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Family foundation as financial institution as defined in Section 8b Corporation Tax Act

In a most recent decision, the Supreme Tax Court held that the legal form of an institution is not relevant for the qualification as financial company within the meaning of Section 8b (7) sentence 2 of the Corporation Tax Act to be read in connection with Section 1 (3) of the German Banking Act. Therefore, a family foundation under private law can also be considered as finance institution if they are primarily engaged in financial activities.

Legal Background

In the case of companies as shareholder in other corporations or associations the dividends received will - under certain circumstances specified in **Section 8b Corporation Tax Act** - be 95% tax-free. Section 8b (7) though provides an exemption for shares held by banks and financial services institutions for short-term trading under Section 1a of the Banking Act. The same applies to shares held by finance businesses within the meaning of the Banking Act with a view to short-term profits from dealings.

According to Section 1 (3) of the German Banking Act financial undertakings are undertakings which are not institutions, investment management companies or externally managed investment companies, and whose principal activity involves certain typical banking transactions as defined in more detail in points 1 through 8 of that paragraph.

Case of dispute

According to the articles of association, the purpose of the foundation (the plaintiff) is to provide adequate care for the founders and their descendants, the appropriate maintenance and care of the family burial site and the holding of participations in companies and the exercise of participation rights in companies whose employment opportunities and earnings are intended to contribute to the social security of the founders and their descendants (private-benefit family foundation).

Decision

The Supreme Tax Court first clarifies that a family foundation that pursues a financial business activity as its main purpose may be treated as a financial enterprise for tax purposes. The decisive factor is for the foundation to primarily carry out activities similar to those in the finance sector. Whether it carries out a main financial business activity depends on an overall assessment of the circumstances in the individual case.

As part of a swap agreement the plaintiff transferred 250,000 shares in A-AG to the Swiss-based B-AG in exchange for 175,167 registered shares in B-AG which had a value of €5,500,000 based at the closing rate. To protect the shares of B-AG against a loss in value of the shares, the plaintiff also concluded an OTC equity collar transaction (option transaction) with the bank and transferred the shares to the bank by way of a securities loan.

In this respect, the share exchange was of such paramount importance that it dominated the plaintiff's entire business activities in the year of dispute, the Supreme Tax Court says. This applies in particular to the specific business volume (value of the transaction) as well as to the fact that the shares in A-AG (and respectively, after the swap the shares in B-AG) accounted for the vast majority of the foundation's assets.

After all, the plaintiff's articles of association not only stipulate the appropriate provision for the founders and their descendants and the adequate maintenance and care of the family grave, but also the shareholding in companies and the exercise of participation rights in companies.

Source:

Supreme Tax Court, decision of 3 July 2024 (I R 46/20) – published on 14 November 2024.

Schlagwörter

family foundation