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By PwC Deutschland | 15 January 2024

Constitutional Court: Tax privileged transfer of business assets also possible for partnership with identical shareholding

The Federal Constitutional Court held that § Section 6 (5) Income Tax Act providing for the transfer of business assets at book values to be incompatible with the German Basic Law insofar as it rules out a transfer at book value between partnerships with identical shareholding. This exclusion from the tax privilege is incompatible with the general guarantee of the right to equality and thus not justified.

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Background

Section 6 (5) Income Tax Act (ITA) as amended by the Corporate Tax Development Act of 2001 (*Act on the further development of the Corporate Tax - Unternehmenssteuerfortentwicklungsgesetz*) enables a tax-neutral transfer of assets under certain conditions. In addition to the transfer of single assets between different businesses (business assets) of the same taxpayer according to Section 6 (5) **sentences 1 and 2** ITA, the provision also covers the transfer of assets within the same partnership (Section 6 (5) **sentence 3 no. 3** ITA) as well as various scenarios in which a transfer takes place between the partner and the partnership (Section 6 (5) **sentence 3 no. 1, no. 2** ITA).

Decision

The Constitutional Court held that transfers of assets between joint assets of sister partnerships with identical shareholdings as in the case at hand are not explicitly mentioned in the law. More specifically, in the opinion of the Constitutional Court the transfer of an individual asset between the joint business assets of sister partnerships is not covered by Section 6 (5) **sentence 1** ITA, as this - from a legal point of view - is always tied to a change of ownership and therefore does not constitute a transfer within the meaning of Section 6 (5) ITA.

Transfers of assets between sister partnerships with identical shareholdings therefore lead to the realization of hidden reserves, even though this is also a transfer of assets within the group of partnerships and - in contrast to the situations privileged by Section 6 (5) **sentence 3** ITA - does in fact not lead to a transfer of hidden reserves to another taxpayer. This puts these transactions at a disadvantage both compared to transfers of assets between different business assets of the same taxpayer and to other transfers of assets within the group of partnerships.

The exclusion from the preferential tax treatment also appears arbitrary to the Court because the same result – i. e. the tax-neutral transfer at book value - can be achieved through a combination of the asset transfers favored by Section 6 para. 5 sentence 3 ITA, which, however, would be accompanied by significantly higher transfer costs for the parties concerned and is also associated with legal and economic risks. It is inexplicable and not at all apparent to the Court why the individual steps can each be carried out at book value, but a direct transfer should lead to the disclosure of hidden reserves.

Outlook

The legislator is now obliged to introduce new regulations immediately and retroactively for transfers (transactions) after 31 December 2000, i. e. the date of first application of § 6 (5) sentence 3 ITA. This obligation covers at least all legally enforceable decisions that have not yet become final, and which are based on the disputed provision now declared unconstitutional.

Until a new regulation comes into force, § 6 (5) sentence 3 ITA also applies for transfers after December 31, 2000 and in cases where an asset is transferred free of charge from the joint assets of a partnership to the joint assets of a partnership with the same shareholding.

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Source:

Federal Constitutional Court, decision of 28 November 2023 (case 2 BvL 8/13), published on 12 January 2024.

Keywords

asset transfer, partnership