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Indirect real estate deals targeted by German real estate transfer tax

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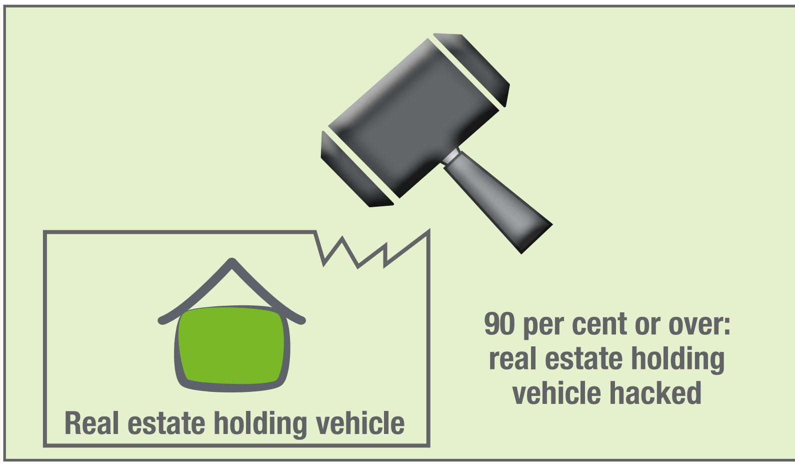
For some time now, transactions of shares or partnership interests in real estate holding companies have been targeted by German legislators. Fiscal authorities estimate an income tax potential of one billion Euro per year for the German federal states as a result of a tightening of the regulations for real estate transfer tax in indirect real estate investments. Even though the current provisions differ in detail between partnerships and corporations, as a basic rule, real estate transfer tax is currently triggered if 95 per cent of the shares or partnership interests of a real estate holding company are sold. After discussing a reduction in this acquisition threshold from 95 per cent to 75 per cent, or even 50 per cent, the Conference of Ministers of Finance decided on June 21, 2018, to reduce the threshold to 90 per cent. At the same time, the existing holding periods for transfers of partnership interests, which may trigger real estate transfer tax if not met, are to be extended from 5 to 10 years in the future. Furthermore, provisions for partnerships and corporations are to be aligned more and more in the future. After the finance ministers of the federal states agreed on a fundamental concept, the Federal Ministry of Finance is now tasked with the drafting of a legislative proposal on this basis.

The current provisions for real estate holding partnerships and corporations seem to be quite similar: For partnerships, real estate transfer tax is triggered if in the past 5 years at least 95 per cent of the limited partnership interests of a real estate holding partnership have changed hands. For corporations, real estate transfer tax is triggered if at least 95 per cent of the shares of a real estate holding company are disposed in one event or 95 per cent of the shares are united in the hands of one purchaser. However, the devil is in the details. A careful analysis of the wording of the current provisions illustrates the differences. Currently, when, in the aggregate, 95 per cent or more of the shares or partnership interests are acquired by two separate investors in separate sale and purchase agreements and, following the acquisitions, none of the investors hold at least 95 per cent of the holding company, real estate transfer tax would be triggered for partnerships but not for corporations. Therefore, under current legislation, real estate transfer tax can be avoided if, for example, an investor acquires 94.9 per cent of the shares of a real estate holding corporation and a separate co-investor buys the remaining 5.1 per cent of the shares.

After tightening the law on indirect participations in real estate holding companies in 2013 and 2015, the German fiscal authorities are still hungry for more tax income from indirect real estate acquisitions. The legislators admit openly that the trend is to make share deals more and more unattractive. The new concept, which was decided on June 21, 2018, includes the further tightening of the existing legislation. The basic concept of the taxation of partnership will not be altered. However, the threshold for triggering real estate transfer tax will be reduced from 95 per cent to 90 per cent. At the same time, the holding period required to avoid real estate transfer tax will be increased from 5 to 10 years.

The abovementioned new threshold of 90 per cent will also apply to corporations. Moreover, in the future, the special provisions for partnerships will be also be applicable to corporations, i.e. under the current provisions, real estate transfer tax is triggered if in total 95 per cent of partnership interests (and, in the future, 90 per cent) are transferred, regardless of whether to one or several buyers. This rule, i.e. the fact that the number of buyers is irrelevant if 95 per cent (or 90 per cent in the future) are transferred in total, will now also apply to any transfer of shares. The consequence thereof is that a tax neutral acquisition with a separate co-investor holding 5.1 per cent (or, in the future, 10.1 per cent) of the shares will no longer be possible. Furthermore, the wording of the concept of the ministers of finance implies that the holding periods will also apply to the acquisition of corporate shares. As a result, for acquisitions of real estate holding corporations, real estate transfer tax can only be avoided if at least 10.1 per cent of the shares remain with the seller for at least 10 years.



To date it is not clear what the consequences to the currently running 5 years holding period (for partnerships) will be. It is possible that they will either remain at 5 years or they will be extended for 5 more years. If real estate assets have been acquired through a 94.9 per cent interest in a partnership with a co-investor holding the other remaining 5.1 per cent, and the purchase agreements include an option for the co-investor to sell its interest after 5 years, such purchase agreements and the sale option contained therein will need to be renegotiated if the legislator decides to extend the holding periods.

All other aspects of the proposed concept should not have a retrospective effect. Therefore, there still is a short time frame to structure real estate transactions under the current tax regime. However, as soon as the legislative draft is submitted to parliament, the legislation may apply with retrospective effect thereafter. Unfortunately, it is currently not foreseeable when the legislative proposal will be submitted to parliament. Thus, the earlier indirect real estate transactions are structured and closed, the more likely such transactions will be able to avoid triggering real estate transfer tax.

In our opinion, avoiding real estate transfer tax through indirect acquisitions is merely the consistent application of the law. Furthermore, the direct acquisition of real estate, as opposed to the acquisition of a company holding real estate, are entirely different transactions and consequently should be treated differently. However, for quite some time, the German authorities have clearly demonstrated that they see things differently with regard to this matter. Therefore, the new legislative proposals can be regarded as a continuation of the tightening of the former legislation that were passed in 2013 and 2015. What is new in this instance is that differences between partnership and corporations will be minimized more and more for real estate transfer tax purposes. Unfortunately, this does not come with any tax relief for partnerships, but the stricter provisions applicable to partnerships will be expanded to apply also to corporations. With respect to an accelerating revenue stream from the real estate transfer tax (the tax revenue of the real estate transfer tax in Germany has more than doubled between 2010 (5.29 bn €) and 2016 (12.4 bn €)), it is disappointing that the authorities once again are focused only on tightening the regulations and not on providing any possible tax relief for the taxpayers.

be in touch: Any questions? Please do not hesitate to contact us!

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