Tax on corporate transactions in Germany: overview

Hardy Fischer
P+P Pöllath + Partners

global.practicallaw.com/1-501-6627

TAX AUTHORITIES

1. What are the main authorities responsible for enforcing taxes on corporate transactions in your jurisdiction?

Generally, taxes are administered and enforced by the responsible local tax offices of the German federal states (*Landesfinanzverwaltung*). These local tax offices are responsible for:

- Taxes on corporate transactions.
- Real estate transfer tax (RETT) (*Grunderwerbsteuer*) (*see Question 3, Real estate transfer tax (RETT) and Question 5*).
- Value added tax (VAT).

Local municipalities (*Gemeinden*) apply trade tax law (*Gewerbesteuersteuerrecht*) (*see Question 4, Trade tax*).

The Federal Tax Office (*Bundeszentralamt für Steuern*), among other things, deals with:

- Advanced Transfer Pricing Agreements.
- The refund and exemption of withholding taxes under double tax treaties and EU Directives.

Pre-completion clearances and guidance

2. Is it possible to apply for tax clearances or obtain guidance from the tax authorities before completing a corporate transaction?

Taxpayers can request a tax ruling (*verbindliche Auskunft*) prior to executing a corporate transaction in order to clarify the tax consequences of a projected transaction. As a prerequisite to obtain such a tax ruling, the party making the request for clarification must prove both:

- A legitimate interest in the ruling and that the transaction has significant tax consequences (which is usually the case in corporate transactions).
- That there is legal uncertainty regarding the tax treatment of the projected transaction.

In addition, a written application must be sent to the competent local tax office in order to qualify for a tax ruling. This application must contain all of the following:

- A detailed description of the projected transaction.
- The distinct legal questions the tax authorities are requested to answer.
- An explanation of the particular interest that the party has in the tax ruling.
- The value of the tax ruling (the difference between the tax effects in best- and worst-case scenarios).

Once it is issued, the tax ruling legally binds tax authorities provided that both:

- The projected transaction is actually implemented as stated in the application.
- The legal provisions relevant to the tax issues in question are not modified.

Tax rulings are subject to administrative fees. These charges usually correlate to the value of the tax ruling and are capped at about EUR110,000. Administrative fees are triggered regardless of whether the tax ruling is issued or not.

Disclosure of corporate transactions

3. Is it necessary to disclose the existence of any corporate transactions to the tax authorities?

Disclosure is in particular required in two scenarios. If the taxpayer wants to file a tax return which presumably deviates from the German tax administration's view, the taxpayer should disclose all relevant facts and circumstances to avoid any subsequent disadvantages or even tax criminal law investigations. Second, in a tax audit the taxpayer must submit information upon request of the tax office.

MAIN TAXES ON CORPORATE TRANSACTIONS

Transfer taxes and notaries' fees

4. What are the main transfer taxes and/or notaries' fees potentially payable on corporate transactions?

Real estate transfer tax (RETT)

Real estate transfer tax (RETT) is levied where German real estate property is being transferred (asset deal). The tax rate varies from 3.5% to 6.5% of the consideration, depending on which federal state the property is situated in. If no consideration is given or cannot be easily ascertained, a special tax value (*Bedarfswert*) is calculated in accordance with the Tax Valuation Act (*Bewertungsgesetz*).

In addition, RETT is triggered if shares in an entity owning real estate are transferred and the acquirer achieves or exceeds a 95% ownership of the economic shareholding in that entity. For this "95% test", indirect transfers are usually also taken into consideration. Additionally, shares in intermediate companies are attributed to one person if that person either:

- Holds 95% in the intermediate company.

© This article was first published in the Tax on Transactions Global Guide 2015/16
and is reproduced with the permission of the publisher, Thomson Reuters.
The law is stated as at 1 September 2015.
THOMSON REUTERS

- Is in control of the intermediate company by holding more than 50% of its shares (RETT fiscal unity) (although certain other prerequisites must also be complied with for this to apply).

RETT is also levied if the real property is held by a partnership and at least 95% of the partnership interests are directly or indirectly transferred to one or more new partners within five years.

Conversely, there is an exemption from RETT if real property is transferred as part of a qualified intragroup restructuring. This can take place in the course of a merger, demerger or spin-off, for example, but is subject to very strict requirements (for example, shares of at least 95% must, in general, have been held for a period of at least five years before, and continue to be held for five years after, the transfer by the group parent).

