May 2026

The Federal Fiscal Court (BFH) rules for the first time on so-called “passive exit taxation” in the event of an amendment to a double taxation agreement

In two rulings dated 19 November 2025 (I R 41/22 and I R 6/23), the Federal Fiscal Court (BFH) clarified that amendments to the treaty situation may, in principle, lead to “passive exit taxation” and thus to corresponding tax liabilities, whilst at the same time defining the limits of such taxation more precisely. Accordingly, taxation of hidden reserves is only possible if the Federal Republic of Germany previously had a right of taxation over these hidden reserves and this right is effectively excluded or restricted by an amendment to a double taxation agreement (DTA). Consequently, for internationally networked companies and shareholders, knowledge of developments in the field of DTAs, as well as of the relevant foreign tax law in each case, takes on even greater significance in the context of tax planning.

International tax cases are often shaped by the interplay of national regulations and DTAs. If the legal framework under the treaty changes, this can shift the allocation of taxing rights between the states involved. For cross-border structures, the question then arises as to whether and to what extent Germany can continue to tax hidden reserves that have already accrued. It has hitherto been disputed whether even a mere amendment to a DTA – an international treaty between two states over whose conclusion the taxpayer clearly has no influence – can trigger a tax liability in the event of shifts in taxation rights (so-called “passive exit taxation”). The Federal Fiscal Court (BFH) has now had the opportunity in two rulings to comment on this and to define in greater detail the conditions for “exit taxation” in the event of changes to the treaty situation.

I. Exit taxation as a risk of cross-border structures

Cross-border situations frequently raise the question of which state is entitled to tax hidden reserves. This is of practical significance whenever Germany loses its previous right of taxation or can only exercise it to a limited extent as a result of a factual or legal change. In such cases, hidden reserves may be subject to taxation even though there are no actual proceeds from a sale to offset them.

This issue arises in various forms. It concerns, for example, exit taxation of individuals holding shares in corporations as part of their private assets under Section 6 of the German Foreign Tax Act (AStG). It is also of considerable significance in the context of so-called "exit" scenarios relating to business assets (Sections 4 (1) sentence 3, 16 (3a) of the Income Tax Act (EStG), Section 12 (1) sentence 1 of the Corporate Income Tax Act (KStG)).

Exit Taxation refers to the loss or restriction of Germany's right to tax hidden reserves. Classic cases of exit taxation are typically linked to an active act on the part of the taxpayer. This may apply both in the event of the taxpayer's departure or a change in their tax residency under treaty law (so-called "subject-related exit taxation"), and in the transfer of an asset to a foreign permanent establishment or its transfer to a foreign business unit (so-called "object-related exit taxation"). As the Federal Fiscal Court (BFH) recently ruled, the transfer of assets to a foreign permanent establishment even leads to exit taxation where there is no loss of German taxing rights whatsoever (BFH judgment I R 5/24 of 26 March 2025).

Unlike in the cases mentioned above, "passive exit taxation" does not require any action on the part of the taxpayer. The decisive factor is the restriction or exclusion of the German right of taxation through purely governmental action, for example due to the first-time application of a newly concluded or revised DTA (see BMF letter of 26 October 2018 – IV B 5 - S 1348/07/10002-01, BStBl. I 2018, 1104) or based on a statutory provision (see BFH judgment I B 44/21 (AdV) of 24 November 2021, BStBl. II 2022, 431, 435 para. 29).

In literature, the question of whether Section 4 (1) sentence 3 of the Income Tax Act (EStG) and Section 12 (1) sentence 1 of the Corporate Income Tax Act (KStG) also cover the "passive exit taxation" of business assets has been the subject of controversy for some time. The tax authorities had already accepted the taxation of hidden reserves in the event of a "passive exit taxation" due to the first-time application of a new or revised DTA in the BMF letter of 26 October 2018 – IV B 5 - S 1348/07/10002-01 (BStBl. I 2018, 1104).

II. "Passive exit taxation" in the event of changes to double taxation agreements: principles and limitations

The two Federal Fiscal Court (BFH) rulings of 19 November 2025 address "passive exit taxation" in the event of a change in the treaty situation from two different perspectives. Whilst ruling I R 41/22 clarifies the fundamental possibility of "passive exit taxation", ruling I R 6/23 sets out its factual limits. The rulings thus complement each other to form a consistent line of case law: whilst a change in the DTA may trigger "passive exit taxation", this always requires the actual loss or restriction of a previously existing German right of taxation. To this end, the relevant foreign tax law must also be considered.

