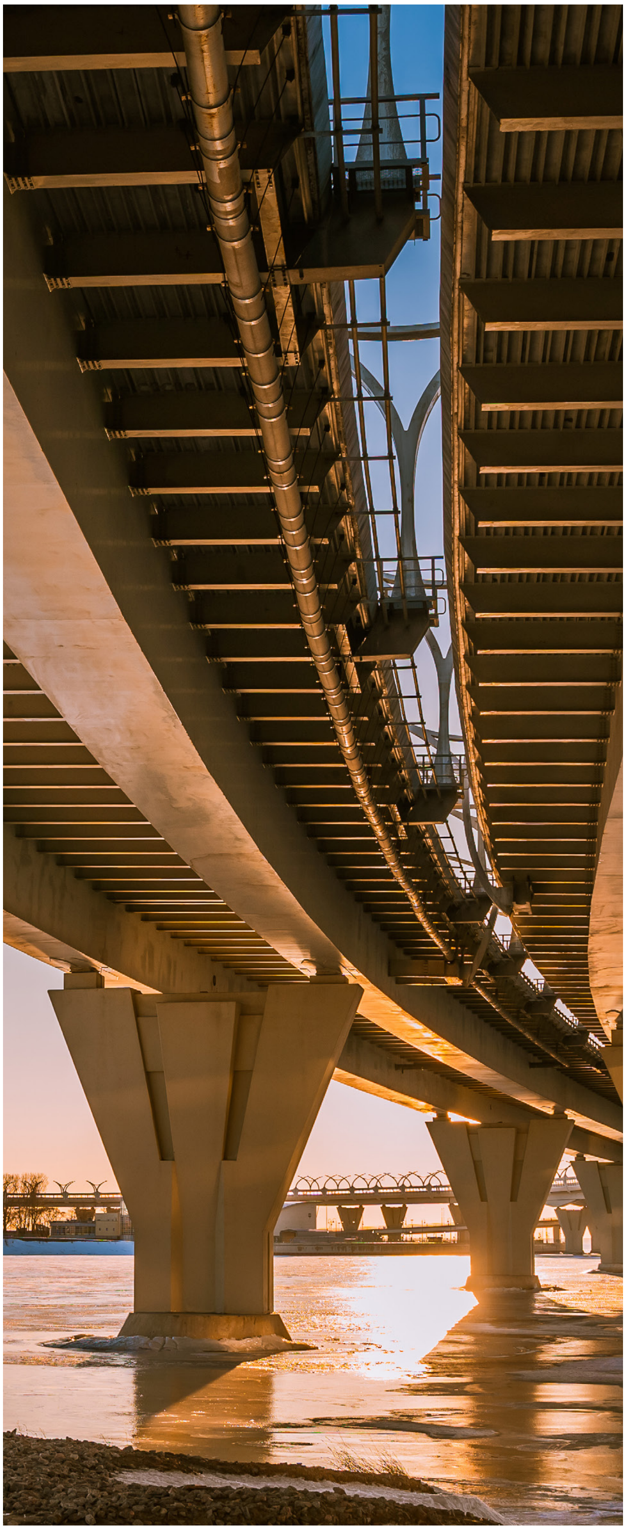
To simplify investment in renewable energies as well as in private equity and venture capital funds in the legal form of partnerships and in infrastructure funds, ZuFinG II extends the tax investment provisions for special investment funds.

According to the draft bill of the ZuFinG II, special investment funds may unlimitedly invest

(i) in all assets listed in Ssection 231 (3) KAGB-E (management assets, renewable energy plants, charging infrastructure for electromobility) and

(ii) in investment units in domestic or foreign investment funds as well as units in domestic or foreign investment funds pursuant to Section 1 (1) KAGB that are not investment funds.

In addition, special investment funds should be allowed to acquire up to 100% of the capital in infrastructure project companies and corporations whose corporate purpose is aimed at the management of renewable energies.



Key Facts

As a result, the draft ZuFinG II contains a large number of changes for the fund industry that would enable (special) investment funds to make legally secure investments in infrastructure projects and renewable energies in future and thus support the financing of the transformation in Germany.

