By PwC Deutschland | 01. April 2019

Non-deductible deemed business expenses not to be derived from merger profits within a tax group

If a corporation is merged into its parent company, which in turn is a controlled company within a corporation tax group (fiscal unity/“Organschaft”) with a corporation as the controlling company (“Organträger”), the Supreme Tax Court has ruled that no flat-rate deemed business expenses are to be added back to profits under Section 8b (3) sentence 1 of the German Corporation Tax Act (CTA) either at the level of the parent company or at the level of the controlled company, where the said non-deductible flat-rate deemed business expenses are derived from a merger gain.

With this decision, the Supreme Tax Court judges rejected the practice of the Finance Ministry in its circular of 11 November 2011.

The dispute revolved around the question as to whether the tax office had correctly added back 5% of the merger gain as deemed non-deductible business expenses under § 8b (3) of CTA to the profits of the ultimate controlling company of a corporation tax group.

Facts

The appellant, an AG as the parent company of the Group held all shares in B-GmbH, which in turn held more than 95% of the shares in C-GmbH. C-GmbH was also a shareholder of D-GmbH with a stake of more than 95%. Corporate tax groups had been set up between the appellant and B-GmbH, between B-GmbH and C-GmbH, and - indirectly - between B-GmbH and D-GmbH, respectively.

The controlled company of the indirect tax group (D-GmbH) was not sold, but merged into C-GmbH (the interim company of the indirect tax group), i.e. the dispute was not about the assessment of a capital gain, but of a merger gain within the meaning of Section 12 of the German Transformation Tax Act.

Applying Section 15 1st sentence no. 2 CTA, according to which the participation exemption (under Section 8b CTA) was only to be applied at the level of the (ultimate) controlling company (the so-called "gross method"), the tax office had treated 5% of the merger gain as taxable in the hands of the appellant as the ultimate controlling company.

The judgment

Section 12 (2) 1st sentence (on the book value transfer) together with 2nd sentence (on the applicability of Section 8b CTA in merger cases) of the Transformation Tax Act 2006 are intended to have the effect that, in the case of an upstream merger -as here- of the subsidiary into the parent company, the merger profit at the level of the surviving corporation is treated as the profit from the sale of an investment within the meaning of § 8b (2) 1st sentence 1 CTA. The consequence of this would be that the transfer profit would have to be "exempted" and 5% of this profit would have to be added to the result of surviving company (here C-GmbH) as a non-deductible operating expense.

However, the non-application of Section 8b (1) to (6) CTA under in Section 15 1st sentence 1 no. 2 CTA means that the participation exemption is not taken into account when determining the income of the controlled company, but is only applied at the level of the controlling company(this is referred to as the “gross method”).

In this decision,the Supreme Tax Court addressed the previously controversial question of the extent to which this “gross method” can also be applied in the case of a merger profit from an upsteam merger to a controlled company in a tax group.

The Supreme Tax Court rejected the so-called “gross method” in this instance and was of the opinion that

in the present constellation the add-back of flat-rate deemed business expenses did not apply to the merger profits from the merger of D-GmbH either at the level of C-GmbH or at that of B-GmbH or at the level of the appellant as ultimate controlling company.

The application of Section 8b CTA to the income of the surviving corporation provided for in the Transformation Tax Act 2006 is unconditionally suspended by Section 15 1st sentence 1 no. 2 1st sentence CTA where the surviving company is a controlled company in a tax group.

According to Section 15 1st sentence 1 no. 2 **1st sentence** CTA, Section 8b (1) to (6) CTA are not to be applied when determining the income of the controlled company.

In a next step, it is a requirement of Section 15 1st sentence 1 no. 2 **2nd sentence** CTA that, in order to apply Section 8b CTA at the level of the controlling company, the income attributable to the controlling compay from the controlled company must "include" the participation income. In this case, however, the income attributable the controlling company (B-GmbH) did not include the merger profit, because this was disregarded according to Section12 (2) 1st sentence Transformation Tax Act 2006. It, therefore, follows that Section 8b CTA (including Section 8b (3)) could not be applied at the level of the ultimate parent as the merger profit were not “included” in the income attributable to the controlling company.

Source: Supreme Tax Court judgment of 26 September 2018 (I R 16/16), published 27 March 2019

Schlagwörter

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