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No extended trade tax deduction on the disposal of an interest in a real estate partnership

Profits arising from the sale of an interest in a partnership are not to be included in the extended trade tax deduction for real estate enterprises.

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According to Section 9 no. 1 2nd Sentence of the Trade Tax Act (TTA), in place of the deduction under Section 9 No. 1 1st Sentence TTA (lump sum deduction of 1.2% of the assessed value of the real estate), enterprises, which exclusively manage and use their own real estate, may make an application to make an (extended) deduction relating to the part of the trading income which relates to the management and use of their own real estate.

B AG (a company) was initially the sole limited partner in the A KG (a limited partnership). In 2004 B AG sold a number of interests in its limited partnership holding and subsequently held an interest of 6%. In that year (2004) A KG managed a single logistics property in Hamburg Harbour. In its trade tax return for the year it declared total income from a trade, including the gains on disposals of the partnership interests made by B AG. An application was made for an extended deduction in the sum of the whole trading income.

The tax office argued that Section 9 No. 1 6th Sentence TTA explicitly excluded the deduction of gains on disposals of this type. A KG countered this argument by contending that Section 9 No. 1 6th Sentence TTA was introduced through a change in the law on 9 December 2014 but that the disposals of the partnership interests had been completed before the law came into force; a retrospective application of the provision would be unconstitutional. The Supreme Tax Court did not consider this argumentation, but rather came straight to the conclusion that the extended deduction (Section 9 no. 1 2nd Sentence TTA) did not apply in the first place.

According to the Supreme Tax Court the extended deduction provision applied solely to untainted income arising from the actual management of real estate (i.e. actually carried out) and not to gains arising from the disposal of a share in a partnership interest. These were operating profits. The reasoning given for this view was that when a partnership interest was sold in an enterprise which managed real estate, the consideration received was not as a rule just fixed in relation to the proportional share in the real estate. Rather the consideration also took into account the forecasted earnings, the potential increases in value and the opportunities to make profits. Accordingly the partial sale of a partnership interest did not amount to the mere exploitation of real estate but rather went beyond the management and use of own real estate.

Reference

Supreme Tax Court decision of 8 December 2016 (IV R 14/13), published on 15 February 2017.

Schlagwörter

Extended deduction for trade tax, Real estate enterprises, Taxation of real estate, limited partnership