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5%-taxation of cross-border merger gains compatible with EU Merger Directive

The transfer gain following an upstream merger must be added back to taxable income of the parent corporation at 5% as non-deductible operating expenses according to Section 8b (3) Sentence 1 Corporation Tax Act in conjunction with Section 12 (2) Sentences 1 and 2 Reconstructions Tax Act. The Schleswig-Holstein Tax Court held this to be in accordance with the EU Merger Directive.

The plaintiff is a German company which owned 100% of the shares in five companies with a seat or place of management in the EU. With effect from 1 April 2010, these entities were merged into the plaintiff. The assets were transferred at book values. Due to lower book values of the shares in the plaintiff's balance sheet, the mergers triggered a merger gain. The German tax office treated 5% of this gain as non-deductible operating expenses similar to a capital gain which would have been triggered in case of a sale of the shares. The plaintiff is of the opinion that the tax exemption of only 95% of the merger gain violates Art. 7 of the Merger Directive as this provision foresees that the full merger gain should be exempt.

By decision 1 K 181/19 of 24 March 2022, the Tax Court of Schleswig-Holstein decided that the factual 5% taxation applicable with regard to a cross-border merger is in line with Art. 7 of the EU's Merger Directive.

The court explains in detail that the predominant opinion in tax literature assumes a violation of EU law, but nevertheless it agreed with the dissenting minority of authors. In the view of the tax court, the assumption of non-deductible expenses cannot be seen as a taxation of the merger gain. As the merger gain itself was still fully exempted under German domestic law the Schleswig-Holstein tax court refrained from referring the case to the European Court of Justice (ECJ) but allowed an appeal against the judgment at the Supreme Tax Court.

The appeal is pending at the Supreme Tax Court under case no. I R 17/22.

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Keywords

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