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Tax Alert. Real Estate Transfer Tax

The reform of the German real estate transfer tax on share deals has been subject to a political discussion for nearly two years now. The ministers of finance of the federal states decided on the cornerstones of such a reform by the end of 2018. The German Federal Government now passed a draft bill presented by the Federal Ministry of Finance. The main amendments to the current legal situation, i.e. the lowering of the 95% thresholds for shareholdings to 90% and the extension of the current holding periods from 5 to 10 or even 15 years were already known and expected.

The bill further provides for rules on the application of the new regime and transitional provisions. According to these, the new regime shall, in principle, apply as of 1 January 2020. However, various deviations from this principle apply due to which the new regime might also tie in with transactions prior to this date. Therefore, the contemplated reformed real estate transfer tax regime already needs to be considered in share deals prior to 1 January 2020.

German Government passes a bill on the tightening of German real estate transfer tax for share deals

During the conference of the ministers of finance on 29 November 2018, the ministers of finance of the federal states (*Finanzminister der Länder*) have taken a decision to reform the real estate transfer tax ("**RETT**") with respect to share deals. The Federal Ministry of Finance (*Bundesministerium der Finanzen* – 'BMF') was asked to implement the suggested amendments in a draft bill. The BMF presented draft bill which was passed by the Federal Government on 31.07.2019. This government bill will be submitted to the Federal council in due course. The amendments are meant to enter into force on 1 January 2020.

The bill implements the suggestions of the ministers of finance with respect to material law (c.f. "**Intended amendments**"). The bill further provides for rules of temporal application and certain transitional provisions (c.f. "**Temporal application and transitional provisions**").

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Current legal situation

Under the current legal situation, share deals in connection with real estate-holding companies trigger RETT, in particular, in the following cases:

- **Example 1**: Direct or indirect **transfer** of at least **95%** of the shares in a real estate-holding partnership within **five years** to (any number of) new shareholders (Sec. 1 para. 2a of the German Real Estate Transfer Tax Act (*Grunderwerbsteuergesetz* – 'GrEStG').
- **Example 2**: Direct or indirect acquisition of shares resulting in a direct or indirect **holding** (**concentration**) of at least **95%** of the shares in a real estate-holding company by **a single shareholder** for the first time (Sec. 1 para. 3 GrEStG).
- **Example 3**: Direct or indirect acquisition of shares resulting in a direct or indirect **economic holding** (**concentration**) of at least **95%** of the shares in a real estate-holding partnership or a real estate-holding corporation by **a single owner** for the first time (Sec. 1 para. 3a GrEStG).

Further, the following exemptions apply:

- **Example 4**: After the lapse of the five-year period (c.f. Example 1), an acquisition of the remaining shares resulting in a concentration of more than 95% of the shares will trigger RETT (cf. Examples 2 and 3). However, an exemption applies in proportion of the shareholding maintained for the last five years prior to the concentration of at least 95% of the shares, if and to the extent, the then concentrated shareholding is further maintained for at least five years.
- **Example 5**: After the lapse of the five-year period (c.f. Example 1) the direct acquisition of the real estate by the shareholder from the partnership will be RETT exempt in proportion of the shareholding this shareholder maintained for the last five years prior to the acquisition of the real estate.
- **Example 6**: The contribution of real estate into a partnership is RETT exempt in the proportion of the shareholding of the contributing partner in the partnership. However, RETT is triggered retroactively, if the respective partners dispose of their shares within five years after the contribution.

Intended amendments

The bill provides for, *inter alia*, the following amendments:

- **Changes to the ownership structure of a real estate-holding corporation**: The (mere) change in ownership of a partnership as covered by Example 1 shall also apply to

corporations. As a result – considering the other amendments as described in the following – a transfer of at least 90% of the shares in a real estate-holding corporation within ten years to (any number of) new shareholders will trigger RETT.

- **Reduction of the threshold from 95% to 90%**: The current threshold of 95% will be reduced to 90%. Hence RETT-neutral share deals (regarding corporations and partnerships) will only be possible if less than 90% of the shares are transferred within 10 years.
- **Extension of the lock-up periods from five to ten years**: It is intended to consistently extend the lock-up periods from five years to ten years. On the one hand, this affects the aforementioned Examples 1, 4, 5 and 6. Further, the prerequisites for the partial exemption in Example 4 will be even stricter. The new rules will require a holding period of at least 15 prior to the acquisition of the remaining shares.

Temporal application and transitional provisions

In general, the amendments shall be applicable on acquisitions made after 31 December 2019.

However, the bill contains several transitional provisions modifying the general temporal application:

- **Status as "old shareholder" will be maintained**: Transfers of shares prior to 1 January 2020 will, in principle, be considered for application of the new 90%-threshold and ten-year period for the transfer of shares in partnerships (c.f. Example 1). Hence, also transfers prior to 1 January 2020, might, together with transfers after 1 January 2020, exceed the then applicable 90% threshold, if they take place within a period of ten years and therefore trigger RETT. However, shareholders of a real estate-holding partnership who will already qualify as old shareholders under the current law (i.e. have been holding their shares for at least five years) on 31 December, shall not be considered as new shareholders under the new rules. Hence the transfer of shares to these old shareholders will not contribute to the new 90% threshold. Accordingly, the extension of the lock-up periods (cf. Examples 4 to 6) shall not be applicable to transfers that take place after 1 January 2020, if the five-year lock-up period under the current rules had already lapsed prior to that date.
- **No RETT-neutral increase of existing shareholdings of at least 90% but below 95%:** If a shareholder currently holds at least 90% but below 95%, the initial acquisitions did not trigger RETT (c.f. Example 2 and 3). An acquisition of additional shares would not trigger RETT under the new rules, since it

would not result in a concentration of at least 90% of the shares for the first time. Such a tax-neutral increase shall be avoided. Therefore, the current rules (c.f. Examples 2 and 3) shall remain applicable to any acquisition which neither triggers RETT under the new law nor follows another transaction that already triggered RETT under the new rules.

– **Grandfathering for transfers of shares to new shareholders:** The application of the tightened thresholds for the direct or indirect transfer of shares in a real estate-holding partnership within 10 years and the newly introduced corresponding rule for real estate holding corporations will be subject to a transitional period. Accordingly, transfers shall be disregarded if (1) the underling contract was signed within the last year before the government bill will be forwarded to the Federal Council (which shall be done in due course) **and** (2) if the transaction itself will be completed within the following year.

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