

By PwC Deutschland | 03 November 2021

# Retention period infringement under Section 6 (5) Sentence 6 Income Tax Act due to change of legal form of a parent company at book value

**According to a decision of the Supreme Tax Court, where, within the framework of a multi-level partnership, an upper partnership, which indirectly participated in an asset transferred at book value under Section 6 (5) Sentence 3 Income Tax Act ("ITA"), changes its legal form into a corporation at book value, this will be considered an infringement of the retention period under Section 6 (5) Sentence 6 ITA**

## Background

The dispute related to whether there was an infringement of the retention period under Section 6 (5) Sentence 6 ITA in a situation where, within the framework of a multi-level partnership, an upper partnership indirectly participating in a previously transferred asset changed its legal form into a corporation at book value.

The plaintiff is a GmbH (limited liability company), which was created by way of change of legal form from B GmbH & Co. KG (B KG). The sole limited partner of B KG was A KG. For its part, B KG was the sole limited partner of Z KG. In the year in dispute (2010), B KG contributed a plot of land to Z KG at book value pursuant to Section 6 (5) ITA. In 2012, both A KG and B KG were transformed into limited liability companies.

The tax office considered the change of the partnership's legal form into a GmbH to be an infringement of the retention period, because the change of legal form within the seven-year retention period under Section 6 (5) Sentence 6 ITA indirectly created a corporation's 100% share in the transferred asset (the business real estate) via its 100% share in the subsidiary partnership.

The Lower Tax Court shared the view of the tax authorities.

## Decision

Referring the case back to the Lower Tax Court, the Supreme Tax Court ruled as follows:

- The reference "the share" in Section 6 (5) Sentences 5 and 6 ITA is to be understood as the (direct or indirect) pecuniary interest of a corporate taxpayer in an asset previously transferred under Section 6 (5) Sentence 3 ITA and thus in the underlying hidden reserves.
- The phrase "for another reason" in Section 6 (5) Sentence 6 ITA covers any transaction which – following a transfer under Section 6 (5) Sentence 3 ITA in a chronological sense - leads to the (direct or indirect) creation or increase of the share of a corporate taxpayer in the transferred asset.
- Where, in the case of a multi-level partnership, an upper partnership changes its form to a corporation at book value within the retention period thereby creating an indirect share of this corporation in an asset previously transferred under Section 6 (5) Sentence 3 ITA , an infringement of the retention period under with Section 6 (5) Sentence 6 ITA will be deemed to have occurred.
- A teleological constriction of Sentence 6 cannot be contemplated where, at the time of the change of legal form, natural persons (also) held an interest in the assets of the parent partnership as co-entrepreneurs and thus as co-entrepreneurs already held a (indirect) share in the assets of the business real estate transferred pursuant to Sentence 3.
- If the indirect share - of a corporation participating as a co-entrepreneur in the upper partnership which has changed its legal form - is reduced in the asset transferred under Section 6 (5) Sentence 3 ITA before the change of legal form (retention period infringement), the extent of the partial valuation in accordance with Sentence 6 shall be determined in accordance with the shareholding

relationships in terms of the assets held at the time of the transfer in accordance with Sentence 3.

**Source:**

Supreme Tax Court decision of July 15, 2021 (IV R 36/18), published on October 28, 2021.

**Keywords**

change of legal form, multi-tier partnerships, transfer at book value