Update on pending changes to the German RETT regime for share deals

Germany: June 2018

In Brief

The heated debate on the tightening of the German RETT Act to expand the scope of this tax to include sales of less than 95% of the company's share capital continued with a meeting of the Finance Ministers of the Federal States on 21 June 2018. Although no formal draft document is available yet, changes are to include a lowering of the threshold to 90% and introduce a new RETT triggering event for corporations that would have a substantial impact not only on real estate investors but also to owners of corporate real estate. The new regime might reach the finish line soon. Investors should closely monitor the legislative process.

Meeting of the Ministers of Finance

In Germany, share sales of less than 95% of the shares in real estate companies owning German real estate are broadly not subject to real estate transfer tax.

Since autumn 2016, the Ministries of Finance of the Federal States are discussing options to broaden the scope of the RETT Act to include share deals of less than 95% as well. The originally discussed options to lower the hurdle to 75% in the present regime or even 50% with a pro rata taxation (please see our previous NewsAlert dated October 2017) have experienced push back due to constitutional law concerns.

Based on the available press release the Ministers of Finance of the Federal States agreed in the meeting held on 21 June 2018 to ask a committee to draft a respective bill and the Federal Ministry of Finance to launch a respective legislative procedure to decide on this bill covering to our understanding:

- the lengthening of the monitoring period for transfers of interest in partnerships to 10 years,
- the introduction of a new RETT triggering event for share transfers in corporations,
- the lowering of the hurdle from 95% to 90%, and
- the lengthening of claw back periods for certain privileges applicable to partnerships only.

Lengthening the monitoring period for interest transfers

Presently, the direct and indirect transfer of 95% or more of the interest in real estate owning partnerships within a five year period to new owners is subject to RETT.

The Ministers of Finance aim at lengthening the monitoring period from 5 to 10 years in order to tax the transfer of interest to different owners. Under the current regime, this rule already triggers concerns regarding the administrative burden and the lack of enforcement. By lengthening the monitoring period to 10 years, these difficulties would be augmented substantially.

New RETT triggering event for corporations

As outlined above, the transfer of 95% of the interest in real estate owning partnerships within a five year period is subject to RETT under the current RETT regime.

The Ministers of Finance aim at applying a similar concept to real estate owning cooperation such that, not only the unification of 95% of the shares, but also the transfer of 95% to new shareholders within a 5 or 10 year period would trigger RETT on the level of the real estate owning corporations. It is presently not specified what monitoring period would be applicable to this and whether the hurdle is at 90% 0r 95%.

Such an amendment would put an immense administrative burden onto the tax payer as this rule would also apply to indirect share transfers that would have to be monitored irrespective of how many corporate levels are interposed between the real estate owning entity and the share transferring parties. As this rule would also apply to, for example, entities listed at a German or foreign stock exchange or entities with free float shares, such a rule would likely suffer a lack of enforcement.

Such an amendment would not only have a substantial impact on the real estate industry but also on all entities that hold corporate real estate in Germany. It therefore remains to be seen whether the legislator is willing to implement a provision with such a substantial impact on all corporations owning real estate to stop certain tax planning of a limited group of investors.

Lowering the hurdle to 90%

In addition, the Ministers of Finance intends to lower the hurdle from 95% to 90% such that the acquisition of 90% of the shares in real estate owning partnerships or corporation would trigger RETT on the full assessment basis.

Such an amendment would not only make RETT neutral share transfers difficult to implement but also add complexity to any reorganisation measures in corporate groups. This amendment applies also to any corporate real estate owning entities.

Lengthening the claw back period

Under the present RETT regime, the acquisition of real estate by a direct partner from the underlying partnership or the remaining interest in such a partnership can be exempt in part from RETT if the partner has participated for more than five years in the partnership or since prior to the acquisition of the underlying real estate by the partnership.

The Ministers of Finance aim at lengthening this claw back period to 10 years.

Our view

In summary, the expected German RETT changes are clearly aiming to reduce the attractiveness of share deals.

However, the discussion was focused on stopping certain tax planning measures within the real estate industry without balancing the impact of the envisaged amendments on other industries and market participants. The discussed new rule for corporations would especially pose substantial challenges to the tax payers and the tax authorities. Complex corporate structures common in today’s globalised world, shares held in free float and entities listed in foreign stock exchanged, would be burdened by the new regime and administrative measures to ensure enforcement of the new rules.

It is important to note that these changes are also relevant at an intermediary or ultimate holding company level.

There is no clear commitment on the entering into force of the new regime yet but it is expected to be on 1 January 2019 at the latest. One will need to monitor the legislative process closely in order to take into account all details of the envisaged new law.

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