For special investment funds, the draft ZuFinG II offers a welcome expansion of investment opportunities and the chance to invest in the generation of renewable energy and electricity in future without the risk of losing their status. However, the possibility of exercising the transparency option of a special investment fund for other domestic income pursuant to Ssection 6 (5a) and (5b) InvStG-E no longer applies. In future, this income must be declared separately by the special investment fund to the tax office and taxed in the assessment procedure. In future , itIt will therefore be important for (special) investment funds to clearly distinguish between income from asset management activities and income from commercial activities in order to ensure correct taxation.

In the interests of an accelerated transformation and to avoid losing valuable time, we believe that the proposed changes should be implemented as quickly as possible. The current draft bill of the ZuFinG II would have to be submitted to the Bundestag as a government bill in the further process and confirmed by the Bundestag and Bundesrat. The legislator does not appear to consider implementation before the end of this year to be realistic and does not envisage application until 1 January 2026.

The further legislative process and any comments from the supervisory authorities on the draft of the Second Company Pension Reinforcement Act[3], which provides for the introduction of a 5% infrastructure quota in the Investment Ordinance, among other things, should continue to be monitored closely. For investors covered by the Investment Ordinance, a synchroniszation with the changes in InvStG and KAGB should be achieved.

(Special) investment funds that now prioritize investments in infrastructure and/or renewable energy projects should check whether the necessary specialist and technical expertise is available in-house. There is also a need for action to set up the necessary processes and systems for recording, processing and distinguishing data for future extended tax declaration obligations at fund level (corporate income tax and trade tax declarations).

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3 *Government draft of a Second Act to Strengthen Company Pensions and to Amend Other Laws (2nd Company Pension Strengthening Act) of 18 September 2024.*

02

Electronic invoicing also for foreign landlords?

Rethinking ECJ ruling “Titanium”

According to the German tax authorities, foreign investors who rent subject to VAT must pay VAT in Germany and issue corresponding invoices to their tenants with an open VAT statement. In principle, the e-invoicing obligations in Germany, which will gradually come into force from next year, should therefore also become relevant for foreign investors. However, it is currently unclear whether a fresh look at an ECJ ruling from 2021 could change this.

E-invoicing obligation for landlords

Due to the Growth Opportunities Act, Section 14 of the German VAT Act , which contains requirements for issuing invoices, will be revised and e-invoicing will be introduced on January 1, 2025. From January 1, 2025, companies must be able to receive electronic invoices in a structured electronic format (hereinafter referred to as e-invoices). After a two-year transition phase, i.e. from January 1, 2027, companies in the B2B sector with an annual turnover of more than €800,000 will be obliged to issue e-invoices if

- the turnover is not tax-exempt in accordance with Section 4 No. 8 to 29 German VAT Act,
- both the supplier and the recipient of the service are based in Germany or in one of the territories specified in Section 1 (3) German VAT Act,
- the invoice is not a low-value invoice or a ticket.

For landlords who provide rental services that are subject to VAT, this also means that they will have to create e-invoice data records in future and meet the requirements of the permitted European structured format EN16931.

Simplifications for e-permanent invoices, but conversion work still required

The German Federal Ministry of Finance has commented on many individual issues in a draft letter and clarified that a one-off electronic standing invoice is permitted for rental agreements. For the first partial service period, an e-invoice should generally be issued to which the underlying contract is attached as an annex or the other content clearly indicates that it is a recurring invoice (Federal Ministry of Finance Circular from 15 October 15, 2024, para. 45 published on bundesfinanzministerium.de). Despite this welcome simplification, rental companies are confronted with an implementation project for their German properties that involves considerable administrative and financial effort. It is advisable to get an overview of the dimensions at an early stage, draw up a timetable and ideally consult a consultant for support or as a sparring partner. Experience has shown that the challenges - even with small e-invoicing projects - often lie in the implementation, where various stakeholders (in particular accounting, tax department, IT department, purchasing department) have to be brought together.