There are further exemptions from RETT concerning partnerships and real property transfers from partners to their partnership and vice versa.

Notaries' fees

To be legally enforceable, some agreements must be notarised (for example, the sale and/or transfer of shares in a limited liability company (*Gesellschaft mit beschränkter Haftung/GmbH*) or real estate property transfers). The respective fees correlate with the agreed transaction's value.

Corporate and capital gains taxes

5. What are the main corporate and/or capital gains taxes potentially payable on corporate transactions?

Corporate income tax (CIT) (*Körperschaftsteuer*)

Companies with a German tax residence (that is, their registered office or effective place of management is located in Germany) must pay CIT on their worldwide income (provided there is no exception under a double tax treaty). However, non-resident companies are only liable to German CIT on their income from German sources. Currently, the CIT rate is 15%. There is an additional solidarity surcharge (*Solidaritätszuschlag*) of 5.5%, meaning that the total tax rate is 15.825%. In order to determine the competent tax office for CIT assessment, it is crucial where the central management of the company is situated.

Partnerships are treated as transparent, which is why they are not liable to CIT and their income is apportioned to their partners on a pro-rata basis. Therefore, the income is levied at each partner's level with (general) income tax.

The computation of the taxable income is established on financial statements made in accordance with German generally accepted accounting principles (GAAP) (*Handelsbilanzrecht*), further to specific provisions and tax law principles.

Although an enterprise's total profit is entirely taxable, there are also some exemptions. With regard to corporations, 95% of dividends received, as well as capital gains, from the sale of shares in corporations are effectively tax-exempt provided that there is no restriction to be employed (for example, in the case of banks and other financial institutions and holding corporations as the selling company who hold the shares as trading assets, such a tax exemption does not apply). In addition, to qualify for the exemption relating to dividends (but currently excluding share capital gains), the parent company must hold at least 10% of the shares in its dividend distributing subsidiary.

Further specific rules confine the deductibility of interest expenses (interest barrier) for tax purposes. Net interest expenses, if equaling or exceeding EUR3 million per annum, can only be deducted up to 30% of the borrower's taxable earnings before taxes, interest, depreciations and amortisations (tax EBITDA). In this regard, the legal term "interest" comprises all interest payments, whether or not paid from/to a related or third party and/or whether or not the debt is secured. However, the 30% limitation does not apply if a company is either:

- Not part of a group, or is only partially part of a group.
- Part of a group with a borrowing German entity that is able to prove that its equity ratio is lower than the group's equity ratio (with a tolerance threshold of 2%).

Additionally, these two exceptions demand the absence of any detrimental shareholder or shareholder-backed financing. Also, net interest expenses which do not qualify for a deduction under these requirements can be carried forward to future tax years, where they will then be considered in the context of the same procedures. In the case of net interest expenses not exceeding 30% of the tax EBITDA, the unused tax EBITDA can be carried forward for a period of five years.

Losses can be both:

- Carried back up to EUR1 million.
- Carried forward, though this is subject to minimum taxation rules.

Therefore, in a given year, up to EUR1 million of profits can be entirely offset against losses carried forward. However, only 60% of any profit exceeding EUR1 million can be offset against losses carried forward. This is because 40% of the profit exceeding EUR1 million is taxed regardless of any loss carry-forward (that is, is it subject to a "minimum taxation" of 40%). With regard to constellations of carry-forwards being waived, see *Question 12, Disadvantages*.

Trade tax

Business entities (*Gewerbebetriebe*) are also subject to trade tax. However, partnerships are only regarded as business entities if either:

- They are engaged in commercial activities generating income from trade-related services.
- All of their fully liable partners are corporations and the partnership's managing director's board is exclusively composed of these corporate partners/third parties.

Typically, GmbH & Co KGs that are formed as limited partnerships where the general partner is a limited liability company (*Kommanditgesellschaft*) are regarded as business entities.

In general, business entities are subject to trade tax on their trade income (*Gewerbeertrag*), which is generally determined by the taxable income for income tax purposes. Nevertheless, there are a number of adjustments for trade tax matters that, for example, add back a portion of any rental expenses, interest and royalties.

