

Tightening of German Real Estate Transfer Tax Rules for Share Deals

IN SHORT

The Situation: Under the German real estate transfer tax ("RETT") law, RETT is not only triggered on the direct acquisition of German properties, but also in case of share deals involving companies with German properties, if certain acquisition or investment thresholds are exceeded. The RETT rules are expected to be tightened significantly for share deals as of January 1, 2020.

The Result: If implemented, the new rules will make it significantly more difficult to avoid RETT in case of share deals. In addition, in order to assess RETT implications of any direct or indirect share transfers in companies owning German properties, it will be necessary to analyze all previous share transfers within the last 10 years.

Looking Ahead: If possible, planned transactions should be closed in 2019, as customary structures to avoid RETT in case of share deals using coinvestors are unlikely to be feasible under the new rules. All direct and indirect share transfers after December 31, 2019, involving companies with German properties will need to be carefully analyzed from a RETT perspective.

On May 8, 2019, the German Federal Ministry of Finance published a draft tax bill, which amongst numerous other measures, provides for a severe tightening of the German real estate transfer tax rules for share deals. The proposal is largely based on a concept developed by the Federal States in mid-2018. Although the concept has been subject to severe criticism for its complexity, it is now likely to be implemented. The cornerstones are as follows:

- Reduction of the acquisition or investment threshold triggering RETT from 95 percent to 90 percent;
- Application of the less favorable partnership RETT change of ownership rules to corporations;
- Extension of the look-back period for cumulative ownership changes from 5 years to 10 years; and
- Elimination of the EURO 25,000 cap on penalties for failure to timely notify authorities of a change in ownership triggering RETT.

According to the draft bill, the new rules generally apply to transactions closed after December 31, 2019. There will be highly complex transitional rules, mainly aimed at ensuring that transactions with investment levels of at least 90 percent but less than 95 percent can still be taxed if the (former) 95 percent threshold is reached in the future.

Under the new rules, RETT would be triggered if an investor (or a group of affiliated investors) acquires a direct and/or indirect ownership of at least 90 percent in the property company.



Current RETT Rules for Share Deals

Under the current rules for share deals, RETT is triggered if an investor (or a group of affiliated investors) acquires a direct and/or indirect ownership of at least 95 percent in a company owning German real estate. The applicable RETT rates range from 3.5 percent to 6.5 percent of the gross value of the properties, depending on in which Federal State they are located.

In the case of property companies in the legal form of *partnerships*, RETT is also triggered if within any period of five years there is a direct or indirect transfer of interests of at least 95 percent to new shareholders.

Example: *In 2015, A acquired 80 percent and B acquired 10 percent of the interests in a partnership with German properties from Z. In year 2018, Z sold the remaining 10 percent to C. Although all shareholders own less than 95 percent in the partnership, the transaction in year 2018 triggered RETT as at least 95 percent of the ownership in the partnership was transferred to new shareholders within 5 years.*

In order to avoid RETT on share deals, it is customary to acquire property companies together with unrelated coinvestors that hold at least 5.1 percent or, in the case of partnerships, leave at least 5.1 percent of the interests for at least 5 years with the seller. Property companies in the legal form of partnerships are frequently converted into corporations prior to the acquisition in order to avoid the application of the special change of ownership rule for partnerships.

Proposed New Rules

Under the new rules, RETT would be triggered if an investor (or a group of affiliated investors) acquires a direct and/or indirect ownership of at least 90 percent in the property company.

The same applies if there is a direct or indirect transfer of the ownership of the property company—in the legal form of a partnership or a corporation—to at least 90 percent new shareholders within any period of 10 years.

As a consequence, it will no longer be possible to avoid RETT on share deals if the main investor acquires the property company together with a >10 percent coinvestor, as both would qualify as new shareholders. The conversion of a partnership into a corporation would also no longer help to avoid RETT as the new change of ownership rules apply regardless of the legal form of the property company.

A share deal may still be executed in a RETT neutral way under the new rules if >10 percent of the shares in the property company remain with the seller for at least 10 years. However, even if the seller continues to hold the >10 percent shares, RETT might be triggered in case of a change of ownership in the seller within the 10 year period (which could be seen as an indirect transfer of its shareholding).

If an investor reaches the 90 percent ownership threshold, the RETT will be owed by him. In contrast, RETT triggered due to a 90 percent transfer of ownership to new shareholders within 10 years will be owed by the respective property company, although it cannot normally control its shareholder base. This will also need to be taken into account by lenders in their risk assessment of the property company. The draft bill does not provide for an exemption for listed property companies, although these will unlikely be able to monitor a relevant change of their investor base.

Although the new rules generally only apply for transactions executed after December 31, 2019, the transitional rules require transactions of the past to be taken into account as well.

Example: *In order to assess whether a transfer of 10 percent of the shares in a property company in 2020 triggers RETT, it needs to be reviewed whether this transfer—together with all (direct and indirect) share transfers during the last 10 years (even before the entering into force of the new rules)—reaches the new 90 percent transfer of ownership threshold.*

In this context, it will be of particular importance to review the RETT impact of the execution of put or exit rights of coinvestors that were negotiated under the current rules.

There are also complex transitional rules for cases where investors have already exceeded the new, but not the old ownership or change of control thresholds. It shall be ensured that these cases can still be taxed once the old thresholds are reached.

Example: *In 2000, Investor A acquired 94.9 percent and B acquired 5.1 percent in a company with*

German properties. In 2020 B sells his 5.1 percent stake to A. The investment in 2000 did not trigger RETT as A stayed below the then applicable 95 percent threshold. Under the new rules, the 2020 transaction would also not trigger RETT, as the new 90 percent threshold is not crossed. The transfer of ownership rule does also not apply as the transfers in 2000 are well outside the 10 year look-back period. However, given that A had already reached the new 90 percent threshold, the special transitional rules would provide for the continued application of the 95 percent threshold. The crossing of the 95 percent threshold in 2020 would hence trigger RETT.

In order to assess the RETT consequences of share transfers under the new rules, it will be required to analyze all direct and indirect share transfers in companies owning German properties which happened during the last 10 years.

The draft bill provides for further RETT changes in addition to the new rules for share deals. Most noteworthy is the deletion of the cap for late payment penalties in case of the delayed notification of transactions that are subject to RETT to the authorities (generally two weeks; one month for non-residents). The penalties amount to 0.25 percent of the applicable RETT for each month which commences during the delay, but are currently capped at EUR 25,000. In particular in large scale property transactions, the deletion of the cap could lead to significant financial exposure if the statutory notification periods are missed.

Next Steps

The draft bill may be subject to amendments in the course of the further legislative procedure. Given the previous thorough consideration of the matter by the authorities and the legislator, it is in our view that the entire concept of the new rules will be revised. We remain available for any questions and will keep you updated on the further process.

FIVE KEY TAKEAWAYS

1. After many unsuccessful attempts to tighten the RETT rules for share deals, this time it is very likely that the proposed changes will actually be implemented.
2. Customary coinvestment structures to avoid or mitigate RETT in share deals are unlikely to be feasible for transactions executed after December 31, 2010.
3. Existing coinvestment structures should be analyzed and, as required, amended in view of the new rules, in particular as put/call arrangements with minority interest holders serving as RETT-Blockers can typically be exercised already after five years, i.e., earlier than permissible under the new rules.
4. All direct and indirect share transfers after December 31, 2019, involving companies with German properties will need to be carefully analyzed from a RETT perspective.
5. From a purchaser's perspective we expect that the attractiveness of asset deals will significantly increase.



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