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By PwC Deutschland | 18 July 2025

Trade tax attribution of profit from the sale of shares in two-tier partnership

The profit from the sale of a share in the upper-tier partnership as prescribed in Section 7 sentence 2 no. 2 Trade Tax Act is not to be allocated to the hidden reserves of the upper-tier partnership and the hidden reserves of the lower-tier partnership. It is rather a single and uniform sales transaction at the level of the upper-tier partnership, the Supreme Tax Court said in a most recently published decision.

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According to **Section 7 sentence 2 no. 2 Trade Tax Act** (TTA) the trading profit (which is the basis for trade tax) includes a gain on sale or closure of the share of a member to be seen as the business proprietor or partner in the partnership business.

Background

90.5% of the shares in A-KG (a limited partnership) were held by B-GmbH and 9.5% belonged to a foundation (C), both with their registered offices in EU countries. C held a 90.1% interest in B-GmbH. A-KG held interests in various limited partnerships, most of which operated hospitals and clinics that were exempt from trade tax pursuant to Section 3 No. 20 letter b TTA.

In the year of dispute (2010), C contributed its 9.5% share to B-GmbH at book value in accordance with Section 20 (2) sentence 2 of the German Reconstructions Tax Act (RTA) in exchange for new shares. As a result, the shares were „blocked“ for seven years to ensure German taxation in the hidden reserves in accordance with Section 22 (1) sentence 1 RTA which formally and verbatim states that „*if a contributor sells the shares received (on a contribution in kind) at less than its market value within seven years (…), the gain from the contribution is to be taxed in retrospect as a gain of the contributor* (…)“

In 2012, X, who was the ultimate beneficiary of C, moved to a country outside the EU. In 2013, the blocked shares were paid out to X. Due to his previous relocation, this led to a de facto realization pursuant to Section 22 (1) sentence 6 no. 6 RTA and the contribution gain was to be recognized and taxed retroactively in 2010. The contribution gain was essentially based on the hidden reserves of the lower-tier company (B-KG).

The plaintiff requested that the contribution gain not be included in the calculation of the taxable trading income. The tax court of first instance had dismissed the action as being unfounded.

Decision

The Supreme Tax Court agreed with the lower tax court and held this to be a uniform sale transaction at the level of the upper-tier partnership. (and not be broken into several sales) and that there is no “carry over” of the capital gain. It follows that the profit from the sale of a share in the upper-tier partnership pursuant to Section 7 sentence 2 no. 2 TTA is not allocated to the hidden reserves of the upper-tier partnership and the hidden reserves of the lower-tier partnership.

With regard to the profit from the sale of the share in the upper-tier partnership, the trading income of the upper-tier partnership is also not subject to the deduction pursuant to Section 9 no. 2 TTA insofar as the profit from the sale is attributable to hidden reserves of the lower-tier partnership. Section 9 no. 2 TTA generally provides for a deduction for profit shares from a domestic or foreign general or limited partnership, or from another entity in which the members are to be seen as business proprietors.

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Furthermore, the tax exemption for hospitals mentioned above does not apply if the upper-tier partnership (here: A-KG) sells its share in the lower-tier partnership whose trade income is (partially) exempt from trade tax in accordance with Section 3 no. 20 letter b TTA. Only the income resulting from the operation of the hospital qualifies for trade tax exemption. Any income that is generated from sources other than hospital operations is subject to trade tax. A KG does not meet the requirements of Section 3 no. 20 letter b TTA as it did not itself operate any hospitals.

Summary of the key points:

In the case of multi-level partnerships, the individual partnerships (here: A-KG) can be co-entrepreneurs and partners of another partnership (here: B-KG) within the meaning of Section 15 (1) sentence 1 no. 2 Income Tax Act. However, this does not necessarily cause the shareholders of A-KG (i. e., B-GmbH and C) to be regarded as shareholders of B-KG. A sale of the shares (or an assumed – fictitious - sale as in the case of dispute) in the parent company therefore takes place exclusively at the level of the parent company (A-KG) for income tax and trade tax purposes and is therefore only to be recognized there (Regulation 7.1 (3), Sentence 5 of the Trade Tax Act Regulations).

Splitting the resulting trading income based on the allocation of the disclosed hidden reserves, as requested by the plaintiff, contradicts the wording and legal context of the provisions of Section 5 (1) sentence 3 TTA (according to which „the company“ is liable for the trade tax) and Section 7 sentence 2 no. 2 TTA.

Source:

Supreme Tax Court decision of 8 May 2025 IV R 40/22- published on 10 July 2025.

Keywords

Two-Tier Partnerships, hidden reserves