

**Summary of the dissertation by Benedikt Jasper pursuant to Section 13 para. 3 no. 2
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The taxation of disproportionate corporate demergers

Corporate income and income tax issues in relation to section 15 German Reorganization Tax Act (Umwandlungssteuergesetz) with emphasis on the taxation of shareholders of the transferring entity

The main research issue of this dissertation is the question of the corporate income and income tax implications resulting from disproportionate corporate demergers (split-ups and split-offs) within the meaning of sections 123, 128 German Reorganization Act (*Umwandlungsgesetz*). Within this scope the particular question arises whether and under which specific prerequisites disproportionate corporate demergers resulting in a transfer of hidden profits between the shareholders of the transferring corporate entity may be consummated, particularly with regard to the involved shareholders, without any adverse tax effects, i.e. disclosure of hidden profits.

For purposes of this dissertation the assessment of the research issue mainly is carried out by two separate lines of analysis. First, the assessment is performed by legal analysis of the applicable sections within the German Reorganization Tax Act as well the so called general taxation principles (*allgemeine steuerliche Grundsätze*) applied by and laid out in a decree by the Federal Ministry of Finance (*Bundesministerium der Finanzen*) dated 11 November 2011 if and to the extent disproportionate demergers result in a transfer of hidden profits between different shareholders of the transferring entity, i.e. different tax subjects. Second, the assessment is carried out by testing the results found by applying the general taxation principles. In particular, the question is raised whether or not Section 13 German Reorganization Tax Act which *by law* generally supersedes the application of any general taxation principles must also prevail in the cases at hand, i.e. disproportionate demergers. The dogmatic issue whether or not Section 13 German Reorganization Tax Act prevails also in the event disproportionate demergers result in a transfer of hidden profits has not been recognized or elaborated further in standing court practice or among specialist researchers or tax law commentators.

Tax consequences for transferring corporate entities (*übertragender Rechtsträger*), acquiring corporate entities (*übernehmender Rechtsträger*) and the shareholders of the transferring entity resulting from corporate demergers are governed by Section 15 in conjunction with Sections 11 to 13 German Reorganization Tax Act. Disproportionate corporate demergers within the meaning of Section 128 German Reorganization Act at the level of the transferring as well as the acquiring entity can be consummated without adverse corporate income tax effects, i.e. irrespective of the tax consequences at the level of the shareholders of the transferring entity.

However, based on the prevailing view Section 13 (in conjunction with Section 15) German Reorganization Tax Act governing the tax consequences of corporate demergers for the shareholders of the transferring entity remains inapplicable if and to the extent the demerger results in a transfer of hidden profits between different shareholders of the transferring entity. Instead, general taxation principles including, inter alia, hidden profit distributions and hidden contributions shall apply.

Based on and assuming this prevailing view, in this dissertation it is as a first key issue analyzed which respective tax consequences arise at the level of the shareholders.

As a conclusion, disproportionate corporate demergers within the meaning of Section 128 German Reorganization Act at the level of the shareholders generally may result in withdrawals (*Entnahmen*) pursuant to Section 4 para. 1 s. 2 German Income Tax Act (*Einkommensteuergesetz*) as well as hidden profit distributions pursuant to Section 20 para. 1 no. 1 s. 2 German Income Tax Act and Section 8 para. 3 s. 2 German Corporate Income Tax Act (*Körperschaftsteuergesetz*). Contrary to the prevailing view and in deviation from the German Federal Tax Court's (*Bundesfinanzhof*) decision on a comparable case dated 9 November 2010 (IX R 24/09) it is concluded in this dissertation that disproportionate corporate demergers do not result in hidden contributions neither pursuant to Section 17 para. 1 s. 2 German Income Tax Act nor Section 8 para. 3. s. 3 German Corporate Income Tax Act.

The taxation based on withdrawals pursuant to Section 4 para. 1 s. 2 German Income Tax Act is only feasible regarding the shares in the transferring entity as relevant assets to be withdrawn (*Entnahmegegenstand*). It is further required that the shares held in the transferring entity by the respective shareholder are fully separated from the business assets (*Betriebsvermögen*) of the shareholder in question. Withdrawal taxation, however, is ruled out regarding hidden reserves in the shares/the value of the shares itself or potential subscription rights for shares in the transferring or the acquiring entities as potential assets to be withdrawn.

The aforementioned results assuming a taxation based on the general taxation principles then as the second key issue of this dissertation are tested against the generally also existing and conflicting dogmatic view that the provisions of the German Reorganization Tax Act supersede general (corporate) income tax provisions. In this regard, the results (i.e. legal consequences) found assuming a taxation based on merely general taxation principles instead of the provisions of the German Reorganization Tax Act (first key issue) must in principle be restricted.

The German Federal Tax Court described the provisions of the German Reorganization Tax Act as a specific area of tax law overriding provisions derived from general (corporate) income tax law. Following on from this, the relevant provisions of the German Reorganization Tax Act

in have been categorized by applying the most relevant taxation principle, the so-called “ability to pay principle” (*Leistungsfähigkeitsprinzip*) which is recognized as the main concept for evaluating (corporate) income tax laws. The provisions of the German Reorganization Tax Act and their general possibility to avoid a taxation upon consummation of the relevant reorganizations such as demergers at a first level result in a breach of the ability to pay principle in the form of its major subprinciple, the so-called subjects taxation principle (*Subjektsteuerprinzip*) pursuant to which hidden profits must be subject to (income) taxation at the level of the person (taxation subject) who has originally built the hidden profits by increasing the value of the respective tax item. Those breaches, however, can be justified by applying the so-called market income principle (*Markteinkommensprinzip*) arguing that the reorganizations, particularly disproportionate demergers, covered under the German Reorganization Tax Act only constitute corporate organizational measures rather than (taxable) market income. This allows for postponing the taxation provided a subsequent taxation of hidden reserves transferred is ensured. This also includes the level of the shareholders of the transferring entity in the course of disproportionate demergers.

The applicability of the general taxation principles would require based on general legal dogmatic conception that Section 13 German Reorganization Tax Act can be overcome either by applying a superseding provision as the general anti-avoidance rule (Section 42 German Fiscal Code, *Abgabenordnung*) or by means of a restricted teleological interpretation of Section 13 German Reorganization Tax Act. Neither of the aforementioned ideas, however, can successfully be applied.

Within a teleological interpretation of Section 13 German Reorganization Tax Act the principle of subjects taxation cannot be consulted as it is by special reasoning of the legislator not implemented in full in the German Reorganization Tax Act and overruled by the market income principle. This general consideration also applies to disproportionate demergers resulting in a transfer of hidden profits between different shareholders of the transferring entity.

Ultimately, based on the analysis performed in this dissertation general taxation principles contrary to the prevailing view must not be applied as Section 13 German Reorganization Tax Act is the more specific rule prohibiting other tax consequences than those specifically set out therein. This also applies for disproportionate demergers resulting in a transfer of hidden reserves between the shareholders of the transferring entity at their level. In this regard, general principles developed by the German Fiscal Tax Court in its so-called *Tauschgutachten* dated 16 December 1958 may not be consulted in the case at hand. The results found in this dissertation also align with the basic systematic ideas of the German Reorganization Tax Act which can be shown by reference to Section 22 para. 7 German Reorganization Tax Act. This provision also allows for (initially) tax-exempt disproportionate reorganization measures even

though such measures explicitly result in a transfer of hidden reserves between different shareholders.