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Federal Tax Court (II R 36/21): Application of the RETT Group Exemption Rule to Transfers of Foreign Shares

In its judgement of 25 September 2024 (II R 36/21), the German Federal Tax Court ruled that the so-called extension of the shareholding chain is also subject to real estate transfer tax for foreign companies in accordance with section 1 (3) Real Estate Transfer Tax Act (RETTA), provided that the company whose shares are transferred owns domestic real estate. Whether the tax-triggering acquisition transaction is a favoured legal transaction within the meaning of the group exemption rule pursuant to section 6a RETTA must be determined in accordance with the relevant foreign law. The application of section 1 (3) RETTA does not violate the EU Directive 2008/7/EC concerning indirect taxes on the raising of capital. Furthermore, the non-application of the group exemption rule does not violate either the freedom of establishment or the free movement of capital.

In the case in dispute, an Irish company (A Unlimited) was the sole shareholder of B Limited, a subsidiary company also resident in Ireland. The latter held shares in other companies via intermediate companies which owned real estate in Germany. In addition, A held all shares in the plaintiff, a foreign company domiciled in the British Virgin Islands. In August 2010, A transferred all shares in B to the plaintiff without notifying the German tax authorities. During a tax audit in 2015, the tax office concluded that the acquisition of the shares in B was subject to real estate transfer tax and subsequently issued a tax notice. In doing so, it rejected the application of the group exemption rule pursuant to section 6a RETTA.

The legal action before the Federal Tax Court was unsuccessful. The extension of the shareholding chain in the case at issue was subject to real estate transfer tax. The requirements for the group exemption rule were not met. A referral to the CJEU or the German Federal Constitutional Court was not necessary.

In the opinion of the Federal Tax Court, taxation in accordance with section 1 (3) RETTA does not violate the EU Directive concerning indirect taxes on the raising of capital (Directive 2008/7/EC of 12 February 2008). The scope of application of Article 4 (1) (a) of the Directive does not cover the case in dispute, as the subject matter was not a contribution of the entire business assets of a corporation – as required by the wording of the provision – but the transfer of a shareholding in a corporation. It is not the acquisition of shares or the transfer of shares that is subject to German real estate transfer

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tax, but the resulting (fictitious) transfer of the real estate of this company. Even if the application of the Directive were to be assumed, the levying of German real estate transfer tax would be permissible at least in accordance with the provision in Article 6 (1) (b) of the Directive. Accordingly, Member States may levy transfer duties in the case of transfers of real estate located in their territory to a corporation.

The application of the group exemption rule of section 6a RETTA fails in the case in dispute because there is no "corresponding reorganisation" under the law of a Member State of the EU. Applying the relevant foreign law, the Lower Tax Court had established that the transfer of shares in the case at issue had taken place by way of singular succession by legal transfer. This process did not have the characteristics of a reorganisation under German Reorganisation Law. Therefore, there was no reorganisation within the meaning of German Reorganisation Law. In the opinion of the Federal Tax Court, the non-application of section 6a RETTA does not violate the freedom of establishment. The plaintiff, resident in the British Virgin Islands, could not invoke the freedom of establishment as it is a third country company. There was also no violation of the free movement of capital. In its reasoning, the Federal Tax Court stated that the free movement of capital only prohibits discrimination against foreign companies and their shareholders but does not require a better position compared to purely domestic situations. Therefore, in the present context, only those foreign transactions that correspond to a reorganisation transaction within the meaning of section 6a RETTA fall within the scope of protection of the free movement of capital. However, this was not fulfilled in the case in dispute. Finally, the Federal Tax Court does not see any justified doubts as to the constitutionality of section 6a RETTA and therefore does not consider a referral to the German Federal Constitutional Court to be necessary.

Federal Tax Court (I R 16/20): Deduction of Foreign Withholding Taxes in the Tax Group for Trade Tax Purposes

In its ruling of 16 October 2024, the German Federal Tax Court decided that foreign withholding taxes (WHT) on dividend income of a domestic controlled company cannot be deducted in isolation when determining the trade income in the tax group for trade tax purposes if the dividend income is tax-free for corporation tax purposes.

