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- 1) **Federal German Tax Court: The acquisition of shares in corporations is free from VAT even if the agent is not authorized by one of the parties to the procurement contract**

With its decision of December 20, 2007, the Federal German Tax Court changed its prevailing legal practice on this question. Until now it was assumed that the tax exemption laid down in Section 4 No. 8 f of the VAT Code (Umsatzsteuergesetz, hereinafter "UStG") was only applicable if the agent who procured the transfer of shares in a corporation was authorized by one of the parties to the contract. This jurisprudence is no longer justifiable since the European Court of Justice (ECJ) interpreted the underlying Directive 77/388/EWG in a different manner.

In any event, the claimant in the case decided was not successful since the Court ruled that the activity which he actually performed was not the acquisition of shares but rather the management of an agency for the acquisition of shares in corporations. Since his activity was only general management and not the encouraging of the closing of share transfer contracts, the court held that he was not entitled to benefit from the VAT exemption.

- 2) **Federal German Tax Court: The requirements of a VAT group can only be found in Section 2 (2) No. 2 VAT-Code and not within the Companies Act**

The crucial question of a case decided on December 5, 2007 by the Federal German Tax Court was whether a corporation which is a controlled enterprise within the meaning of

Section 17 (1) of the German Share Companies Act (Aktiengesetz; hereinafter "AktG") simultaneously fulfils the requirements of a dependent corporation for the purposes of establishing a VAT group.

51% of the shares of the corporation in question (Company X) were owned by a private person and the other 49% by a second corporation (Company Y). According to Company X's articles of association, each shareholder was entitled to name a chief executive officer with each CEO having unlimited power of representation.

According to Section 2 (2) No. 2 UStG, in order to constitute a VAT group, the dependent corporation must be integrated into the controlling corporation in financial, economic as well as organizational aspects. Financial and economic integration were not doubted in the case decided, but organizational integration was not clearly existent.

The lower financial court found that Company Y, as the minority shareholder of Company X, was able to exert sufficient controlling influence on the latter and therefore on the basis of the German corporation law confirmed the existence of a VAT group.

The Federal German Tax Court, however, stressed that the UStG contains its own definition of a VAT group which allows no reference to definitions

found in other statutes. The Court stated that organizational integration, which is one of the requirements of Section 2 (2) No. 2 UStG, must be negated in a case in which the corporation in question has two CEOs each of whom has unlimited power of representation since, in such a structure, not only the CEO of the majority shareholder but also the CEO of the minority shareholder can determine the management of the dependent corporation. According to the Court, such a structure does not fulfil the requirement of organizational integration required by the UStG and thus does not constitute a VAT group.

3) **Federal German Tax Court: The Germany-Italy Double Taxation Treaty allows the German taxation of a German resident shareholder in regard to profits resulting from a change in the legal form of an Italian company**

An individual resident in Germany held 80% of the shares of an Italian private limited partnership (Società in accomandita semplice) which converted itself into a corporation (Società a responsabilità limitata). The Italian tax law allowed the corporation to assume the assets of the partnership at book value and therefore assessed no tax on the profits resulting from the conversion. Subsequent to the conversion, the German resi-

dent shareholder sold his shares in the new corporation for around EUR 1 million which, after deduction of the share acquisition costs, resulted in a profit of approximately EUR 440,000, which was not taxable under Italian law.

The German shareholder was of the opinion that the profit should also remain tax free in Germany since Art. 24 (3)a and Art. 7 of the Germany-Italy double taxation treaty exempts profits resulting from the transfer of shares in corporations from taxation in the shareholder's state of residence.

In its decision of October 17, 2007, the Federal German Tax Court interpreted the Germany-Italy double taxation treaty in a different manner and argued that the intent of Art. 24 (3) together with Art. 7 and the treaty's protocol is to only exempt profits which have already been taxed in the corporation's state of domicile. If this state taxes neither the conversion nor the transfer of the shares, the shareholder's state of residence, in this case Germany, retains its right of taxation.

- 4) **Federal German Tax Court: Losses which could have been but were not deducted by a decedent are not deductible for the decedent's heirs – Change of the 46-year legal practice**

With its decision of December 17, 2007 the Great Senate of the Federal German Tax Court changed a 46-year-old legal principle. A provision of the German income tax guidelines, which are binding on German tax offices, provides that losses resulting from negative income of a decedent which are qualified as deductible losses but which could not be deducted from positive income during the lifetime of the decedent, remain deductible for the tax assessment of an heir.

The Court has now reached the conclusion that the wording of Section 10d of the Income Tax Code (Einkommensteuergesetz, hereinafter "EStG") as well as the entirety of the German system of income taxation do not allow the continuance of this legal practice. Rather, the Court stated, while German tax law contains several provisions dealing with certain aspects of the inheritance of assets, enterprises and shares, Section 10d EStG, which regulates the deduction of losses not in the year of origination but in preceding or succeeding fiscal years, does not mention the case of inheritance at all. Therefore, the Court reverted to one of the basic principles of German income tax law, namely that of individual taxation, which holds that only the income and expenses of a single individual can be used to determine the tax burden of such person and that expenses borne by third persons cannot



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reduce the taxable income of an individual shareholder.

In its 23-page decision, the Court discusses various arguments which might justify the old legal practice but eventually concludes that these are no longer valid. Therefore, the old legal principle will only remain applicable for inheritance-tax cases which were not finally assessed prior to the day on which the decision was published.

For more information,
please contact:

Peter H. Dehnen
peter.dehnen@dehnen.de
Tel +49 (0) 211 4497-07

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Dehnen.

German and international
Tax and Business Lawyers
and Executive Advisor

Prinz-Georg-Strasse 91
40479 Düsseldorf
T +49 211 44 97 07
F +49 211 44 97 722

peter.dehnen@dehnen.de
www.dehnen.de



www.germanbusinessforum.de