# YPOG Article

## Share flips: What evidence should individual contributors produce?

Berlin, March 11, 2022 | Ann-Kristin Lochmann

## Treatment of share flips for tax purposes

A contribution of shares in a corporation(1) into another corporation against the grant of new shares in the acquiring company (so-called "share exchange" or "share flip") should generally be executed at fair market value for tax purposes (ie, hidden reserves in the contributed shares are disclosed as a consequence of the share flip).

A share flip requires the granting of new shares in the acquiring company (ie, a capital increase, in cash or in kind) must take place at the level of the acquiring company prior to or at the time of the share contribution. The capital increase amount can be chosen by the involved parties; there is no minimum nominal amount.

The German Reorganisation Tax Act (GRTA) allows a share flip to be executed at book value (or an intermediate value) for tax purposes, provided that:

- the acquiring company was founded in an EU or EEA state and has its registered office and place of management in an EU or EEA state(2)
- after the contribution the acquiring company holds the majority of shares in the company whose shares were contributed (so-called "qualified share flip")
- the fair market value of other considerations granted in addition to the new shares does not exceed certain thresholds

A respective book value application must be filed by the acquiring company no later than the time for the first submission of the tax balance sheet of the year in which the share flip took place.

## No retroactive effect

For tax purposes, no retroactive effect is possible in the case of a share flip, so the contribution date for tax purposes is determined according to general principles. The decisive date is the transfer of

beneficial ownership. Depending on the circumstances of the individual case, this can be at the conclusion of the contribution agreement, a later date of transfer of (beneficial) ownership provided for in the contribution agreement, the filing of the registration of the capital increase in the commercial register or – at the latest – the registration of the change of shareholders in the commercial register.

## Evidence obligation of the individual contributor

In the case of individual contributors, a share flip executed at book value for tax purposes results in the contributed shares being subject to a seven-year retention period combined with a specific annual evidence obligation of the individual contributor(3).

For a period of seven years following the contribution date, the individual contributor must provide evidence as to whom the contributed shares are attributed at the end of the day corresponding to the relevant contribution date (a "share flip anniversary").

If the evidence is not provided, the contributed shares are deemed to have been sold. This would result in the same consequences as a breach of the retention period by sale of the contributed shares by the acquiring company, or the occurrence of a harmful event (similar to the sale of the shares) as defined in the GRTA. In these circumstances, the contribution will retroactively be executed at fair market value for tax purposes; therefore, available hidden reserves in the shares at the time of contribution will be disclosed and taxed at the level of the individual contributor. The gain is, however, reduced by one-seventh for each full year that has elapsed since the contribution.

Details about evidence obligation:

### *Who must provide evidence?*

The individual contributor (or his legal successor) is obliged to provide the evidence.

### *To which tax office is evidence submitted?*

The evidence must be submitted to the tax office responsible for the taxation of the individual contributor.

In the case of legal succession, it is disputed whether the evidence must be submitted to the tax office responsible for the legal successor or to the tax office responsible for the contributor. It is best to provide the evidence to both tax offices to ensure its validity.

### *What form of evidence is required?*

The form of evidence is not specified by law; it only says that there must be proof of the attribution of the shares at the end of the day of the share flip anniversary (for more details see the following section).

Given that the evidence is a tax-related obligation, the attribution for tax purposes is relevant. Thus, in case the legal and beneficial ownership is different, it is the beneficial ownership position that is decisive. Exact guidance on how to confirm the attribution for tax purposes can neither be found in the guidelines to the GRTA nor in the tax literature. However, practically this should only be a minor concern as in most share flip cases legal and beneficial ownership of the contributed shares are the same.

The general recommendation in the tax literature for the evidence is to show the following:

- a written confirmation from the acquiring company regarding the beneficial ownership of the contributed shares as per the respective share flip anniversary
- proof of the shareholder status (eg, an extract from the share register or the list of shareholders)

The evidence must also clearly identify the contributor (eg, full name, address and date of birth) and the contributed shares (eg, share numbers).

### *When is evidence provided?*

The GRTA states that 31 May is the due date for the annual evidence.

To determine the seven-year evidence period the contribution date is relevant. According to the prevailing opinion, the evidence must be provided for the first time after the first share flip anniversary.

*Example one*

If the contribution date is after 31 May – for example, 30 September of year one – then by 31 May of year three, the evidence must be provided of to whom the contributed shares are attributable on the first anniversary date (ie, on 30 September of year two).

By 31 May of year four, the evidence must be provided of to whom the contributed shares are attributable on the second anniversary date (ie, on 30 September of year three).

Thus, the seven-year evidence period runs from year three up to and including year nine.

*Example two*

If the contribution date is before 31 May – for example, 31 March of year one – then by 31 May of year two evidence must be provided of to whom the contributed shares are attributable on the first anniversary date (ie, on 31 March of year two).

By 31 May of year three, the evidence must be provided of to whom the contributed shares are attributable on the second anniversary date (ie, on 31 March of year three).

Thus, the seven-year evidence period runs from year two up to and including year eight.

## Comment

As outlined above the contributor must provide the tax office with information which does not relate to them personally, but rather to the acquiring company (ie, whether the acquiring company still holds the contributed shares.

From the contributor's perspective it is, therefore, recommended to include in the contribution agreement an obligation for the acquiring company to provide the individual contributor (upon request) with the required information in due time. It might also be worth attaching to the contribution agreement a draft of the written confirmation required from the acquiring company.

## Endnotes

(1) In particular the legal forms of a Societas Europaea, a stock corporation, a partnership limited by shares and a company with limited liability.

(2) As a consequence, share flips of shares in a German corporation into a corporation with its registered seat or place of management outside the European Union (EU) or the European Economic Area (ie, in particular the United States, the United Kingdom and Switzerland), always result in a disclosure (and taxation) of the hidden reserves available in the contributed shares.

(3) Corporation contributors are not subject to this evidence obligation as any gain resulting from a disclosure of hidden reserves in the contributed shares would be tax-exempt anyway (only 5% of such gain is treated as a non-deductible business expense for tax purposes and thus, subject to corporate income and trade tax); therefore, no abuse prevention is required.

We are happy to support you and open for further exchange.

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