In the case in dispute, a tax group relationship for income tax purposes existed between a corporation 1 (C 1, holding company and plaintiff) and a corporation 2 (C 2). C 1 acted as the controlling company and C 2 as the controlled company. In the 2007 tax year in dispute, C 2, as the controlled company, received dividends from domestic and foreign corporations. These were exclusively free float shares (shareholding of less than 10% in each case). The foreign dividends were subject to WHT in the countries of residence of the distributing corporations.

According to the version of the relevant tax provisions applicable in the year in dispute, the dividends could be exempted in the tax group at the level of C 1 for corporation tax purposes. However, they were included in full in the trade income to be determined for the tax group at the level of C 1 and were subject to trade tax.

By law, foreign WHT cannot be credited against German trade tax. The wording of the provision (Section 34c (1) German Income Tax Act) expressly only permits a credit against German corporation tax. According to Section 34c (2) Income Tax Act, foreign WHT can be deducted on application when calculating income (instead of being offset) if it is attributable to foreign income that is not tax-exempt.

The plaintiff therefore attempted to deduct the foreign WHT from the trade income with tax effect.

The Federal Tax Court rejects such a deduction. On the one hand, the Trade Tax Act is based on the profit determined in accordance with corporation tax principles when determining the trade income, so that there is no room for a specific trade tax deduction of foreign WHT. In addition, dividends are tax-exempt in the tax group when determining the income for corporation tax purposes, which excludes the requested deduction. According to Section 34c (2) Income Tax Act, foreign tax can only be deducted on request when calculating income if it is attributable to foreign income that is not tax-exempt. It is not important that the dividends are subject to trade tax in a second step, separate from corporation tax, due to an addition for trade tax purposes. According to the Federal Tax Court, this result is also not contrary to EU law.

Note: According to the current legal situation, free float dividends (shareholding of less than 10%) are fully subject to corporation tax. However, the issue should continue to be relevant for cases in which the shareholding is between 10% and less than 15% (exemption for corporation tax purposes, but full trade tax liability).

Federal Tax Court (I R 36/22): Bonus Payments as a Hidden Profit Distribution

In its judgement dated 24 October 2024, the Federal Tax Court decided that remuneration agree-

ments between a stock corporation and a member of the management board who is also a minority shareholder are generally to be recognised under tax law.

Only in exceptional cases a hidden profit contribution can be assumed if there are clear indications in the individual case that the supervisory board of the stock corporation has unilaterally oriented itself towards the interests of the management board member in the remuneration agreement.

In the case in dispute, a stock corporation, through its supervisory board consisting of three persons, had concluded a remuneration agreement with the management board member X, who was authorised to represent the company alone, which provided for bonus payments dependent on turnover and profit. Two members of the supervisory board were minority shareholders alongside X, the third member had no shareholding in the stock corporation. There were no family relationships between X and the members of the supervisory board. The tax office and subsequently the lower tax court treated the turnover and profit-related remuneration payments to X as a hidden profit contribution. This resulted in higher corporate income tax for the stock corporation.

The Federal Tax Court decided against the opinion of the tax authorities and the lower tax court. It is true that turnover-related bonuses in particular are only to be recognised under tax law in exceptional cases due to the risk of profit absorption. However, the lower tax court had not taken into account the fact that the case law it had referred to concerned the remuneration of the shareholder-managing director of a limited liability company. In the case of a stock corporation, however, the circumstances are different. In this case, a supervisory board acts on behalf of the stock corporation, which is obliged by law to protect the interests of the stock corporation when agreeing the remuneration of the management board. In the case in dispute, X, as a minority shareholder, was also unable to control the supervisory board because he did not have the majority of shares required for the election of the supervisory board members and he was also not close to the members. In such a constellation, hidden profit contributions in connection with turnover- or profit-related bonuses can only be recognised in exceptional cases if special circumstances clearly showed that the supervisory board had unilaterally oriented itself towards the interests of the management board member.

