ALLEN & OVERY

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Current developments regarding the German real estate transfer tax reform

1. Long awaited: German Federal Ministry of Finance has published draft bill

Already in **June 2018**, the German Federal States agreed in their Finance Minister Conference to considerably tighten the real estate transfer tax (**RETT**) treatment of **share deals**. The main purpose was to encounter the transfer of 100% of the shares in a real estate holding corporation which under the current rules is generally possible without triggering RETT. In practice, RETT could be avoided in this case if two independent and unrelated purchasers (legally and economically) have each acquired more than 5% of the shares (e.g. with a split of 94.9% and 5.1%, as customary in the market).

After the German Federal Ministry of Finance had first voiced various concerns with regard to the contemplated changes, in March this year the German Federal Minister of Finance Olaf Scholz has finally agreed with the German Federal States to support the reform.

As part of the **annual tax act 2019** (so called *Jahressteuergesetz 2019*, technically implemented as *„Gesetz zur weiteren steuerlichen Förderung der Elektromobilität und zur Änderung weiterer steuerlicher Vorschriften*“) the German Federal Ministry of Finance has now (publication at 8 May 2019) also provided a **draft bill of the RETT reform**.

2. Major contemplated changes

The present draft bill mainly corresponds to the (not officially published) proposals by the German Federal States in their Finance Minister Conference at the end of November 2018.

In practice, the **most important changes** are as follows:

(i) Decrease of the RETT relevant threshold from currently 95% to 90%;

(ii) Extension of the RETT relevant monitoring periods from currently 5 years to (mainly) 10 years. The holding period for purposes of the RETT exemption under Sec. 6 German RETT Act will even be extended to 15 years to disallow current structuring with "option models" for the acquisition of real estate holding partnerships in the future. The current five year monitoring period will only remain in place for purposes of the intra-group privilege under Sec. 6a German RETT Act.

(iii) Introduction of a new RETT provision (future Sec. 1 para. 2b German RETT Act) according to which the current "transfer rule" for real estate holding partnerships pursuant to Sec. 1 para. 2a German RETT Act shall now also apply to real estate holding corporations. This would result in RETT being triggered if in the future at least 90% of the shares in a corporation were transferred to new shareholders within a period of 10 years. Similar to the current partnership rules, such

RETT would then be owed by the real estate holding corporation which was (directly or indirectly) transferred.

(iv) Application of the “regular” value determination rules for transfers of real estate within the retroactivity period of reorganisations under the German Reorganisation Tax Act (*Umwandlungssteuergesetz*) as opposed to the technical application of the purchase price. Under current rules, disposals of real estate could be structured RETT efficient in these circumstances;

(v) Abolishment of the cap for late filing charges (*Verspätungszuschlag*) with respect to the lack of notification of RETT events to the German tax authorities.

3. Effectiveness of new rules

The draft bill foresees that the new rules will generally apply to any (RETT relevant) transactions after 31 December 2019, *i.e.* as **from 2020**.

However, it remains unclear whether for purposes of the new transfer rules for corporations (future Sec. 1 para. 2b German RETT Act) also past transactions need to be taken into account. Absent of a clear statement in the application rules of the draft bill in this regard, in our view room for interpretation persists. Therefore, as a matter of precaution also transactions as far back as 2010 should be taken into consideration for purposes of evaluating RETT related risks. As an inclusion of past transactions raises considerable concerns from a German constitutional law point of view (especially against the background that – on the basis of the most recent administrative guidance – the tax authorities may take into account indirect transfers also outside the period of (currently 5, in future) 10 years monitoring period) a clarification in the course of the further legislative proceeding would be strongly recommended.

For transactions which have been signed but not yet closed (which is relevant in practice in particular for so called “forward sales”) a grace rule is foreseen if signing has occurred no earlier than 1 year prior to the draft bill being introduced to the Bundestag as German Lower Chamber (which is likely to take place in June 2019) and closing happens within 1 year thereafter.

Apart from that the new rules also aim to prevent majority shareholders from increasing their stake (in a current 94.9% / 5.1% structure) to 100% without triggering RETT. Technically this shall be achieved in a way that the current 95% threshold for RETT purposes shall continue to apply simultaneously to the new 90% threshold, at least for a transitional period in relation to Sec. 1 para. 2a German RETT Act and indefinitely in relation to Sec. 1 para. 3 and 3a German RETT Act.

4. Outlook

Although it is definitely to be welcomed that the new rules shall become effective only as from 2020, unfortunately many of the content-related as well as constitutional law-related concerns were not addressed. This applies in particular if the application rules were to be understood such that also past share transfers within the last 10 years would have to be taken into account for purposes of the new transfer rule under Sec. 1 para. 2b German RETT Act. In addition, the lack of an exemption for listed companies raises significant concerns: a tracking of indirect share transfers of listed companies is often impossible in practice. Even though this is already reality for participations in real estate holding partnerships this issue will be exacerbated in the future when also real estate holding corporations would be included. Finally it may also be legitimately criticised that existing “option models” with regard to partnership interests shall effectively be taxed retroactively under the new rules; such option agreements will therefore have to be very closely analysed for adjustments needed.

It is expected that the draft bill will be introduced to the Bundestag in **June 2019**. It remains to be seen whether

the draft bill will still be amended in the course of the legislative proceedings (e.g. by the Federal States via the participation of the Bundesrat as German Upper Chamber).

Key contacts

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