The trade income is multiplied by a factor of 3.5% (*Steuermesszahl*). The resulting trade tax product (*Steuermessbetrag*) is then multiplied by the specific local tax multiplier (*Gewerbesteuerhebesatz*). This figure is fixed by each local authority and varies from 200%, as the statutory minimum local rate, to up to about 500%, depending on the attractiveness of the respective municipality. If the local tax multiplier is 400%, for example, the effective trade tax for trade income will be 14%. The trade tax is determined by the local tax office. It is the local municipality's duty to apply the local tax multiplier on the product and to collect the taxes.

Value added and sales taxes

6. What are the main value added and/or sales taxes potentially payable on corporate transactions?

VAT

In accordance with EU harmonised law, VAT must be charged by the trading business on the domestic supply and import of goods.

When a business charges VAT on a supply that it makes, it must account to the tax authorities for that VAT (output VAT). When a business pays VAT on a supply that it receives, that VAT is known as input VAT.

To the extent that the business uses a supply that it receives for the purposes of, or otherwise in connection with, a supply that it makes, it can deduct the input VAT on the supply received from the output VAT on the supply that it makes and account to the tax authorities for only the difference.

To the extent that a supply received is used for the purposes of, or otherwise in connection with, a supply that it makes that is exempt from VAT, the input VAT on the supply received is not deductible.

If the business' input VAT exceeds its output VAT, the excess is refunded by the tax authorities.

The German VAT rate is currently 19%, although a reduced rate of 7% is applied to certain vital goods and services. Furthermore, specific supplies are exempt from VAT, which include, for example, almost all financial services and transfers of shares/partnership interests. However, for some of these exemptions there is an option to apply VAT.

In corporate transactions the transfer of shares is usually VAT-exempt. However, the supplier can opt for VAT to apply so that it can deduct input VAT on any associated supplies received. It should be noted that in this instance, the supplier opting for VAT to apply can be disadvantageous to the buyer of the shares if the buyer cannot deduct the VAT on the share purchase as input VAT. In addition, as the German tax authorities usually try to limit the deduction of input VAT on share acquisitions, taxpayers often refrain from opting for VAT to apply to share transfers.

VAT applies in the context of asset transfers. It is the supplier who must usually pay VAT to the tax authorities. This consequently increases the purchase price. Accordingly, the buyer must claim a VAT refund from the tax authorities as input VAT. For some specific services the buyer must directly transfer the VAT to the tax authorities (reverse charge). Nonetheless, the buyer may be able to simultaneously claim the respective input VAT in the same amount.

The transfer of a business as a going concern (*Geschäftsveräußerung im Ganzen*) is not subject to VAT.

The VAT assessment is carried out by the local tax office responsible for the area in which the enterprise mainly performs its business.

Other taxes on corporate transactions

7. Are any other taxes potentially payable on corporate transactions?

There are no further taxes potentially payable for common corporate transactions.

Taxes applicable to foreign companies

8. In what circumstances will the taxes identified in *Questions 4* to *7* be applicable to foreign companies (in other words, what "presence" is required to give rise to tax liability)?

RETT and notaries' fees

Domestic and foreign entities are subject to RETT and notaries' fees in corporate transactions. RETT is likely to be triggered if the real estate is situated in Germany, regardless of the buyer's or seller's tax jurisdiction.

CIT

In order for CIT to be levied, a foreign entity must have German-source income and the German authorities' right to charge the tax must not be limited or exempted by a double tax treaty.

An entity that has a permanent establishment (PE), a representative in Germany or real estate located in Germany will usually be subject to CIT on its German-source income. Capital gains from the sale of shares in a German corporation are considered as German-source income provided that the seller holds at least 1% in the German corporation. However, where there is an applicable double tax treaty, the home jurisdiction of a foreign seller will usually have the exclusive right to tax this capital gain, provided that the shares in the German corporation are not held through a German PE of the foreign seller.

Trade tax

A foreign company must pay trade tax on its trade income if the income is derived through a PE in Germany. It should be noted that capital gains from the sale of German businesses within an asset deal, or of an interest in a German business partnership, are generally subject to trade tax.

VAT

The residence of the supplier is not relevant to the levying of VAT, but the location of the performed transaction regarding the supplies generally is. Therefore, non-resident corporations that engage in the distribution of goods or services in Germany may need to register for German VAT.