Federal Ministry of Finance: Synthesised Texts of the Double Taxation Treaties and the Multilateral Convention

The Federal Ministry of Finance (MoF) has published on its website synthesised texts of the double taxation treaties and the multilateral convention of 24 November 2016 on the implementation of tax treaty-related measures to prevent base erosion and profit shifting (BEPS-MLI).

The Act on the Application of the Multilateral Convention of 24 November 2016 and Further Measures sets out the modifications to the tax treaties covered by the BEPS-MLI and specifies the application and priority of the BEPS-MLI regulations with regard to the respective treaty.

In view of the diverse selection decisions and declarations of reservation, the legal practitioner is faced with the challenge of reading the tax treaties adapted to the MLI in the "correct" version in each case. Synopses of the tax treaties covered in their respective modifications by the BEPS-MLI are now provided as an application aid.

The respective synthesised texts of the double taxation treaties and the BEPS-MLI can be found in the country-specific information on France, Greece, Croatia, Malta, Slovakia, Spain and Hungary on the MoF website.

Note: For the double taxation treaties with these countries, the BEPS-MLI already applies from 1 January 2025.

Federal Ministry of Finance: Individual Questions on the Income Tax Treatment of Certain Crypto Assets

The Federal Ministry of Finance (MoF) has worked with the federal states to develop guidelines on the obligations to cooperate and keep records under income tax law for crypto assets such as Bitcoin. This would provide taxpayers with assistance in documenting and declaring their income and the tax authorities with guidance on the examination and assessment of corresponding tax returns.

The MoF guidance dated 6 March 2025 comments on individual issues relating to the income tax treatment of certain crypto assets and deals with the following topics:

I. Explanatory notes
II. Classification for income tax purposes
III. III. Tax filing, cooperation and record-keeping obligations
IV. IV. Scope of application and transition period

The guidelines replace the previous MoF guidance dated 10 May 2022, which was republished under the title "Individual questions on the income tax treatment of certain crypto assets". For this

reason, the previously used wording "virtual currencies and other tokens" has been replaced by the term "crypto assets" in line with the further development of regulatory terminology in particular.

The MoF guidance does not contain any comments on income from employment or wage tax deduction in connection with the granting of crypto assets as part of an employment relationship.

According to the explanations provided by the MoF, in addition to the detailed description of the obligations to cooperate and keep records (from para. 87), individual facts and regulations in the chapters of the existing MoF guidance have been supplemented. This relates in particular to the so-called tax reports (para. 29b), but also, for example, the claiming of crypto assets (para. 13, 48a) and the use of second-by-second and daily prices (para. 43, 58 and 91).

Non-fungible tokens (NFTs) and liquidity mining are not yet covered by the MoF guidance. The MoF will continue to deal with the relevant income tax issues relating to crypto assets in close consultation with the supreme tax authorities of the federal states and with the involvement of the associations and will successively supplement the MoF guidance.

Due to the cross-border nature of the issues dealt with, the MoF also provides a legally non-binding translation of the guidance.

Tax Policy Exploratory Results between CDU, CSU and SPD

On 8 March 2025, the Christian Democratic Union/Christian Social Union (CDU/CSU) and Social Democrats (SPD) adopted the results of their exploratory talks, which form the basis for further coalition negotiations.

The exploratory paper dated 8 March 2025 essentially addresses the following tax issues:

- Incentivising investments:
  - Setting tangible incentives for entrepreneurial investment in Germany immediately after a government takeover
  - Introduction of a corporate tax reform in the coming legislative period
- Competitive energy costs / industrial electricity prices: including a reduction in electricity tax for all to the European minimum level
- Relieve the middle class:
  - Relief for the broad middle class through income tax reform
  - Increasing the commuter allowance
- Flexibility in the labour market:
  - Tax exemption of bonuses for overtime
  - Tax relief for a bonus paid by the employer for extending the working hours of part-time employees.

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