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By PwC Deutschland | 12 February 2025

Trade tax treatment of the sale of a partnership share with an atypical sub-participation

In a recently published decision, the Supreme Tax Court held that the profit from the sale of a limited partnership share which is proportionally encumbered with an atypical sub-participation is fully subject to trade tax.

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Background

The case at issue dealt with the trade tax treatment of the sale of the share in a partnership with atypical sub-participations. The dispute before the tax courts concerned the interpretation of Section 7 Sentence 2 No. 2 Trade Tax Act (TTA), which states that „the trading profit (also) includes a gain on sale or closure of the share of a member to be seen as the business proprietor or partnership business.“

The plaintiff was a family business in the legal form of a limited partnership (a commercial GmbH & Co. KG). Individual family members, who are not limited partners themselves, were granted sub-participations in limited partnership interests. These were undisclosed partnerships but were consistently structured in such a way that the sub-participants are to be regarded as partners for tax purposes (so-called atypical sub-participations). In 2014, one of the limited partners (a natural person) sold his entire limited partnership share to a GmbH expressly without transferring the existing sub-participation in favor of an association of co-heirs in the amount of approximately 1/3 of the limited partnership share.

Decision

If an atypical sub-participation is established in a partner's share, a further partnership is created in the form of the sub-participation company and thus (at least) a two-tier partnership.

The plaintiff is a partnership. At the same time, several (atypical) sub-participations existed prior to the date of sale. The sub-participants had to bear the entrepreneurial risks equal to those of „regular“ partners; they participated in profits and losses as well as in the hidden reserves. At the same time, they were able to exercise entrepreneurial initiative as their participation rights exceeded the control rights of a silent partner or limited partner.

In the case of dispute, the Supreme Tax Court held that the profit from the sale of the co-entrepreneur's share is subject to trade tax in its entirety, i.e. contrary to the opinion of the court of first instance and also to the extent that it is attributable to the “unencumbered” part of the natural person's co-entrepreneur's share because the individual was also a co-entrepreneur (partner) of the sub-holding company. The sub-participation only takes effect under the law of obligations, and it does not result in the sub-participant having a material co-entitlement to the company share. The sub-participant's consent to the sale was therefore not required.

The application of Section 7 Sentence 2 No. 2 TTA is not precluded by the fact that the sub-holding company is purely an internal company (without company assets). The main shareholding - the limited partner's share in the plaintiff - is to be attributed to the sub-holding company as taxable business assets for the duration of the sub-holding.

Source:

Supreme Tax Court judgment of 21 November 2024 (IV R 26/22) – published on 6 February 2025.

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Keywords

Sale of shares, limited partnership