DIVIDENDS

9. Is there a requirement to withhold tax on dividends or other distributions?

Corporations must normally withhold taxes for all dividend and other capital distributions (*Kapitalertragsteuer*) whether the recipient or shareholder is a foreign or German entity. The withholding tax rate is 25% with a solidarity surcharge of 5.5%, resulting in a total tax rate of 26.375%. However, there is a tax credit regarding tax withheld against the overall CIT amount if the shareholder has to pay German CIT. Non-resident shareholders can request a decrease of the withholding tax to 15%, or where there is an applicable double tax treaty for an even lower rate between 0% and 10% if the recipient is a corporation in charge of a certain minimum holding. There is also an exemption from withholding tax if the dividend is distributed to a parent company that both:

- Is resident in another EU member state.
- Holds at least 10% of the share capital in the paying German subsidiary for a minimum period of one year (*Directive 90/435/EEC on the taxation of parent companies and subsidiaries*).

However, any exemptions from, or decreases to, dividend withholding tax are subject to the anti-treaty shopping rules. Therefore, there is no relief where the recipient is an interposed

entity with insufficient "substance". This anti-treaty shopping rule is not applicable where either and to the extent:

- The recipient's shareholders would be eligible to a limitation if the dividends are received directly.
- The foreign enterprise does have income for the respective year from its own business activities.
- There are economic or other justifiable conclusions for the foreign company's interposition in relation to this income and the foreign company has a physical business establishment.

SHARE ACQUISITIONS AND DISPOSALS

Taxes potentially payable

10. What taxes are potentially payable on a share acquisition/share disposal?

RETT and notaries' fees

The disposal of shares is likely to trigger RETT if the company sold owns real estate property in Germany, provided there is a transfer of 95% of the shares and/or a unification of at least 95% of the shares in the hands of an acquirer (*see Question 4, Real estate transfer tax (RETT)*). For the transfer or sale of real property and shares in GmbHs, the notarisation of these agreements is necessary, which triggers notaries' fees (*see Question 4, Notaries' fees*).

CIT, VAT and trade tax

In general, 95% of any capital gains originating from a disposal of shares are not liable to CIT if the seller is a corporation, though losses cannot be deducted (*see Question 5, Corporate income tax (CIT) (Körperschaftsteuer)*). As the trade tax is interrelated to CIT, only 5% of the capital gains are affected by trade tax (*see Question 5, Trade tax*). The sale of partnership interest is usually treated like an asset deal, that is, like the sale of the assets held by the partnership, and is therefore subject to income tax and trade tax (*see Question 15*).

The sale of shares or a partnership interest is usually not subject to VAT, but the seller can opt for VAT taxation (*see Question 6, VAT*).

Exemptions and reliefs

11. Are any exemptions or reliefs available to the liable party?

There is a 95% exemption for specific capital gains arising from the disposal of shares (*see Question 5, Corporate income tax (CIT) (Körperschaftsteuer)*).

Tax advantages/disadvantages for the buyer

12. Please set out the tax advantages and disadvantages of a share acquisition for the buyer.

Advantages

RETT can be avoided in the case of share deals if the 95% threshold is observed (*see Question 4, Real estate transfer tax (RETT)*).

Disadvantages

Where the purchase price is higher than the equity of the acquired entity, there is no step-up of the entity's assets for tax purposes.

At the level of the company being transferred, loss carry-forwards may forfeit at least partially in the case of direct or indirect share transfers. If such transfers are conducted to one acquirer (solely or together with related parties/persons with aligned interests) in any given five-year period:

- A partial forfeiture of any loss carry-forward will take place if more than 25% of the company's share capital or voting rights are transferred.
- A complete forfeiture of any loss carry-forward will take place if more than 50% of the company's share capital or voting rights are transferred.

There are some exceptions to this rule, which have strict requirements. Losses and loss carry-forwards survive to the extent they equal the amount of the company's domestic taxable built-in gains in its assets. Therefore, built-in gains in corporate shares are not considered as taxable under the 95% tax exemption (*see Question 5*). The loss forfeiture rules are not to be applied in a qualified intragroup transfer setting. As a prerequisite, the share transfer needs to be conducted between a transferring and an acquiring company that are both directly or indirectly held 100% by the same individual or company. The European Commission challenged another exemption to this rule for qualified restructuring situations, and as a result this exemption is currently not available anymore. The same rules need to be applied with regard to interest carry-forwards generated by the interest barrier (*see Question 5, Corporate income tax (CIT) (Körperschaftsteuer)*).

