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German Tax and Legal News

German tax authorities issue guidance on transition provisions for amended RETT rules

Guidance is limited to transition rules; further guidance on the broader interpretation of amended RETT rules is awaited

The German tax authorities on 19 July 2021 issued guidance regarding the transition provisions for the application of the amended real estate transfer tax (RETT) rules that apply as from 1 July 2021. The guidance is dated 29 June 2021 and provides helpful insight into the tax authorities' interpretation of how the original RETT rules and the amended RETT rules operate together.

Background
On 7 May 2021, the German legislature passed a comprehensive reform of the German RETT rules, in particular in the context of share deals involving corporations owning German real estate. The legislation subsequently was published in the federal gazette on 17 May 2021. Key features of the amended RETT legislation include the following (see GTLN dated 05/10/21):

- Introduction of a new RETT provision covering share deals (section 1, paragraph 2b of the Real Estate Transfer Tax Act (RETTA)): German RETT is triggered where 90% or more of the shares in a German real estate-owning corporation are directly or indirectly transferred to either one new owner or multiple new owners within a 10-year monitoring period;
- Reduction of the RETT triggering threshold and extension of holding periods with respect to the existing RETT provision covering transfers of partnership interests (section 1, paragraph 2a of the RETTA): German RETT is triggered where there is a 90% (prior to the amendment, 95%) or greater change, directly or indirectly, of the partners in a German real estate-owning partnership within a 10-year monitoring period (prior to the amendment, five-year);
- Reduction of the RETT triggering threshold under the existing RETT rules covering transfers of interest either in German real estate-owning corporations or partnerships (section 1, paragraphs 3 and 3a of the RETTA): German RETT is triggered where 90% or more (prior to the amendment 95% or more) of the interest in a German real estate-owning entity is directly or indirectly transferred to a new shareholder/partner, or where 90% or more (prior to the amendment, 95% or more) of the interest in a German real estate holding entity is directly or indirectly combined for the first time in the hands of a shareholder/partner;
- Extension of pre- and post-retention periods in respect of certain exemptions for transactions involving transfers between partners and partnerships from five and 10 years, respectively, to 15 years (sections 5, 6, and 7of the RETTA); and
- Introduction of an exemption rule for entities whose shares are traded on stock markets in the European Union or European Economic Area and qualifying stock markets in Australia, Hong Kong, and the US (section 1, paragraph 2c of the RETTA).

Guidance provided by the German tax authorities
The guidance provided by the German tax authorities is limited to the transition rules that govern the coexistence of the previous rules and the amended RETT rules. Other key aspects of the amended RETT rules are not covered and it is expected that these will be the subject of additional guidance to be published either later in 2021 or during 2022.

The key aspects of the application of the transition rules can be summarized as follows:

<u>Transition rules for German real estate-owning partnerships</u>

Based on the amended RETT rules for partnerships, RETT is triggered where at least 90% of the interest in a partnership is transferred to "new" partners within a 10-year period; transfers between "old" (i.e., existing) partners are not taken into account. The amended RETT rules extend the holding period to qualify as an old partner from five years to 10 years.

The tax authorities' guidance includes welcome clarification of the definition of an old partner, with confirmation that partners that have held an interest in a real estate-owning partnership for at least five years as at 1 July 2021 qualify as old partners for the purposes of the amended RETT rules and are not required to meet the extended 10-year holding period.

For partners holding a partnership interest between 90% (the new RETT triggering threshold) and 95% (the previous RETT triggering threshold), the 95% threshold continues to apply for a transition period through 30 June 2026, i.e., any increase in the partnership interest to at least 95% will trigger RETT during the transition period.

Transition rules for German real estate-owning corporations

One of the most significant features of the amended RETT rules is the extension to corporate entities of the rules previously applicable only to partnerships, i.e., RETT now is triggered where 90% or more of the shares in a corporation are transferred to new shareholders within a 10-year period.

Similar to the application of the rules to real estate-owning partnerships, the guidance provided by the German tax authorities confirms that the shareholders of a German real estate-owning corporation as at 1 July 2021 qualify as old shareholders and that share transfers between these shareholders are not taken into account when applying the amended rules. The guidance also clarifies that any share transfers that occurred before 1 July 2021 do not count towards the 90% threshold.

Transition provisions for the exemption rule for publicly traded entities

The newly introduced exemption rule for certain transactions involving publicly traded entities applies to all open cases, i.e., including transactions involving real estate-owning partnerships that took place before 1 July 2021 provided these cases may still be amended in accordance with the status of the respective assessment notice.

Transition rules for share combinations

Under the amended RETT rules, the initial consolidation of 90% or more of the shares in a real estate-owning entity in the hands of a single shareholder or partner qualifies as an RETT triggering event. The provision was included in the previous RETT rules but the former 95% threshold has been reduced to 90%. The 95% threshold, however, continues to apply where a shareholder/partner already holds between 90% and 95% of the shares/interest in a German real estate-owning entity; only where the shareholding/interest increases to 95% or more will RETT be triggered. This transition provision applies to future transfers indefinitely and presents a potentially significant risk in future transactions that must be considered in particular when conducting due diligence.

Transition rules for certain exemptions from RETT involving German real estate-owning partnerships

Exemptions from RETT are available for certain transfers of real estate or shares in real estate-owning entities that take place between a partnership and its partners. The application of the exemptions typically is subject to certain minimum holding periods both pre- and post-transaction. Under the previous RETT rules, the minimum holding period generally was five years; under the new rules, the pre- and post-transaction minimum holding periods are extended to 10 years and 15 years, respectively. The guidance confirms that where the five-year minimum holding period had been met by 1 July 2021, the extended minimum holding periods do not apply; they are relevant only where the five-year minimum holding period was still running as at 1 July 2021.

Comment

The tax authorities' guidance provides welcome clarification regarding the application of the amended RETT rules. However, owing to the complexity of the rules, many unanswered questions remain and there still exists considerable uncertainty about how certain aspects of the amended RETT rules will apply. For example, the decree is largely silent on how the transition provisions operate where there are indirect shareholder changes in German real estate-owning entities.

The tax authorities are expected to issue additional guidance on the interpretation of the amended RETT rules but in the meantime, taxpayers owning German real estate should assess carefully the potential impact of the amended RETT rules and ensure that transactions within the scope of the amended rules are monitored and analyzed rigorously. Transactions involving German real estate-owning entities require significant additional diligence.

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