Autumn update on pending changes to the German RETT regime for share deals

Germany: December 2018

In Brief

The heated debate on the tightening of the German Real Estate Transfer Tax (RETT) Act to expand its application to sales of less than 95% of a company's share capital continued with another meeting of the Finance Ministers of the Federal States on 29 November 2018. Although a formal draft document has not yet been publicised, changes are to include a lowering of the threshold to 90% and the introduction of 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. Investors should continue to closely monitor the legislative process as the proposed changes to the RETT regime draw closer to enactment.

Meeting of the Ministers of Finance

In Germany, sales of less than 95% of the shares in a real estate company owning German real estate are broadly not subject to RETT under the current RETT regime.

However, since autumn 2016, the Ministries of Finance of the Federal States have been discussing options to broaden the scope of the RETT Act to apply to share transfers of less than 95%. The original proposals to lower this threshold to 75% in the present regime or even 50% with a pro-rated taxation (please refer to our previous NewsAlert dated October 2017) were met with push back due to constitutional law concerns.

Based on the press release shared last Friday, the Finance Ministers of the Federal States agreed in the meeting on 29 November 2018 on draft legislation and have requested the Federal Ministry of Finance to commence its legislative procedures. We expect the bill to address:

- the lengthening of the monitoring period for transfers of interest in partnerships to 10 years;
- the introduction of a new RETT triggering event for direct and indirect share transfers in corporations;
- the lowering of the threshold from 95% to 90%; and
- the lengthening of claw back periods for certain benefits available to partnerships only.

Lengthening the monitoring period

Presently, the direct and indirect transfers of 95% or more of an interest in real estate owning partnerships within a five year period to new owners is subject to RETT. The Ministers of Finance are aiming to lengthen this period from five to 10 years.

The administrative burden and lack of enforceability of the existing provisions is already considered a matter of concern. By lengthening the monitoring period to 10 years, we expect that these concerns will only increase.

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 regime.

The Ministers of Finance aim at applying a similar concept to real estate owning corporations with the impact that not only the unification of 90% of the shares, but also the transfer of 90% to new shareholders within a 10 year period would trigger RETT at the level of the real estate owning corporations. Interestingly, the RETT liability would arise to the real estate owning corporation itself so that its equity value would be threatened by indirect share transfers which it cannot control.

This amendment would put an immense administrative burden onto the taxpayer as this rule would apply to indirect share transfers. In larger structures, this would therefore need to be monitored at multiple levels within a corporate holding structure to ensure compliance with the rules. As this rule would also apply to, for example, entities listed at a German or foreign stock exchange or entities with free float shares, this rule would likely be difficult to enforce.

This 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. The hope however that the legislator will create provisions for relief for widely held indirect investment structures are fading.

Lowering the hurdle to 90%

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

This 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 would also apply to indirect transfers, i.e. where an entity holds shares in another real estate holding company.

Lengthening the clawback period

Under the current RETT regime, relief can be claimed on certain transfers of assets into or out of a partnership in which the transferor also holds an interest. This relief requires certain holding periods of five years to continue to be met; otherwise, any relief obtained upon transfer can be subject to claw back.

The Ministers of Finance intend to lengthen this clawback period to 10 years and for certain situations to 15 years.

Our view

In summary, the expected German RETT changes are clearly aiming at dramatically reducing the attractiveness of share transfers of real estate entities.

The new rule for corporations would in particular pose substantial challenges to taxpayers and the tax authorities. Complex corporate and fund structures common in today's globalised world, shares held in free float and entities listed in foreign stock exchanges, 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 still no clear commitment on when the proposed provisions will enter into force; however, it is expected to include a cut-off date for transfers of interests once the legislative proposal is formally submitted to Parliament with the effect that the law, upon coming into force, will apply retroactively from the date of submission. Given the backing in last week's meeting, this could in theory be any day from now on. The action taken by the Finance Ministers of the Federal States on 29 November does not however constitute a submission to Parliament but only a request to the Federal Minister of Finance to do so in the near future.

The legislative process should be monitored closely in order to take into account all details of the proposed new law.

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