Tax advantages/disadvantages for the seller

13. Please set out the tax advantages and disadvantages of a share disposal for the seller.

Advantages

95% of a capital gain is not taxed if the seller is a corporation and sells shares in a corporation (*see Question 5, Corporate income tax (CIT) (Körperschaftsteuer)*).

Disadvantages

The buyer usually deducts built-in taxes of the target from the purchase price.

Transaction structures to minimise the tax burden

14. What transaction structures (if any) are commonly used to minimise the tax burden?

With regard to a tax-exempt exit, the buyer usually acquires the German target through holdings in jurisdictions with full capital gains exemption rules and double tax treaties with Germany.

ASSET ACQUISITIONS AND DISPOSALS

Taxes potentially payable

15. What taxes are potentially payable on an asset acquisition/asset disposal?

RETT and notaries' fees

RETT and notaries' fees are payable if real property is transferred (*see Question 4*).

CIT and trade tax

Any gains that are generated by asset disposals are subject to trade tax and CIT (*see Question 5*).

VAT

In general, VAT is levied on a sale of business assets. However, a main exception lies in the sale of real property that is VAT-exempt, though the seller can still opt for VAT to apply.

When a seller transfers its business as a going concern to a buyer planning to use the assets to carry on the same kind of business,

the supply is normally not included within the scope of VAT (*see Question 6*).

Exemptions and reliefs

16. Are any exemptions or reliefs available to the liable party?

Capital gains from the disposal of land or buildings can be rolled over to other land or buildings bought in the year of the sale, the year before the sale, or in the following four years after the sale (under certain circumstances, six years after the sale) through a tax-exempt reserve. However, the European Court of Justice recently held that the tax relief may violate EU law due to the fact that the roll-over of the capital gain is only possible to the acquisition of domestic business assets. The German legislator's reaction and future development need to be observed.

Further, the German Reorganisation Tax Act may allow for a tax book roll-over under certain conditions.

Tax advantages/disadvantages for the buyer

17. Please set out the tax advantages and disadvantages of an asset acquisition for the buyer.

Advantages

The buyer attains a full asset tax basis step-up for the price paid and consequently higher tax depreciations and amortisations are caused in the future, assuming hidden reserves paid for. Furthermore, the buyer does not acquire any tax risk associated with the target entity.

Disadvantages

In the case of a business disposal as a going concern through an asset deal, the buyer is liable for the seller's business-related tax liabilities incurred in the year of closing and in the year before the closing of the asset deal.

Tax advantages/disadvantages for the seller

18. Please set out the tax advantages and disadvantages of an asset disposal for the seller.

Advantages

The step-up to the level of the buyer (*see Question 17*) may assist in accomplishing a higher purchase price.

Disadvantages

Gains are fully subject to trade tax and CIT.

Transaction structures to minimise the tax burden

19. What transaction structures (if any) are commonly used to minimise the tax burden?

Buyers generally attempt to agree on a detailed allocation of the acquisition price for the purchased assets and liabilities with the sellers to reach an optimal allocation of depreciation, although this is not binding on the tax authorities.

LEGAL MERGERS

Taxes potentially payable

20. What taxes are potentially payable on a legal merger?

RETT and notaries' fees

In the case of the merged company owning real estate property in Germany, RETT is triggered as long as the intragroup exemption is not applicable (*see Question 4, Real estate transfer tax (RETT)*). As far as the transferee (that is, the resulting entity) is concerned, RETT is not triggered to the extent the transferee owns German real estate before and after the merger. Consequently, the amount of RETT can be diminished by selecting the merger direction. Notaries' fees will be payable because parts of the merger documents must be notarised (*see Question 4, Notaries' fees*).

CIT and trade tax

Any of the company's built-in gains will be realised and so CIT and trade tax (*see Question 5*) need to be considered unless there is an exemption under the Reorganisation Tax Act (*Umwandlungssteuergesetz*) (GRTA) (*see Question 21*). However, any gains may be set off against current losses or losses carried forward within the usual requirements (*see Question 5*). Last, but not least, any of the transferor's persisting loss carry-forwards will be forfeited.

VAT

Not applicable.

Exemptions and reliefs

21. Are any exemptions or reliefs available to the liable party?

CIT and trade tax

Under the Reorganisation Tax Act, mergers between corporations can be executed tax-neutrally (that is, built-in gains will not be realised through a rollover of book values) if both:

- There is no exclusion or restriction on Germany being entitled to tax future capital gains for transferred assets through the resulting company.
- Any consideration consists of shares in the resulting company.