Elimination of the e-invoicing obligation for foreign landlords by invoking the ECJ ruling „Titanium"?

The Federal Ministry of Finance has not yet commented specifically on the question of whether foreign rental companies that rent out German properties for tax purposes are also affected. At first glance, this seems obvious, as the tax authorities require foreign taxable persons who are liable for German VAT to declare this accordingly. For the Federal Ministry of Finance, taxable persons who own a property located in Germany and rent it out for tax purposes „are to be treated as resident in Germany" and „must declare these transactions in the general taxation procedure" (Section 13b.11 para. 2 sentence 2 German VAT Guidelines). This means that they are effectively treated as if they had a German permanent establishment. Without this, the reverse charge principle would apply.

This view contradicts the case law of the European Court of Justice in the „Titanium" case (ECJ ruling of June 3, 2021, case C-931/19), according to which no VAT permanent establishment is created if foreign entrepreneurs merely rent out real estate and have no other local human resources. For entrepreneurs who were already registered for VAT in Germany and declared VAT, there was generally no significant incentive to invoke the ECJ's „Titanium" ruling, as the existing registration is much more convenient in terms of input VAT deduction compared to the input VAT refund procedure.

The German e-invoicing obligation only applies to companies based in Germany, for which a permanent establishment is sufficient. With the introduction of the e-invoicing obligation, the question therefore arises as to whether foreign companies can invoke the principles of the Titanium ruling in this context in order to dispute their residence for VAT purposes and thus the obligation to issue e-invoices.

Practical implications

It cannot be ruled out that the tax authorities will comment on the significance of the Titanium ruling in the context of the e-invoicing obligation. However, this is likely to be accompanied by a comprehensive position on how the German tax authorities will deal with the Titanium case law. It is currently not possible to predict when this can be expected. In the meantime, it is advisable for all affected (VAT-liable) foreign rental companies to individually analyse and reassess whether an appeal to the Titanium case law would be advantageous.

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Key Facts

- The German e-invoicing obligation also applies to foreign landlords.
- From 2025, companies must be able to read electronic invoices.
- In general e-invoices must be issued from 2027.
- The transition to e-invoicing involves considerable effort and should be tackled in good time.
- For foreign landlords without personnel resources in Germany, refering to the case law of the ECJ („Titanium“) could be an option in order to avoid e-invoicing obligations.
- Coordination

03

Intragroup financing relationships

Planned amendment to the Administrative Principles on Transfer Pricing dated June 6, 2023 - Interpretation of para. 1 sec. 3d and sec. 3e Foreign Tax Act by the tax authorities

On August 14, 2024, the Federal Ministry of Finance (BMF) issued a draft revision of the Administrative Principles on Transfer Pricing 2023 (VWG VP 2023) regarding intra-group financing activities to various associations. This revision is intended to reduce the previously controversial interpretation of para. 1 sec. 3d and sec. 3e Foreign Tax Act (FTA) and provides guidance for the treatment of existing and new intragroup financing activities.

In its draft from August 14, 2024, the BMF published its interpretation of the new para. 1 sec. 3d and sec. 3e FTA. Although this is only a draft, which has currently been commented by various associations, it already provides „some guidance" on how the tax authorities will interpret the amendment to the law on intra-group financing activities. The planned interpretation by the tax authorities is of particular importance for the real estate sector, as investments – in addition to bank loans and equity – are financed by means of intragroup or shareholder loans and it is precisely these instruments that are a key subject to disputes in tax audits. Against this background, an interpretation of the law by the tax authorities is generally to be welcomed. In the following, the key content of the BMF draft is summarised and implications for the real estate sector are outlined.

1. Delineation of the transaction (Debt Capacity Analysis)

Regarding the appropriateness of intra-group financing transactions on the merits, a debt capacity analysis (DCA) must be carried out in addition to the proof of the economic necessity of the financing. To this end, the BMF clarifies that the assets or other assets acquired in connection with the financing relationship can be included in the analysis (sec. 3.124). At the same time, it becomes apparent that the mere requirement for follow-up financing to a financing relationship (sec. 3.124) or the fact that the financing is particularly risky (e.g. renovation phases for property investments) (sec. 3.125) does not automatically mean that it is not at arm's length. The same applies for financing of profit distributions by granting an intercompany loan (sec. 3.127).

