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By PwC Deutschland | 20 June 2017

Supreme Tax Court to refer question to European Court of Justice on whether the real estate transfer tax exemption on conversions constitutes illegal state aid.

On 30 May 2017 the Supreme Tax Court decided to refer to the European Court of Justice (ECJ) the question of whether the real estate transfer tax (RETT) exemption on conversions - in Section 6a Real Estate Transfer Tax Act - constitutes illegal state aid.

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In the case in question the taxpayer, a public limited company/stock corporation, had, for a period of more than 5 years, been the sole shareholder of a subsidiary which was the owner of certain real estate. In the relevant period the subsidiary was merged into the taxpayer. The tax office took the view that the merger gave rise to a transfer subject to RETT, for which, however, no exemption under Section 6a Real Estate Transfer Tax Act was available.

According to this provision certain taxable transfers made in the course of a conversion (e.g. a merger) can be exempted from RETT. The exemption was available provided that the parties to the conversion comprised a controlling enterprise and a controlled enterprise. Under the provision the controlling enterprise had to have held at least a 95% interest in the controlled enterprise in both the 5 year period prior to the transaction and in the 5 year period after it.

The tax court upheld the taxpayer's appeal and the tax office appealed to the Supreme Tax Court.

On the domestic law question on the interpretation of Section 6a Real Estate Transfer Tax Act as it applied to the facts, the Supreme Tax Court viewed the merger of the subsidiary into the taxpayer as a transaction covered by Section 6a Real Estate Transfer Tax Act. The fact that it was impossible for the appellant to continue to hold the shareholding in the subsidiary after the merger did not invalidate the relief.

The Supreme Tax Court further commented on interpretation of the term "controlling enterprise". The Court favoured a broad interpretation of the term, stating that it was not a requirement that the controlling enterprise should be an entrepreneur within the meaning of Section 2 of the VAT Act.

From a domestic law point of view, therefore, the Supreme Court would have ruled in favour of the taxpayer on the points in question. However, the final decision had to be postponed until the state aid process (see below) had been completed.

The Supreme Tax Court decided to refer the matter to the ECJ on the question as to whether the RETT relief in Section 6a Real Estate Transfer Tax Act constituted illegal state aid within the meaning of Article 107(1) Treaty on the Functioning of the European Union (TFEU). This provision prohibits any state aid which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods.

The Supreme Tax Court took the view that the ECJ should be asked to clarify whether Section 6a Real Estate Transfer Tax Act gave rise to a *selective advantage* because (i) it only applied to conversions (e.g. mergers, de-mergers, asset transfers) but not to other reorganizational measures (ii) it excluded group enterprises where the controlling enterprise in the group did not hold an interest of more than 95% in the controlled enterprise or where the interest in the controlled enterprise was not held for the whole of the minimum holding period (i.e. as such giving rise to a disparity between the treatment of economic operators).

The Supreme Tax Court was, however, of the opinion that the provision was justifiable as the chargeable

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events under Sections 1 (1) No.3, 1 (2a) and 1 (3) Real Estate Transfer Tax Act were defined too broadly from a RETT perspective and thus needed to be corrected in certain group-related circumstances by limiting the scope of application.

If the ECJ sees a case of illegal state aid under Article 107(1) TFEU, Section 6a Real Estate Transfer Tax Act would become non-applicable until the European Commission reached a decision about its compatibility with the internal market. A decision in the instant case would also have to be postponed until that time.

Source: Decision to request a preliminary ruling from 30 May 2017, published 14 June 2017: ***BFH II R 62/14***

Keywords

Article 107 TFEU, European Court of Justice (ECJ), conversions, real estate transfer tax, state aid