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No tax effect on income of deceased shareholder after retroactive merger

The Supreme Tax Court held that a merger with retrospective tax effect does not lead to a merger profit for a former and meanwhile deceased shareholder of a limited company even if the shares were acquired gratuitously after the effective (retroactive) tax transfer date.

Statutory provisions in the Reconstruction Tax Act (RTA)

Sec. 2 (1) sentence 1 RTA provides that the income and the assets of the transferring corporation and of the acquiring entity are to be computed as though the assets of the company had been wholly or partly transferred to the acquirer at the close of the day as of which the merger balance sheet was drawn up (tax date of transfer).

Sec. 5 RTA deals with the taxation of the shareholders of the transferring company. According to Sec. 5 (2), shares in the transferring corporation, that, on the tax date of transfer, were not business assets of (...) the acquiring natural person, rank for the computation of the gain as having been contributed on that date to the business assets of the acquirer (...).

Case of dispute

The interpretation of the above statutory provisions was the matter before the courts. The dispute centered on whether there is a merger profit for a deceased GmbH shareholder on the occasion of a subsequent retroactive merger. The plaintiff initially held a 48% interest in a limited company (GmbH); the remaining 52% of the shares were held by his father, who died in 2005 (the year in dispute). The plaintiff inherited his share in GmbH and has been its sole shareholder since then. Beginning of 2006, the GmbH was merged with the assets of the plaintiff as its now sole shareholder. A date prior to the death of the father was determined as the transfer date for tax purposes. The GmbH set up a closing balance sheet as of this date.

The tax office took the entire merger profit to income tax in the hands of the plaintiff whereas the latter claimed only a share of 48% as being subject to the tax as a result of the merger. The appeal before the Lower Tax Court of Munich was not successful.

Judgement

The Supreme Tax Court saw no tax effect on the income of the deceased shareholder after the tax transfer date due to its retroactive merger into the sole shareholder and thus rejected the appeal as unfounded.

The retroactive effect as stated in Sec. 2 (1) Sentence 1 RTA *only affects the determination of the income of the transferring corporation (the GmbH) and the plaintiff (as the acquirer)*. It does not lead to a merger profit for the deceased shareholder, even if the GmbH is retroactively merged with its new sole shareholder after the date of death. Presently, therefore, the retrospective effect is granted only as far as the GmbH and the plaintiff (as the transferee) are concerned. Former shareholders of the transferring corporation (the GmbH), on the other hand, are not mentioned in Sec. 2 (1) Sentence 1 RTA. The RTA exclusively addresses the effects on the profit of the acquiring natural person (here: the plaintiff). The determination of profits of former shareholders - in particular shareholders who died during the retroactive period - is not addressed by the relevant statutory provisions of the RTA.

The Supreme Tax Court further expressly confirms the view taken by the Federal Tax Ministry insofar as shares acquired in the time between the tax date of transfer and the effective date of the reconstruction

under civil law are regarded as having been acquired on the tax date of transfer pursuant to Sec. 5 (1) RTA.

Source:

Supreme Tax Court decision of 8 September 2020 (case ref.: X R 36/18), published on 18 February 2021.

Keywords

deceased shareholder, merger profit, retroactive merger