In practice, this implies that the preparation of a DCA is now more than ever a mandatory component of the transfer pricing documentation of the financing relationship. The net asset value and capitalised earnings value of the property can be used to demonstrate that the obligations arising from the loan can be serviced. A corresponding stability in the value of the property would argue in favour of follow-up financing. Typical construction or renovation periods, during which there is usually insufficient cash flow, should not be detrimental, provided that the property generates a reasonable profit over the total period.

2. Rating determination

Regarding the importance of the group rating for determining an arm's length interest rate, the BMF emphasises that, in general, the interest rate must be based on the creditworthiness of the group (sec. 3.133). To determine a suitable group rating, the BMF suggests a test sequence in which the first step is to check whether there is a published rating from one of the rating agencies authorised by the EU (sec. 3.135). [1] If this is not the case, private information[2] from rating agencies can be used. As a final option, the BMF allows the rating to be determined using standard market rating software, whereby, in particular, the qualitative input factors used must be included and documented. If the corporate group does not have a rating or no rating can be determined using the above-mentioned test scheme, the group rating can be derived from external financing costs of the corporate group (sec. 3.136). It is also possible not to apply the group rating if the taxpayer is able to prove that a rating

1 The Federal Ministry of Finance bases this on Article 2(1) of Regulation (EC) No 1060/2009.
2 These are ratings that have been prepared on the basis of an individual order and are not intended for public disclosure or dissemination to subscribed.

derived from the corporate group rating complies with the arm's length principle. When assessing whether this escape clause applies, the potential implicit group support, in particular, must be taken into account in addition to qualitative and quantitative factors (sec. 3.137-3.139), whereby the BMF explicitly refers to top-down and bottom-up approaches from leading rating agencies.

In the case of real estate structures, group ratings are regularly not available, meaning that an individual rating can be prepared using standard market rating software, taking qualitative and quantitative factors into account. The reference to a bottom-up approach, i.e. the rating determination based on the borrower's individual key financial figures, taking into account a potential Implicit group support, is particularly positive, as the tax authority always had a strong preference for simply applying the group rating for inbound financing transactions. This interpretation of the law is particularly welcome for real estate structures, as the effect of the group membership should converge towards zero due to the structuring by means of SPVs or PropCos and the interest rate determination can therefore be based on the individual rating of the borrower. This would per se lead to higher deductible interest. In addition, this interpretation corresponds to the view of the OECD Guidelines 2022 (sec. 10.78).

3. Selection of transfer pricing method

The determination of an arm's length interest rate for debt instruments between related parties should generally be based on the comparable uncontrolled price method (CUP method), taking into account comparability factors (sec. 3.147).

The explicit emphasis on the fundamental preference for the CUP method is to be welcomed, as the method was regularly rejected by the tax authorities in tax audits of shareholder loans and instead either the cost-plus method or the hypothetical arm's length comparison was applied. The two methods regularly lead to significantly lower interest rates in inbound cases.

4. Scope of application

Sec. 1 para. 3d FTA does not apply to interest expenses that are based on financing relationships that were agreed before January 1, 2024, and whose actual implementation began before January 1, 2024. This does not apply if the loan is significantly modified after December 31, 2023, or continues beyond December 31, 2024 (sec. 3.146).

The „grandfathering" rule does create clarity regarding the application, which is fundamentally positive. However, only loans that were granted before 2024 and expire in 2024 without being amended are effectively excluded. In simple terms, the new regulation covers loans that were granted before 2024 and will continue unchanged after 2025. This does not represent any significant relief for taxpayers

