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Supreme Tax Court refers question on EU Merger Directive to the ECJ (Case X R 27/22)

The German Supreme Tax Court has referred a question to the Court of Justice of the European Union (ECJ) concerning the compatibility of German tax law with the EU Merger Directive's tax-neutrality provisions (Article 7(1) of Directive 2009/133/EC). The key issue is whether a Member State can impose a flat-rate non-deductibility rule on business expenses—specifically, a 5% add-back of tax-exempt merger gains resulting from a parent company absorbing its subsidiaries.

Background

The Supreme Tax Court has suspended the proceedings in case **X R 27/22** and referred a question to the Court of Justice of the European Union (ECJ) concerning the compatibility of national tax law with Article 7(1) of the EU Merger Directive (Directive 2009/133/EC).

The appellant, a German GmbH, held a 100 per cent stake in five limited companies with their registered offices in other EU Member States. In the calendar year 2010, these companies were merged into the appellant in accordance with Section 122a et seq. of the German Merger Act. The transfer of the assets took place at book value in accordance with Section 12(1), first sentence, in conjunction with Section 11(2) of the German Merger Tax Act.

As, in the case of four of the five merged subsidiaries, the book values of the shares held by the appellant were lower than the book values of the transferred assets, each of the mergers in question resulted in a capital gain (the amount of which is undisputed) for the appellant. The defendant tax office treated 5% of the respective capital gain as non-deductible business expenses on the basis of the reference in Section 12(2), second sentence Merger Tax Act to Section 8b of the German Corporation Tax Act, which incorporates the provision in Section 8b(3), first and second sentences Corporation Tax Act.

Appellant's submission

The appellant contended that this 5% add-back is incompatible with the tax-neutrality principle enshrined in Article 7(1) of the Merger Directive, which mandates that merger-related gains be exempt from taxation without preliminary taxation or disadvantage. The appellant further points out that unlike the Parent-Subsidiary Directive, the Merger Directive contains no explicit “opening clause” that would permit Member States to impose a flat-rate disallowance of expenses linked to tax-exempt gains.

Court's Reasoning

The parties disagreed solely on whether the flat-rate assessment of non-deductible business expenses at 5 per cent of tax-exempt profits, based on Section 8b(3), first sentence Corporation Tax Act is to be regarded as a ‘taxation of capital gains’ prohibited by Article 7(1) of Directive 2009/ 133/EC.

According to the Supreme Tax Court, Section 12(2), second sentence Merger Tax Act, read in conjunction with Section 8b(3), first and second sentences Corporation Tax Act - in accordance with the wording, structure and legislative purpose of national law - governs only business expenses incurred in the period prior to the merger. The provision does not result in the taxation of merger gains. Nor does it apply to business expenses directly related to the merger. In essence, this constitutes a notional treatment of non-deductible business expenses.

It is only for the purposes of determining the amount of the lump sum that the provision is linked to the amount of profit made. This does not restrict the full tax exemption any more than would be the case if the business expenses actually incurred were not deductible under the general rule in Section 3c(1) of the Income Tax Act.

The Supreme Tax Court further stated that in its view, it must be assumed under EU law that the tax regime for profit distributions (governed by the Parent-Subsidiary Directive) corresponds to the tax regime for disposals by way of merger (governed by the Merger Directive). It would therefore be contradictory to assume that flat-rate taxation of non-deductible business expenses is permissible in one case but not in another.

Referral to the ECJ

Though inclined to uphold the German provision, the Supreme Tax Court recognises the legal uncertainty and the divergent opinions in the professional literature on whether Article 7(1) of the Merger Directive permits such a national non-deducibility rule. Given that the ECJ has not adjudicated this precise issue, the Supreme Tax Court requests the Court to clarify whether Article 7(1) of Directive 2009/133/EC precludes Member States from treating 5% of tax-exempt merger gains as non-deductible business expenses.

Key takeaway:

Provided the underlying merger fulfils the conditions for a merger within the meaning of the Merger Directive 2009/133/EC, tax assessment notices issued to acquiring entities in which non-deductible business expenses were taxed under Section 12(2), second sentence Merger Tax Act in conjunction with Section 8b(3), first and second sentences Corporation Tax Act, should be kept open referencing the order for a preliminary ruling X R 27/22 of the Supreme Tax Court (the ECJ case number is not yet known).

Reference:

Supreme Tax Court decision **X R 27/22**, published on 6 August 2026.

Schlagwörter

European Court of Justice (ECJ), lump sum, merger, non-deductible expenses