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European Court of Justice: RETT exemption on conversions not illegal State Aid

Back in June 2017 we informed you of the Supreme Tax Court's referral to the European Court of Justice of the question as to whether the RETT exemption on conversions(Section 6a Real Estate Transfer Tax Act) constitutes illicit State Aid.

On 19 December 2018, the European Court of Justice held in *A-Brauerei* (C-374/17) that the RETT exemption granted in the case before it of an upstream merger did not infringe the State Aid rules.

In the case in question the taxpayer, A-Brauerei, 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 upwards into the taxpayer. As the subsidiary held real estate the merger would have given rise to a transfer subject to RETT, unless the exemption on conversions under Section 6a Real Estate Transfer Tax Act was available. The Supreme Tax Court referred the question as to whether the RETT exemption on conversions (here the merger) constitutes illicit State Aid. Illicit State Aid in this context is state aid that distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods, i.e. *inter alia*, provisions which are considered "selective".

Section 6a Real Estate Transfer Tax Act applies to:

- (i) Restructurings/conversions regulated by the German Restructuring Act or any equivalent (company) law of a Member State of the EU or the European Economic Area;
- (ii) Entities involved in the restructuring must form part of the same group (i.e. there must be a common parent, which - directly or indirectly - holds at least 95% of the shares in all entities involved; the parent itself may also be part of the restructuring);
- (iii) Restructurings where the participation(s) of at least 95% exist during the five years before and after the transaction.

All requirements must be met cumulatively. The German tax authorities disputed A-Brauerei's compliance with the conditions, and the case went eventually up to the Supreme Tax Court. The Supreme Tax decided that the benefits of the RETT exemption had to be granted to A-Brauerei unless the rule constituted illegal State Aid. In the view of the Court the provision may give rise to a "selective advantage". so on 30 May 2017, the Supreme Tax Court referred the case to the ECJ expressing doubts in respect of Section 6a RETT and its compatibility with EU State Aid rules.

The ECJ examined the selectivity of Section 6a RETT Act, and held that the general rule ("the reference framework") in this case was, in principle, that all transfers of ownership in German real estate triggered RETT. The ECJ concluded that Section 6a RETT Act is a derogation from this reference framework as it exempts group restructurings from the RETT levy even if another entity acquires the property. The ECJ noted that both entities involved in group restructurings covered by Section 6a RETT Act and other entities which perform other types of ownership transfers or do not form part of a group can be considered to be in a comparable situation in the light of the objective of the general rule. The provision was, therefore, found to be *a priori* selective.

However, the ECJ found that the derogation could be justified by the nature or general scheme of the German tax system and the intention of the German provision to prevent double taxation. The ECJ held that

in an upstream merger case like the one at hand it can be assumed that the taxpayer (parent) had already paid RETT when it integrated the subsidiary with the property into the group because the parent owned more than 95% of the shares in the subsidiary (i.e. the acquisition of such amount of shares in a property owning company is an event triggering German RETT). Exempting such a parent from the second RETT levy is therefore justified by the objective to prevent double taxation. As regards requirement (iii) relating to the duration of the holding, the Court found it to be justified by the objective to prevent abuse. The ECJ did not comment on requirement (i).

Source: Decision of the European Court of Justice on 19 December 2018 in A-Brauerei (C-374/17)

Keywords

illicit state aid, real estate transfer tax