Key Facts

The planned amendment to the Administrative Principles on Transfer Pricing 2023 provides initial clarity on how the statutory regulation of sec. 1 para. 3d and para. 3e of FTA on group financing is to be interpreted. The comments on debt capacity analysis, rating determination and selection of the transfer pricing method are positive for real estate financing. In contrast, the regulation on the timing of application does not provide any significant relief. However, it remains to be seen which specific adjustments will result from the comments of the associations and to what extent the current version of the BMF draft will be implemented. It is expected that by the end of the year at the latest, there will be clarity on the new FTA on financing relationships, perhaps as was the case 25 years ago when the BMF issued a circular on December 24, 1999, – in specialist circles known as the „Christmas Decree"

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04

Developments in business splits

News and not so news on the ban on enforcement

In the case of group structures, the trade tax burden is regularly reduced by the transfer of real estate within the group and the associated use of the extended real estate deduction. This is why there was even more internal unrest in the industry when the Fourth Senate of the Federal Fiscal Court abandoned the prohibition of pass-through taxation for owner partnerships at the end of 2021. Some even saw the typical OpCo/PropCo structures at risk. Only since the Third Senate confirmed the prohibition of pass-through in the case of owner-corporations at the beginning of 2024 has calm slowly returned.

Time to take stock.

No extended property deduction in the case of a business split

The extended property reduction pursuant to Section 9 no. 1 sentence 2 et seq. GTT is excluded, among other things, if the management or use of the company's own real estate exceeds the limits of commerciality. This is particularly the case if the real estate company generates (original) commercial income as a result of a business split..[1]

Nach ständiger Rechtsprechung der Finanzgerichte liegt eine Betriebsaufspaltung vor, wenn

1. an operating company is provided with essential foundations for its business by an owning company (so-called "**material interdependence**") and

2. the persons behind the operating company and the owning company have a uniform business purpose (so-called "**personal interdependence**"). This can be assumed if the person or group of persons controlling the owning company can also assert their will in the operating company.

Due to the violation of the exclusivity requirement, the application of the extended reduction pursuant to Ssection 9 no. 1 sentence 2 et seq. GTT is denied.[2]

Change in the case law on the prohibition of pass-through with regard to property partnerships

According to tax case law and the opinion of the tax authorities, a property is regularly an "essential basis for a business", meaning that in the case of letting, the criterion of **material interdependence** should regularly be indisputably fulfilled.

In the case of personal interdependence, the indirect participation via a corporation has so far had a "shielding effect"[3] according to both tax case law and the tax authorities. In other words, there was no interlocking of persons if the operating company only held an indirect interest in the owning company via a corporation or if the joint parent company only held an indirect interest in the operating company and the owning company via corporations.

However, the BFH changed its case law in its ruling of September 19, 2021.[4] The underlying facts of the ruling were simplified as follows:

- H-GmbH held the majority of shares in X-GmbH.

- X-GmbH in turn held 100% of the shares in Y-KG.

- Y-KG was the owner of a property which it let to H-GmbH. H-GmbH used the property for its own business purposes.

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1 *German Fiscal Court of March 29, 1973, I R 174/72, BStBl. II 1973, 686, BeckRS 1973, 22002084; v. September 12, 1991, IV R 8/90, BStBl. II 1992, 347, DStR 1992, 246; v. August 20, 2015, IV R 26/13, BStBl. II 2016, 408, DStR 2015, 2536 and H 9.2 para. 2 „Business split" GewStH.*

2 *German Fiscal Court of September 16, 2021, IV R 7/18, BStBl. II 2022, 767, DStR 2022, 189 (191); Wagner, in Wendt/Suchanek/Möllmann/Heinemann, GewStG, 2nd ed. 2022, § 9 no. 1 marginal no. 1. 50 et seq.*

3 *So-called prohibition of recourse, cf. also Broemel/Klein, DStR 2022, 857.*

4 *German Fiscal Court, judgment of September 16, 2021, IV R 7/18, BStBl. II 2022, 767.*

The German Fiscal Court came to the conclusion that a business split existed. According to the ruling of the Fourth Senate, an indirect shareholding held via a corporation must also be considered when examining the interdependence of personnel.