The original company's shareholders usually acquire shares in the resulting enterprise in the context of a merger as reimbursement for their shares in the original company being erased. The shareholders can roll over the book value into the new shares without triggering any taxable gain provided German rights to tax capital gains arising from a later sale of the newly issued shares remain unaffected.

Transaction structures to minimise the tax burden

22. What transaction structures (if any) are commonly used to minimise the tax burden?

Depending on which entity holds real estate or, if both transferor and transferee do, RETT may be alleviated by selecting the merger direction (*see Question 20*). In addition, as far as intragroup restructurings are concerned, the exclusion for real estate transfers may also alleviate RETT (*see Question 4, Real estate transfer tax (RETT)*). A merger may be tax-neutral if the requirements of the Reorganisation Tax Act are complied with (*see Question 21*).

JOINT VENTURES

Taxes potentially payable

23. What taxes are potentially payable on establishing a joint venture company (JVC)?

CIT and trade tax

A contribution of cash is tax-neutral. However, a contribution of assets usually results in a realisation of built-in gains for the contributor and in capital gains that are also affected by trade tax and CIT, unless there is an exception due to special rules (*see Question 24*).

RETT

RETT may be triggered if real property, or at least 95% of a real property owning company, is transferred to the JVC (*see Question 4, Real estate transfer tax (RETT)*).

VAT

In general, the contribution of assets against shares in the JVC is affected by VAT unless an exception can be applied (*see Question 6*).

Exemptions and reliefs

24. Are any exemptions or reliefs available to the liable party?

A number of exemptions can apply to transfers, making them potentially tax-neutral.

Corporations

The contribution and transfer of a business, business unit or partnership interest to a corporation is tax neutral under the Reorganisation Tax Act if the following apply:

- The contributor receives as consideration only new shares in the receiver or another consideration capped at an amount of the book value of the contributed business, partnership interest or business unit.
- There is no exclusion or any restriction concerning German taxation rights with regard to future capital gains of the transferred assets through the receiver.
- The tax value of the transferred property is not negative.

However, the sale of the new shares conducted within a seven-year period may result in tax being retroactively due on the built-in gains at the time of the original transfer (entirely or in part relating to the time passed since the transfer).

Additionally, a correspondent exemption (with potential retroactive taxation) needs to be considered if shares in a corporation are contributed to another corporation that in turn owns the majority of voting rights in the contributed corporation.

Partnerships

Both the rules on the transfer or contribution of a business, business unit or partnership interest into a partnership and the respective rules for corporations are largely similar. Nevertheless, the transfer of a corporation's shares into a partnership is only tax-neutral under the Reorganisation Tax Act if 100% of the shares are transferred.

There are further exceptions if other assets are contributed (against issuance of shares or for no consideration) into a partnership complying with additional prerequisites, including that both:

- The partnership does not sell the asset within three years.
- Only the corporation being the contributor participates in the actuating partnership within a period of seven years.

Any built-in gains may be rolled over or temporarily allocated to a tax-exempt reserve in the case of contributing buildings or land (*see Question 16*). However, an elaborate analysis needs to be performed if not all of the participants are German tax residents.

Transaction structures to minimise the tax burden

25. What transaction structures (if any) are commonly used to minimise the tax burden?

The parties generally try to meet the prerequisites for a tax-neutral contribution (*see Question 24*).

COMPANY REORGANISATIONS

Taxes potentially payable

26. What taxes are potentially payable on a company reorganisation?

Mergers

See *Questions 20* to *22*.

Contribution of assets into corporations and partnerships

See *Questions 23* to *25*.

Conversion of a corporation into a partnership

In this situation, the rules for a merger of the corporation into the partnership are to be applied and any built-in gains are realised and taxed through the corporation. However, the conversion can be executed as tax-neutral if the following prerequisites under the Reorganisation Tax Act are met:

- A corporation's liabilities and assets become business property of the partnership.
- There is no restriction whatsoever regarding German rights to tax future capital gains in the transferred assets through the partnership.
- The consideration exclusively consists of newly issued shares.

Conversion of a partnership into a corporation

The same rules concerning the contribution of the partnership (or interest in the partnership) to the corporation are to be applied (*see Questions 23* to *25*).

