Real Estate Tax Services News

Keeping you informed

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German tax administration publishes new decrees on real estate transfer tax (RETT) rules

In brief

In May 2022, the Finance Ministries of the German Federal States published long-awaited decrees on the interpretation of the RETT transfer rule introduced with effect as of 1 July 2021 on transfers in property holding corporate entities. At the same time, an amended decree on the interpretation of transfers in property holding partnerships was published.

Whilst the decrees clarify some of the views of the German tax authorities on certain aspects of the RETT transfer rules that were previously in doubt, they remain silent on other aspects that are under controversial discussion in the profession. Taxpayers might be forced to wait for case law that deals with the topics that have not been discussed in the recent decrees. We also note the high level of complexity in both decrees that shows how complicated the rules and their interpretation has become.

In detail

The German RETT rules have been amended several times, with the latest change with effect as of 1 July 2021, when (inter alia) the "partnership transfer rules" in Section 1 (2a) Real Estate Transfer Tax Act (RETTA) were tightened and the "corporate transfer rules" in Section (2b) RETTA were newly introduced. The wording of both rules is similar to a large extent. The unification rules in Section 1 (3) and (3a) RETTA were amended and remain applicable as well.

The Ministries of Finance of the German Federal Sates now issued new decrees regarding both transfer rules only summarizing the interpretation of this new regime by the tax authorities. Another decree on the new stock exemption has been announced but is not expected until later this year at the earliest.

Basic concept of the partnership / corporate transfer rules

In a nutshell, under the transfer rules RETT is triggered if at least 90% of

(i) the interest in a partnership with German real estate, or
(ii) the shares in a company with German real estate

are transferred directly or indirectly to new shareholders within a period of ten years (“monitoring period”).

For indirect transfers, the calculation of the quantum of share transfers that are considered as transferred differs depending on whether the intermediate entity is a partnership or a corporate. If the intermediate is a partnership, a “look through approach” applies: the quantum is determined by multiplying the percentages transferred in the partnership with the shares held by the partnership. If the intermediate is a corporate, the 90% threshold applies instead: if at least 90% of the shares in the intermediate corporate are transferred, all shares held by this intermediate are deemed as transferred and thus fully count towards the 90% threshold.

The most important aspects of the decrees are described in the following.

Monitoring period for indirect share transfers

In the former decree regarding the partnership transfer rule, the German tax administration had introduced the concept that the ten-year monitoring period only applied to direct transfers in partnerships. Indirect transfers in a partnership, i.e., in the intermediate chain of corporate entities above, were considered without any time limitations (so-called “eternal view”). This eternal view was not clearly referenced in the wording of the law and hence heavily criticised by RETT experts.

In the new decree, this eternal view is no longer mentioned which indicates that the tax authorities no longer take this view. However, there is no explicit statement whether the monitoring period applies at all levels of the structure. First verbal statements from a member of the tax administration in one of the federal states suggest that the tax authorities will apply the ten-year monitoring period at each level of a given structure. Therefore, we understand at present that the eternal view has been abolished albeit recommend monitoring any respective communication of the tax authorities in the coming months.

Change of legal form

The decrees confirm that any conversion of the legal form (from a partnership to a corporate, or vice versa) does not trigger RETT as such, neither at the level of the property holding entity itself, nor at the level of the (indirect) shareholders. Share transfers that happened prior to the conversion will count towards the 90% threshold, irrespective of the conversion. In other words, a conversion cannot be used to prevent triggering RETT.

However, the conversion of a direct or indirect shareholder of the property holding entity (i.e., the intermediate entity) from a partnership to a corporation or vice versa should be closely monitored, especially in light of any past or future share transfers in this converted shareholder. This is due to the different approaches to indirect share transfers, as explained above, and the application of the “look through” approach to partnerships. If an intermediate corporate is converted into a partnership, the “look though” approach applies to share transfers in that converted entity retroactively, that means it applies even to periods before the corporate became a partnership – so it will be treated as a partnership for the entire monitoring period of ten years. In contrast, if the intermediate is a partnership that is converted into a corporate, the look though approach still applies for all share transfers in the converted partnership prior to the conversion. Having in mind those different approaches, particular attention should be paid when determining the quantum of share transfers in case of any conversions having taken place in the structure.

