

## **Impact of upcoming amendments to the German Real Estate Transfer Tax Act on real estate share deals**

Upcoming amendments to the German Real Estate Transfer Tax Act (RETTA) will have significant implications on real estate transactions structured as share deals. Still available options for implementing restructurings without triggering RETT should be made use of.

On 31 July 2019, the German Federal Government approved a draft law amending the Real Estate Transfer Tax Act (RETTA) in order to increase Real Estate Transfer Tax (RETT) revenues by limiting the options of share deals.

Following a statement by the Bundesrat - within the framework of which various proposals for amendments were made - and a counter-statement by the Federal Government, the draft bill of the Federal Government in the version of BT-Drs. 19/13437 was the subject of the first reading and deliberation in the Bundestag on 27 September 2019 and was subsequently referred to the Finance Committee for lead consultation.

Irrespective of the further course and outcome of the legislative project, the forthcoming legislative amendments will have far-reaching consequences. Following previous articles in the Deloitte Tax-News, the following article intends to shed light on the practical effects of the pending amendments to the law and to highlight the options still currently available for structuring real estate transactions such that no RETT is triggered.

### **I. Background and current legal situation**

According to the concept of the German RETTA, RETT is triggered if a transfer of the ownership of a property located in Germany takes place.

However, the RETTA does not only take into account transactions directly related to a property. Further, the acquisition of at least 95% of the shares in a real estate holding company is treated as a transfer of the ownership in the real estate and is subject to RETT.

In practice, the thresholds and holding periods explicitly provided in the RETTA have been used so far to possibly allow RETT neutral transactions.

#### **1. Acquisition of real estate by transfer of shares/participations in a real estate holding partnership under current law**

Based on current law, in case that a property is acquired by way of a share deal through a transfer of shares/participations in a partnership (e.g., KG or GmbH & Co. KG), RETT is triggered if at least 95% of the shares in the partnership are transferred directly or indirectly to new shareholders within a five-year period (cf. Section 1 para. 2a RETTA).

Thus, to date, the transfer of shares in a real estate holding partnership frequently has been structured as follows:

Initially, the purchaser acquires 94.9% of the shares in the partnership, while the seller retains the remaining 5.1% of the shares for at least 5 years. After a period of at least 5 years, the purchaser acquires the remaining 5.1% of the shares. The additional acquisition of 5.1% of the shares does lead to a unification of all shares in the hands of the purchaser, which triggers RETT (cf. Section 1 para. 3 no. 1 RETTA). However, RETT is only due in respect of the 5.1% of the shares in the partnership acquired later, as the acquirer has now held the (initially acquired) 94.9%-share in the partnership for more than 5 years and can therefore benefit from the tax exemption pursuant to Section 6 para. 2 and para. 4 RETTA.

#### **2. Acquisition of real estate by transfer of shares in a real estate holding corporation under current law**

In case of a transfer of shares in a corporation holding real estate (e.g., a GmbH), under current law, a direct or indirect transfer of at least 95% of the shares in the corporation triggers RETT (cf. Section 1 para. 3 no. 1 RETTA).

Here, transfers often were effected as follows:

The purchaser acquires 94.9% of the shares in the real estate owning corporation. The remaining 5.1% of the shares are either acquired by a co-acquirer, who, however, may not be associated with the acquirer in accordance with group law or in an economic way, or remain with the seller.

Unlike in the case of the acquisition of shares in a partnership holding real estate, there is no possibility here to transfer the remaining 5.1% shares in the corporation in a RETT neutral way. If the initial acquirer or a company affiliated with him acquires the remaining 5.1% of the shares at a later date, this results in RETT on 100% of the real estate held by the corporation.

## **II. Upcoming changes to the RETTA**

### **1. Basic principles**

The Federal Government believes that the practice of avoiding the incurrence of RETT when acquiring real estate through so-called share deals is an "abusive practice of tax avoidance" and wishes to prevent it. Practice has shown, states the Federal Government in its draft of a law for the change of the RETTA, that especially in the range of high-end real estate transactions, by taking structuring measures, market participants succeed again and again in avoiding RETT.

### **2. Status of the legislative procedure**

On 8 May 2019, the Federal Ministry of Finance published the draft bill for a law on further tax incentives for electromobility and amendments to further tax regulations. This draft law contained regulations aimed at curbing abusive tax arrangements in connection with RETT. This concerns in particular the so-called share deals. The basis for the proposed regulations was a catalogue of measures adopted by the Conference of Finance Ministers already on 21 June 2018 (see Deloitte Tax-News).