Conversions of a corporation into a partnership and vice versa usually do not trigger VAT or RETT. Crucial parts of the conversion must be notarised and consequently trigger notaries' fees.

Exemptions and reliefs

27. Are any exemptions or reliefs available to the liable party?

See *Question 26*.

Transaction structures to minimise the tax burden

28. What transaction structures (if any) are commonly used to minimise the tax burden?

The parties usually try to meet the prerequisites of a tax-neutral restructuring or conversion (*see Questions 20 to 25*).

RESTRUCTURING AND INSOLVENCY

29. What are the key tax implications of the business insolvency and restructuring procedures in your jurisdiction?

In German tax law, there are no specific rules for insolvency or financial restructuring of a company.

However, if a corporation's liquidation is planned, its taxable income is calculated for the liquidation period of three years and not on an annual basis.

In all other scenarios, the general rules as stated in *Questions 3* to *9* apply within the following framework:

- A waiver of receivables by a creditor results in a taxable gain at the level of the debtor company and usually in tax deductible expenses for the creditor.
- Shareholders of the company who are creditors are entitled to a waiver qualifying as a tax-neutral contribution to the company capped at the waived claim's value.
- The same approach is to be applied if the company's debt is transformed into equity and new shares in the debtor are issued (debt-equity swap).
- A gain arising from a waiver can be offset against losses or loss carry-forwards within the concept of the minimum taxation (*see Question 5*).
- There is a specific set of rules to be considered if a restructuring qualifies with regard to the "bail-out decree" or restructuring decree of the Federal Ministry of Finance (*Sanierungserlass*). However, the decree is currently under investigation by the Federal Tax Court. If it remains applicable, certain requirements need to be fulfilled in order to obtain a tax relief. For example, the tax authorities usually demand an external restructuring plan set up by an expert to prove the financial need, the ability for a bail-out and the creditors' respective restructuring goals. In general, authorities do not approve restructurings in which only shareholders waive claims as a qualifying measure to be entitled to benefits under the bail-out decree. Within the application of the decree, the following consequences need to be considered:
  - restructuring gains will be set off against the entire amount of loss carry-forwards (aside from the restrictions of the concept of minimum taxation);
  - the tax on any remaining restructuring gain will be waived following the restructuring.
- Within certain circumstances, a taxable gain may be avoided if the shareholder assumes the debt of its enterprise instead of waiving it. Furthermore, another option to avoid a taxable waiver gain may be to merely subordinate the shareholder's receivables against its enterprise instead of waiving them.
- The mere contribution of further equity into its enterprise by the shareholder usually does not have any tax-related consequence. However, tax loss carry-forwards may be forfeited if, as a consequence, there is a change of the share-ownership-ratio in the amount of at least 25%.
- With regard to the forfeiture of losses in the event of a share transfer of more than 25% or 50% (*see Question 12, Disadvantages*), a provision existed that losses remain unchanged if a share transfer happened in the course of a qualified bail-out. However, the European Commission has challenged this rule and it is currently no longer applicable.

SHARE BUYBACKS

Taxes potentially payable

30. What taxes are potentially payable on a share buyback? (List them and cross-refer to *Questions 4* to *7* as appropriate.)

For share buybacks German tax law distinguishes between the two levels.

For the shareholder, such share buybacks are handled in the same way as a sale of shares, resulting in the taxation of capital gains and not as a partial liquidation or even a distribution. In general, the 95% exemption for share transfers applies if the shareholder is a corporation. As a result, only 5% of any capital gain is affected by trade tax and CIT (*see Question 5*). If the shareholder is a private individual, participations in the amount of at least 1% of the company's share capital results in 60% of the capital gain being levied with a personal tax rate of between 14% and 45%, with a solidarity surcharge of 5.5% on that rate. If the shareholding is less than 1%, the full capital gain is subject to income tax and taxed at a flat tax (*Abgeltungssteuer*) of 25% with a 5.5% solidarity surcharge.

However, for a company acquiring its own shares, German tax law follows the GAAP treatment and regards share buybacks as partial liquidation/decrease of share capital. Nevertheless, no withholding tax on the proceeds of up to 26.375% is triggered.

Exemptions and reliefs

31. Are any exemptions or reliefs available to the liable party?

See *Question 30*.

Transaction structures to minimise the tax burden

32. What transaction structures (if any) are commonly used to minimise the tax burden?

Not applicable.

