Real Estate Tax Services News

Keeping you informed

PwC Germany I April 2021

German real estate transfer tax (RETT) reform back on track

In brief

On 24 October 2019, the German coalition government issued a joint press release announcing that the proposed reforms to the German Real Estate Transfer Tax Act (RETTA) would be delayed until the first half of 2020. This delay was caused by a need for additional time to further consider any necessary changes after leading German real estate industry associations presented arguments at a public consultation on 14 October 2019.

At that time, the parties failed to reach a solution in the first half of 2020 and progress had since halted.

Now, efforts have started to adopt the original draft with few amendments despite the requests for changes. In the following, we briefly summarise the possible outcome to recap and highlight the proposed amendments which could be enacted mid or end of April to become effective by 1 July this year.

Draft legislation proposing upcoming changes to the German RETT regime

Following previous discussions on proposed changes to the German RETT Act (please refer to our previous NewsAlerts as of December 2018, May, August and October 2019), the draft legislation amending the German RETT Act will possibly go through the normal legislative process involving the two chambers of Parliament.

The proposed changes in the draft bill are as follows:

- the lengthening of the monitoring period for transfers of interests in partnerships from five to ten years (section 1 IIa RETTA);
- the introduction of a new RETT triggering event for transfers of 90% or more of the shares in a corporation within a period of ten years (new section 1 IIb RETTA);
- the lowering of the hurdles from 95% to 90% for legal, economic or tax group unification of shares as well as section 1 IIa RETT; and
- the lengthening of the clawback periods for certain privileges applicable to partnerships only.

An exemption for share transfers is envisaged for the ten years/90% share or partnership interest transfer provisions where the share transfers relate to shares listed on EU/EEA regulated markets or very limited specified non-EU/EEA stock exchanges, such as in Hong Kong, USA and Australia.

The new regulations are expected to apply to transactions which are signed (relevant for unification of shares/interests) or closed (relevant for transfers of shares/ interests) after 1 July 2021.

Application and transitional arrangements

The transitional provisions regarding the rules concerning transfers of shares and interests are complex due to the different structure of the RETT provisions and the fact that the Federal Ministry of Finance wishes to avoid situations where non-taxable situations as loopholes arise.

Below you will find a brief overview:

As a basic principle, the new rules apply from 1 July 2021. Therefore, and in relation to the unification rules, the new unification threshold of 90% applies from then on. If, however, before that date a share quota of at least 90%, but less than 95% was reached, the old 95% threshold will continue to apply indefinitely.

For the other rules, ie, the old 95% partnership rule, the relevant transfers are determined by the date of the closing event, being the effective transfer of shares or interests, and not by the signing of the purchase agreement. In addition, there is a specific transition rule for the transfer of partnership interests that allows the application of the old 95% threshold for five years where the sum of changes had reached a quota of at least 90% but less than 95%.

For the new corporation rule (transfer of 90% within ten years), shares transferred after 30 June 2021 would be caught, transfers before that date are aimed to be excluded due to a grandfathering ratio of the law.

Our view

Real estate investors should continue to monitor the legislative process closely as the proposed changes to the RETT regime draw closer to enactment.

Given (i) the high tax rates in the federal states (*Bundesländer*) of up to 6.5%, (ii) that upon a 90% trigger event, the full tax basis is applied, and (iii) the cost at shareholder level in the case of a unification is usually not effectively tax deductible, the implications of this new regime will be far-reaching. Absent a “real estate rich entity limitation”, the application of these rules is not limited to the real estate industry. They will have a substantial impact on corporate real estate owners as there are only limited exceptions for certain listed corporations and, last but not least, none for any type of funds focusing on real estate investments or, for example, UCITS investing in corporations. Both for the already existing direct or indirect partnership transfer of interest rule and the new one for shares in corporations, the 90% test has to be monitored by the management of the real estate owning entity and the latter has to notify the tax authorities about a taxable event.

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