The tax authorities have endorsed the view of the German Fiscal Court but will only apply the ruling from the 2024 assessment period onwards in order to protect legitimate expectations.[5]

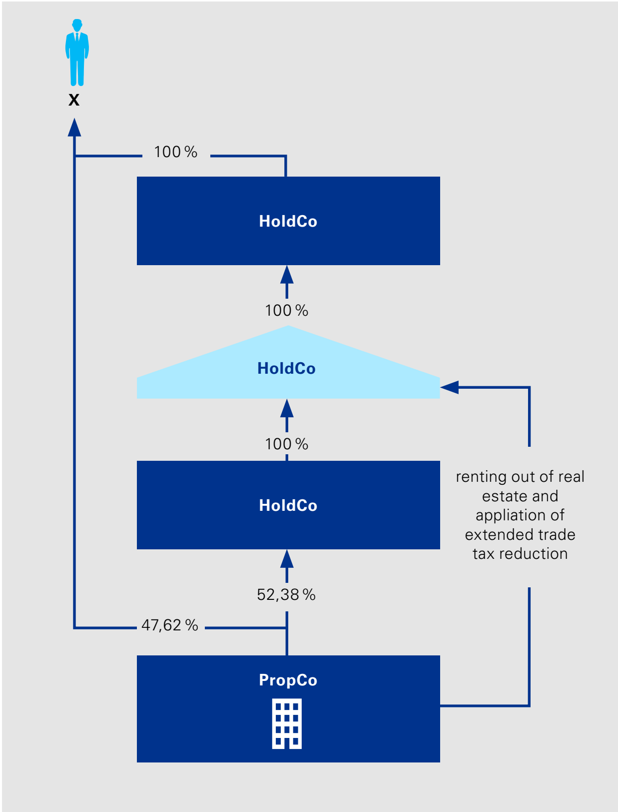
Against the backdrop of this ruling, it was unclear whether the prohibition of pass-through still applies in the case of a holding corporation.

But: The BFH has confirmed a prohibition of enforcement regarding holding corporations.

Most recently, the Third Senate of the German Fiscal Court dealt with the question of whether the transfer of real estate by a corporation to its (indirect) shareholders leads to a business split (so-called reverse business split) in the appeal decision of February 22, 2024. In this constellation, the classic transfer relationship between sister corporations (keyword: OpCo/PropCo structure) was not addressed, but the dispute concerns the prohibition on passing through corporations and is therefore nevertheless relevant for the transfer of real estate between sister corporations.[7]

The ruling was based, in simplified terms, on the following facts:

Figure 1:
additional taxation



Source: KPMG, Germany, 2024

5 *Supreme tax authorities of the federal states, GLE of November 22, 2022, and BMF of November 21, 2022 - IV C 6 - S 2240/20/10006.*
6 *German Fiscal Court of February 22, 2024 - III R 13/23, DStR 2024, 1078; lower court: Munich tax court of April 17, 2023 - 7 K 434/19, DStR 2023, 2168.*
7 *Broemel/Hillers, DStR 2023, 2428, 2430.*

The German Fiscal Court ruled - as the Lower Tax Court did - that in the present case the utilisation of the extended reduction pursuant to Section 9 no. 1 sentence 2 GTT was **not** excluded due to the existence of a business split. In other words, there was no business split.

If a corporation is a holding company, the Senate ruled that the personal interdependence depends on whether this company itself can enforce its business activities. However, recourse to the shareholders behind the owning corporation is not permitted (thus: confirmation of the prohibition of recourse).[8] A business split therefore does not exist if a holding corporation does not itself hold a direct or indirect interest of more than 50 percent in the operating company.[9] According to the judgement, neither the shares in the operating company held by its shareholders nor the control function associated with this shareholding can be attributed to a holding company. Such an attribution would constitute an unauthorised encroachment on the persons behind the holding corporation.[10]

The prohibition of passing through follows from the principle of separation of corporations.[11] This does not allow the existence of a uniform business and operating will, with regard to the activities of the operating company, to be based on the shareholding or influence of the shareholders of the holding corporation.[12] This is what distinguishes corporations from partnerships, so meaning that equal treatment of holding corporations and holding partnerships is not required.[13]

