Germany: Federal Tax Court rules on requirements for partnership to head a tax group

Germany’s Federal Tax Court has ruled that when a partnership is the controlling entity of a German tax group (Organschaft), the partnership does not have to carry out its own genuine business activities from the beginning of the first year of the Organschaft; it is sufficient if the partnership commences such activities during the first year in which the tax grouping is effective.

German tax law provides for the establishment of an Organschaft, under which participating companies can pool their profits and losses for corporate and trade tax purposes. One of the requirements to set up a tax group with a partnership as its head is that the partnership must carry out its own genuine business activities (no similar requirement applies when a corporation is the head of a group). As a result, a partnership that is merely a holding/financing entity cannot act as the head of a group. “Genuine business activities” typically means that the partnership must earn income from engaging in a trade or business, such as providing services to other affiliated entities.

The Federal Tax Court (BFH) recently ruled on whether a partnership that is the head of an Organschaft is required to carry out its own genuine business activities from the beginning of the first year for which the Organschaft is effective, or whether the activities can begin at a later point during that first year. In the case, the taxpayer applied for Organschaft treatment from 1 January 2006, even though the head of the group (a limited commercial partnership, or KG) did not commence its own business activities until 1 March 2006. The BFH ruled in favor of the taxpayer, holding that it is sufficient if the partnership starts its own genuine business activities during the first year of the Organschaft.

The BFH decision may provide some relief in M&A transactions where the parties intend to set up a tax group between the acquisition vehicle (a partnership) and the target entities, and Organschaft treatment is to become effective on or shortly after the date the deal is closed. In such cases, it previously was necessary for the acquisition vehicle to engage in genuine business activities between the time the deal was signed and the time it closed. The BFH decision should offer more flexibility from a timing perspective in these cases.

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