1. Two DTA amendments as the starting point

Both decisions were based on changes to the initial treaty law framework. Ruling I R 41/22 concerned the 2011 DTA with Spain, which, from 1 January 2013, contained a so-called "real estate company clause" for the first time. Such a clause provides that, upon the sale of shares in which most of the assets consist of immovable property in the other contracting state, not only the shareholder's state of residence but also the other contracting state has a right of taxation. The case in question concerned a holding in a Spanish corporation, held within special business assets (*Sonderbetriebsvermögen*), more than 50 % of whose assets consisted of immovable property situated in Spain. The tax office regarded the German obligation to credit Spanish tax, established for the first time by the amended DTA-Spain, as a restriction on German taxing rights and assumed a "passive exit taxation" pursuant to Section 4 (1) sentence 3 of the Income Tax Act (EStG).

Consequently, it imposed tax consequences, even though the taxpayer had no influence whatsoever on the conclusion of the amended DTA-Spain.

In ruling I R 6/23, the amendment of the DTA concerned a commercial property situated in Australia. The 2015 DTA with Australia contained, for the first time, an explicit provision for gains from the disposal of immovable property. The tax office assumed that it was only because of this new provision that Germany had lost its right of taxation on any future capital gains and assessed a notional capital gain in accordance with Section 12 (1) sentence 1 of the Corporate Income Tax Act (KStG).

2. Lower courts: No exit taxation in either case

In both proceedings, the claims had already been successful at the lower court, albeit on different grounds. In I R 41/22, the Münster Fiscal Court rejected a "passive exit taxation" on the merits. In its view, Section 4 (1) sentence 3 of the Income Tax Act (EStG) required an active act of withdrawal or transfer attributable to the taxpayer. A mere change in the treaty situation was not sufficient for this.

In contrast, in I R 6/23, the Hessian Finance Court did not focus on a requirement for action but rejected a loss of German taxing rights. In its view, Germany had no right of taxation on a gain from the sale of the Australian property even under the 1972 DTA with Australia, because Article 6 of the 1972 DTA with Australia also covered capital gains from immovable property.

3. BFH: "Passive exit taxation" possible in principle

The Federal Fiscal Court (BFH) addresses the fundamental issue of "passive exit taxation" primarily in its ruling I R 41/22. In that ruling, it recognises that Section 4 (1) sentence 3 of the Income Tax Act (EStG) does not require the taxpayer to have actively withdrawn, transferred or shifted assets. The exclusion or restriction of German taxing rights may therefore, in principle, also arise from a change in the legal situation, through the first-time applicability of a new or amended DTA.

The parallel ruling I R 6/23 concerning Section 12 of the Corporate Income Tax Act (KStG) builds on this and refers especially to the limits of "passive exit taxation" (see under 4.).

In its reasoning, the Federal Fiscal Court (BFH) bases its decision on the wording, structure and legislative history of the exit taxation provisions. The wording of the law does not require any active or deliberate action on the part of the taxpayer. Furthermore, the equating of "passive exit taxation" with a withdrawal or disposal ("fictitious disposal") merely concerns the legal consequence and does not establish any additional requirement for action. Nor does the legislative history imply any exclusion of passive exit taxation cases. The BFH also rejects objections based on constitutional and EU law.

4. Restriction of the right to tax: BFH requires more than an abstract risk

However, the fundamental recognition of "passive exit taxation" does not mean that every amendment to a double taxation agreement automatically triggers exit taxation. In I R 6/23, the BFH clarifies that "passive exit taxation" presupposes that Germany had a right of taxation over the relevant hidden reserves at all prior to the application of the new DTA. Only an existing right of taxation can be excluded or restricted by the new treaty situation.

This was lacking in the Australian case. In the BFH's view, Article 6 of the 1972 Australia DTA covered not only current income from immovable property but also gains from the disposal of immovable property, even though the earlier 1972 DTA did not expressly mention the disposal of real estate. The BFH bases this interpretation on an autonomous interpretation of the treaty. Neither the absence of a separate provision on capital gains from immovable property nor the subsequent explicit provision in Article 13 of the 2015 Australia DTA justified a different assessment. Germany therefore had no right of taxation over the relevant capital gains from the sale of immovable property even under the old DTA. Consequently, no German right of taxation could have been lost because of the 2015 DTA with Australia.

This captures the central limit of "passive exit taxation" in a nutshell: there can be no exit taxation without a prior tax nexus in Germany and subsequent actual taxation abroad.