8 German Fiscal Court of February 22, 2024 – III R 13/23, DStR 2024, 1078 Rn. 13.
9 German Fiscal Court of February 22, 2024, – III R 13/23, DStR 2024, 1078 Rn. 16.
10 German Fiscal Court of February 22, 2024, – III R 13/23, DStR 2024, 1078 Rn. 16.
11 German Fiscal Court of February 22, 2024, – III R 13/23, DStR 2024, 1078 Rn. 13
12 German Fiscal Court of February 22, 2024, – III R 13/23, DStR 2024, 1078 Rn. 17.
13 German Fiscal Court of February 22, 2024, – III R 13/23, DStR 2024, 1078 Rn. 17.

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Key Facts

The German Fiscal Court judgement III R 13/23 is very pleasing, as the Court confirms the prohibition of pass-through taxation for corporations. The decision is particularly important for groups of companies that make use of the extended reduction for property transfers within the corporate group. This is because if the property is transferred within the group by a corporation, it will also be possible in future to avoid a business split that is detrimental to the extended reduction.

This is a view that is also expressly supported by the tax authorities.[14]

14 *Federal Ministry of Finance of November 21, 2022 – IV C 6 - S 2240/20/10006 :002, BStBl. I 2022, 1515, DStR 2022, 2441.*

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Business identity for corporations for the purpose of loss utilisation

Business identity when a corporation has received a trade loss from a partnership by way of universal succession through accrual with the transfer of all assets and liabilities without liquidation - comments on the Federal Tax Court judgement of 25.04.2024 (III R 30/21).

In its ruling of 25 April 2024, the Federal Tax Court commented on the question of the extent to which the continuation of a trade loss determined at the end of the previous year for a corporation remains dependent on the criterion of so-called "business identity". A special feature is that the corporation had received the trade loss from a partnership by way of universal succession through accrual with the transfer of all assets and liabilities without liquidation.

Legal background

Corporations and commercially active partnerships are generally subject to trade tax in Germany. The taxable basis for trade tax is the profit from business operations (so-called trade income). Unused trade losses are determined separately and can be carried forward, i.e. they can be offset against profits in subsequent years.

Under German civil law, a partnership must consist of at least two partners. If, for example, a partnership has two corporations as partners and one is merged into the other, its assets, including its trade losses, are transferred to the last partner and it ceases to exist (so-called accrual). However, the use of the trade loss by the absorbing corporation requires, among other things, the business identity. This is the case if the business operation existing in the loss deduction year is identical to the one that existed in the year in which the loss was incurred. This is to be assessed according to the overall picture, in particular according to the type of activity, the customer and supplier base and the workforce.

In the case of corporations, however, it should be noted that, unlike in the case of partnerships, their activities are always and, in their entirety, regarded as business operations. The criterion of business identity therefore has no significance - at least in principle - for the continuation of the trade loss in the case of a corporation. Until now, however, it has been disputed whether something different applies in exceptional cases if a corporation takes over a trade loss from a partnership by way of accrual. The question arises as to whether the absorbing corporation must continue the business of the partnership that it has accrued until the loss has been fully utilised.

Decision of the German Federal Tax Court

In the case in dispute, the plaintiff (corporation) sold the business taken over from a partnership to another corporation by way of an asset deal approximately two years after the accrual. From then on, it only acted as a holding company.

According to the Federal Tax Court, the asset deal is not detrimental to the continued use of trade losses. These are not lost. No exception is to be made to the principle of irrelevance of business identity in the case of a corporation, even following an accrual.

Key Facts

- An accrual, which is only governed by civil law, is popular in tax practice in order to carry out a tax-neutral restructuring in the group outside of the German Reorganiszation Tax Act [UmwStG].
- The question of the extent to which the continuation of a trade loss determined at the end of the previous year for a corporation, which it had taken over from a partnership due to an accrual, also remains dependent on the criterion of business identity for the acquiring corporation, and is therefore of great practical relevance.
- It remains to be seen whether the first highest court judgement on this topic can be published in the Federal Tax Gazette and thus be generally applied beyond the case decided or whether it will be negated by a new statutory regulation.

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