PRIVATE EQUITY FINANCED TRANSACTIONS: MBOS

Taxes potentially payable

33. What taxes are potentially payable on a management buyout (MBO)?

There are no specific rules concerning MBOs. For further information regarding the respective tax consequences, see *Questions 10* and *15*. Particular tax issues may arise for management participations. In this context, certain requirements must be fulfilled in order to not treat share capital gains as employment income that is levied with full taxation at the standard rates.

Exemptions and reliefs

34. Are any exemptions or reliefs available to the liable party?

Not applicable.

Transaction structures to minimise the tax burden

35. What transaction structures (if any) are commonly used to minimise the tax burden?

In the context of managers acquiring shares, the transactions are in most of the cases structured to ensure that the manager is treated as a beneficial owner of the shares.

REFORM

36. Please summarise any proposals for reform that will impact on the taxation of corporate transactions.

There are currently no material reforms envisaged. However, it is expected that for the 95% tax relief with regard to share capital gains generated with the disposal of shares (*see Question 5, CIT*), a minimum shareholding of 10% is introduced, similar to the already existing requirement for dividends. In addition, some changes lead to more stringent requirement for a tax relief under the Reorganisation Tax Act for the contribution of business/assets (*see Question 24*) might be tightened.

Practical Law Contributor profiles

Hardy Fischer, Partner

P+P Pöllath + Partners
T +49 30 253 53 220
F +49 30 253 53 999
E hardy.fischer@pplaw.com
W www.pplaw.com

Professional qualifications

- Admission to Bar in 2007.
- Admission as tax advisor in 2010.
- Lecturer at the University of Potsdam (Master Program Corporate and Tax Law).
- Assistant at the Institute of Tax Law and the Law of Non-Profit Organisations at Bucerius Law School, Hamburg.
- Study of law and economics at Bucerius Law School in Bayreuth and Hamburg (PhD in 2004).

Areas of practice. Domestic and international tax law; corporate tax law; real estate tax law; tax structuring; refinancing.

Non-professional qualifications

- German national tax reporter for the International Fiscal Association in 2012.
- German national tax reporter for the International Bar Association in 2013 and 2014.

Recent transactions

- IPO of LEG Immobilien AG and pre-IPO restructuring/refinancing (volume: EUR1.3 billion).
- ECE/Blackstone Joint Venture: Sale and Refinancing of German based shopping centres (EUR500 million).

Languages. German, English

Professional associations/memberships:

- IFA (International Fiscal Association).
- ZIA (Zentraler Immobilien Ausschuss; Member of tax committee).
- Sächsischer Steuerkreis e.V.

Publications

- *Verfassungsgericht entsorgt Teile der Grunderwerbsteuer (Constitutional Court disposes of part of the Real Estate Transfer Tax) (23 July 2015, Interview Immobilien Zeitung, issue 29/2015, p13).*
- *31 Immobiliengesellschaften – Sonderthemen (31. Real Estate Companies – Special Issues) (2015, Beck'sche Steuerkommentare/Wassermeyer - Doppelbesteuerung Festgabe zum 75 Geburtstag von Prof Dr Dr hc Franz Wassermeyer (Double Taxation – Commemorative publication on the occasion of Prof Dr Dr hc Wassermeyer's 75th birthday), pp231-234).*
- *Steuerliche Kontinuität im neuen Jahr (Tax Continuity in the New Year) (3 January 2015, Börsen-Zeitung 1/2015, p9).*
- *Liquidation von überschuldeten Gesellschaften – BFH schafft keine Klarheit (Liquidation of overindebted companies – Federal Tax Court does not establish clarity) (28 May 2014, Handelsblatt online, Steuerboard).*
- *Verfassungsgericht entsorgt Teile der Grunderwerbsteuer (Co*
- *German Court Questions Constitutionality of Interest Barrier Rule (28 April 2014, Worldwide Tax Daily, Tax Notes International).*
- *Finance Ministry Revises Position on Loss Forfeiture Rule (21 April 2014; Worldwide Tax Daily, Tax Notes International).*
- *Overview Germany: Trends & Developments Corporate Tax (2013; Chambers Legal Practice Guide Corporate Tax).*
- *The debt-equity condundrum Germany: Summary and Conclusions (Cahiers de droit fiscal international 2012, ed. by International Fiscal Association; Vol. 97b, 307-327).*