GERMANY

German Real Estate Transfer Tax and Share Deals

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Transactions concerning German real estate usually trigger Real Estate Transfer Tax (RETT) of 3.5% to 6.5% of the purchase price or the asset value. The actual tax rate depends on the location of the real estate. However, there are some opportunities to avoid this tax by executing a share deal rather than an asset deal. Consequently, such share deals are gaining more and more attention from the fiscal authorities and the politicians want to propose a reform of RETT. This article provides an occasion to more precisely examine the related factual and legal situation.

Share Deal – Status Quo

According to the German RETT law, it is possible that the acquisition of a company that owns real estate may not always trigger RETT. In contrast to the direct acquisition of real estate (asset deal), the acquisition of a company holding real estate does not involve RETT if a 95% limit is observed. If the investor alone – or in connection with associates – directly or indirectly combines less than 95% of the shares in the real estate company, no RETT is due. In the case of partnerships with real estate holdings, there is the additional requirement that also the remaining + 5% were not transferred in the last five years. The applicable, partially complicated details in such cases of indirect acquisitions of shares will be disregarded here. If the 95% limit is reached, RETT is triggered, namely on 100% of the total domestic real estate portfolio of the company.

On a percentage basis, the RETT probably has the most increased share of total tax revenue in recent years (from EUR 4.9 B in 2009 to over EUR 11.2 B in 2015). This is primarily thanks to the many major investors that still make acquisitions by way of asset deals. The constantly increasing taxation rates since 2007 (in some German federal states, they almost doubled from 3.5% to 6.5%) have undoubtedly led to great interest in share deals in relation to RETT. However, RETT-free share deals are nevertheless not reprehensible:

- The share deal cannot be compared in any way with an asset deal with respect to risk and cost effectiveness. Some politicians state that real estate investors can easily switch between asset deals and share deals – but that is by no means the case. In a share deal, the acquirer acquires an independent company and thereby assumes all economic, legal and other risks, respectively all potential liabilities from the past. The due diligence in a share deal is much more comprehensive; often, planned share deals become asset deals in the end, even if this means incurring RETT. In an asset deal, the investor acquires "solely" a real estate property, without the history of the company that held the real estate.
- There are many good reasons for investors to have more than 5% of shares in real estate companies, e.g. in joint venture project development (often with the participation of public entities). In such cases, it may make sense for the project developer to retain a shareholding in the company in the course of the sale (and if possible without incurring RETT), in order to bear the economic risks of the project development.
- In relation to RETT, the tax privileges offered by a share deal have been incorporated into the law for many decades and have led to the privatization of large residential portfolios owned by public entities being carried out in the form of share deals within the last 12 years. Thereby, much greater purchase prices could be achieved for the federal government and the states. Incidentally, today there are still share deal privatizations through public entities.

RETT for Share Deals – Would it violate jurisdictional and legal standards?

RETT LIABILITY FOR SHARE DEALS – VIOLATION OF EU LAW?

A general liability for RETT on share deals will not be so simple to implement, e.g., there are stable and confirmed legal positions on the RETT treatment of partnerships as compared to corporations. The two legal forms are handled differently in a technical way and, where applicable, are released from tax liability. The introduction of tax liability on share deals would be a "major reform", much like the major RETT reform of 1983, which was also connected with a massive reduction in the RETT rate.

RETT liability for share deals would also lead to difficult questions on delimitations. Just one example: an Asian aviation enthusiast electronically buys shares in the Dutch Airbus Group S.E. on NASDAQ in the U.S. Would there possibly be RETT on the level of the indirect German subsidiary of the AIRBUS Group with real estate holdings? What would the tax exemptions be? Would there not be a massive execution deficit on such share deal RETT, connected to the consequence of unconstitutionality? In addition, mid-sized companies with company-owned properties would potentially be burdened, e.g., upon change of shareholders in the family company.

Furthermore, the issue of whether it is currently legally possibly to amend the real estate transfer taxation of share deals, was recently called into doubt with some good arguments by a tax officer of the Ministry of Finance (article in UVR 2016 pg. 16 et seq., which was not written in tax officer's official capacity):

- In significantly reducing the applicable quota from the 95% limit, the real property correlation would be lost and, consequently, there would no longer be any real estate-related transfer tax, but instead a capital transfer tax. In this case, the federal government would then have administrative power and tax sovereignty, not the federal states, as is currently the case. In addition, it would not be permissible for the EU member states to begin to impose capital transfer taxes on their own according to the guidelines of 2008/7/EC.
- It would be difficult to base it on the systems used in other EU member states. There it is tied to subjective elements of an offense, which could however present difficulties in reviewing it, as well as the risk of unconstitutionality due to structural execution deficits. Alternatively, e.g., in the Netherlands, there is a minimum requirement for real estate property. The administrative expenses connected thereto just to examine the taxability would, however, be enormous.

Conclusion

Any amendment of the RETT in connection with the transfer of shares in real estate companies, in particular reduction of the 95% limit, leads to fundamental questioning of the system. The German federal states could lose their administrative power and tax sovereignty and the legal amendments would be problematic with regard to European law.