Shortening the chain of shareholdings

The decrees confirm that the shortening the corporate chain of shareholdings does not trigger RETT or count towards the 90% threshold, if

(i) there is a consistent shareholding of at least 90% at all levels prior to and after the shortening of the corporate chain of shareholdings, and
(ii) the direct shareholder of the property holding entity remains unchanged, i.e., there must not be a direct change in the shareholding of the property holding entity itself.

If there are any partnerships in the chain, the look through approach applies when verifying the consistent 90% shareholding at all levels. Due to the complexity, any shortening in corporate chains should be analysed from a German RETT perspective, if any entity in the chain holds German real estate.

Procedural aspects

Many transactions may trigger RETT under both the transfer rules and the unification rules. Pursuant to the wording of the law, the transfer rules take precedence over the unification rules. As the unification rules are triggered already on signing and the transfer rules only on closing, it was previously uncertain how the tax administration would handle this in practice. The decrees now state that on signing, a RETT assessment is issued under the unification rules, and another RETT assessment is issued on closing under the transfer rules. The earlier RETT assessment issued on signing will be revoked provided there is no change in the underlying properties. The decree also states that in principle, a RETT assessment on signing under the unification rules should only be issued if the tax office is aware that closing is not expected within one year after signing.

To avoid triggering RETT under the unification rules if the transaction aborts between signing and closing, we recommend filing a precautionary RETT notification notice within the deadline of two weeks (or four weeks for non-German RETT payers) after signing.

Open points

Several issues were not addressed in the decrees.

On the one hand, during the implementation of the new regime, it was extensively discussed whether under the transfer rules RETT can be triggered multiple times, namely at each level, in case of any indirect share transfers of 90% or more in multiple tier chains of entities. This discussion is based on the rather technical aspects of how the unification rules (Section 1 (3) and (3a) RETTA) and the transfer rules (Section 1 (2a) and (2b) RETTA) interact. Simply speaking, the transfer rules could trigger RETT at each level of a structure with a 90% shareholding at each level with regards to the German Real Estate held by the lowest tier entity, as the same property is allocated to each entity in the chain either due to legal ownership (on the lowest tier) or due to a deemed ownership under the unification rules (on higher levels of the structure). The new decrees remain silent in this respect, but according to initial verbal statements from a member of the tax administration in one of the federal states, the tax authorities do not want to exclude such a double taxation and rather await case law from the German Federal Tax Court.

On the other hand, the decrees do not mention anything on how cases will be treated where signing occurred prior to 1 July 2021 but closing only took place after 30 June 2021. Under the plain wording of the law, in case of corporations RETT would be triggered twice: on signing the transfer rules for corporates had not come into effect yet and therefore, the precedence of the transfer rules for corporates over the unification rules did not yet apply. Therefore, there is a risk of double taxation caused merely by the timing of the transaction. The decrees are silent in respect of this risk. However, we understand from an initial discussion with a member of the tax administration in one of the federal states that they intend to limit the taxation to one. However, we recommend monitoring any tax assessments closely and file timely objections, if needed.

Our view

Overall, the detailed decrees demonstrate the complexity of the new RETT regime.

Whilst it is positive that the tax administration seems to have abolished their “eternal view”, several important issues have not been addressed. The avoidance of double taxation under both the transfer and unification rules is an important point that is only partially addressed in the decrees. We hope that the expected decree on the stock exchange exemption of Section 1 (2c) RETTA will contain more noteworthy content and clarify any controversies that these latest two decrees have left open.

For taxpayers, it remains important that any indirect share transfer need to be monitored closely, especially in fund structures where there are frequent changes, or for stock companies that are traded at a stock exchange which does not benefit from the stock exchange exemption. Furthermore, the statements on legal conversions have brought even more complexity to the monitoring process and it remains to be seen how this can be tracked in practice.

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