It follows that, in the opinion of the Federal Fiscal Court (BFH), a restriction of the German right of taxation can only be considered if a deemed disposal of the respective asset would be taxable under the applicable foreign tax law and (i) could thereby give rise to foreign tax that is creditable in Germany or (ii) Germany were obliged to exempt the underlying foreign income from German tax base. According to this, it would not be decisive merely that the DTA assigns a right of taxation to the other contracting state in principle. Rather, it would also be necessary for that state to be able to exercise its right of taxation under its domestic law in the specific case.

In doing so, the BFH is clearly taking a stance in favour of a concrete approach and against a purely abstract understanding of the exit taxation as a mere risk factor. Although the statement is not decisive for the ruling, it is likely to be of considerable practical significance. When assessing a possible "passive exit taxation", one would therefore need to consider not only the allocation of taxing rights under the treaty but also the actual taxability in the other contracting state. Consequently, in the field of international tax planning, a timely assessment of planned measures (relocations, transfers of management) and existing structures is required, taking into account any forthcoming changes to double taxation agreements as well as to German and relevant foreign tax laws.

5. Date of exit taxation

In both rulings, the Federal Fiscal Court also comments on the relevant date at which exit taxation occurs. The tax authorities had assumed that the legal consequences of "passive exit taxation" would take effect at the time the new or revised DTA first became applicable (see BMF letter of 26 October 2018 – IV B 5 - S 1348/07/10002-01, BStBl. I 2018, 1104).

The Federal Fiscal Court (BFH) does not agree with this. In its view, the legal consequence of exit taxation does not take effect only upon the commencement of the first application of the DTA, but already in the very last legal moment prior to that. The decisive factor is therefore the point in time immediately before the exclusion or restriction of the German right of taxation takes effect.

For ruling I R 41/22, this meant that any "exit tax gain" would not have had to be recognised in the disputed year 2013, but rather in the final legal second before the end of31 December 2012. For this reason, the claimant ultimately prevailed in this case. Whether and to what extent the tax authorities can still recognise the exit tax in the "correct" year depends on the specific facts of the case; the Federal Fiscal Court's judgment does not address this point.

In ruling I R 6/23, the BFH applies this reasoning to Section 12 (1) sentence 1 of the Corporate Income Tax Act (KStG). There too, any exit tax would have had to be recognised not only at the time of the first application of the 2015 DTA with Australia, but immediately prior to that. Ultimately, however, this point in time was not decisive because there was already a lack of a pre-existing German right of taxation. Here too, the claimant prevailed over the tax authorities.

III. Key takeaways for practice

The decisions provide clarity on the tax treatment of "passive exit taxation" but also create new complexities. It is now established that a change in the treaty situation can, in principle, trigger "passive exit taxation" without requiring any active action on the part of the taxpayer. Whether exit taxation applies in an individual case, however, continues to depend on a careful analysis of the previous and new treaty situations and the relevant foreign tax law in each instance.

It is precisely this that makes "passive exit taxation" particularly significant in practice. Taxpayers are generally unable to control the relevant triggers themselves: neither the conclusion or amendment of a DTA nor the domestic taxation practices of the other contracting state are within their control. Tax consequences may therefore arise from developments that they themselves did not initiate.

This gives rise to considerable practical challenges. In future, companies and shareholders must not only keep an eye on their own cross-border restructurings or asset transfers, but also monitor changes in the legal environment, in particular new or revised DTAs. To identify potential risks of tax avoidance at

an early stage, it is necessary to continuously monitor the treaty landscape and assess its impact on German tax rights on a case-by-case basis.

> For advisory practice, this implies a clear need for action. Cross-border structures involving hidden reserves should be continuously reviewed to determine whether changes in the treaty landscape could affect German taxing rights. Such DTA monitoring should not only commence upon the entry into force of a new DTA but should also consider ongoing treaty negotiations and published drafts. Only in this way can potential consequences of decoupling be identified, assessed and, where necessary, addressed through structural measures at an early stage.

The decisions must therefore be viewed as ambivalent: they bring an end to the fundamental dispute over "passive exit taxation" in business assets whilst simultaneously setting important limits. For taxpayers, however, they significantly increase the burden of monitoring and auditing. "Passive exit taxation" thus becomes an issue that must be considered not only on an ad hoc basis but also on an ongoing basis in cross-border structures.

This client information provides only a non-binding overview of the subject matter addressed herein. It does not constitute legal advice. We are happy to assist you regarding this client information and your advisory matters:

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