The RETT regulations from the draft bill JStG2019 were then transferred into a separate bill; on 31 July 2019, the Federal Government adopted the government proposal for a law amending the RETTA.

In its statement on the bill, the National Standards Control Council raised objections to the presentation of the legal consequences in the bill, which were, however, rejected by the Federal Government. In its meeting on September 20, 2019 the Bundesrat adopted a statement on the draft government. In its statement, the Bundesrat welcomes the proposed regulations against share deals. However, against the background of what they consider to be the threat of excessive taxation, the Bundesrat is calling for an exception for listed corporations by inserting a so-called stock market clause. The Bundesrat also sees a need for change for real estate transactions within groups and therefore asks that in the further legislative process it be examined how § 6a RETTA can be adapted so that restructuring measures within groups can (continue to) be tax-neutral.

On 23 September 2019, the Federal Government submitted the bill it had passed to the President of the German Bundestag and requested that the requisite resolution be passed by the German Bundestag (Bundestag printed paper 19/13437). In this context, it was announced that a counter-statement by the Federal Government would be submitted to the Bundesrat subsequently. The Federal Government reacted to the Bundesrat's proposals with a counter-statement dated 25 September 2019. The Federal Government agrees with the Bundesrat's concern that listed stock corporations should not be subject to RETT in the event of changes in their shareholder structure. However, the concrete form of the proposal would require in-depth examination. The Bundesrat's request to waive RETT on real estate transactions between group subsidiaries is also to be examined.

On 27 September 2019, the Bundestag debated the bill of the Federal Government in its first reading. The bill, together with motions from the right wing AfD parliamentary group and the left wing Die Linke parliamentary group, was subsequently referred to the Finance Committee for lead consultation.

The present contribution is based on the government draft with the content following from BT-Drs. 19/13437. However, it also attempts to take into account the statement of the Bundesrat as well as the counter-statement of the federal government and the possible adjustments to the draft law that go along with it.

## **III. Consequences for the real estate transaction practice**

### **1. Basic principles**

Regardless of the final form, it should be clear that the forthcoming changes to the RETTA will have far-reaching consequences for the possibilities described under I. for making real

estate transactions neutral in terms of RETT.

## 2. Reduction of threshold values and extension of holding periods

The upcoming amendments to the RETTA will have an huge impact on the above-mentioned transaction options. The first change envisaged by the legislator in this respect is the decrease of the decisive threshold from 95% to 90%. *(Potential changes during the legislative procedure: The recommendations of the Bundesrat and its committees include the suggestion to introduce a quota system and to review, respectively, whether a reduction of the threshold to 75% could be feasible. The final statement of the Bundesrat, however, does not include that suggestion anymore. .)*

Further, the holding periods shall be extended from 5 years to 10 years and to 15 years, respectively.

## 3. Changes in the shareholdings of a corporation

In addition, a provision corresponding to the rule for partnerships is to be introduced for corporations. This means that in future a change in the shareholder structure of a corporation will essentially be treated similar to a change in the shareholder structure of a partnership, so that share transfers of at least 90% within ten years - irrespective of the number of acquirers - will become subject to RETT. In contrast to partnerships, however, no exemption will be granted for corporations in respect of the shares initially acquired in the event of a later acquisition of further shares. If RETT is triggered, it will be owed by the corporation (for further details, please refer to the previous articles in the Deloitte Tax-News).

## 4. Transfer of shares/participations in partnerships

For the structure explained under I 1. above relating to the transfer of shares in a partnership owning real estate, the change in the law means that in the first step the purchaser can only acquire a maximum of 89.9% (instead of 94.9%) of the shares and the seller must retain the remaining 10.1% (instead of 5.1%) of the shares for at least 10 (instead of 5) years.

The further acquisition of the shares initially remaining with the seller of 10.1% is only possible for the acquirer 15 (instead of 5) years after the acquisition of the initial holding if the acquisition is intended to be RETT-privileged. If the purchaser (89.9% shareholder) acquires further shares in the partnership before the expiry of 15 years and exceeding the threshold of 90%, there is no RETT exemption with regard to the 89.9% of the shares acquired within the scope of the initial acquisition, so that RETT is triggered on 100% of the real estate held by the partnership (and not only with respect to the later acquisition of 10.1%).

If the acquirer wishes to release the participation of the seller in the partnership as early as possible, this can only be achieved neutrally in terms of RETT by transferring the remaining shares of the seller to a co-acquirer not legally and/or economically linked to the acquirer 10 years after the initial acquisition. A unification of all shares in the hands of the initial acquirer, which is RETT neutral, is only possible after the expiry of additional 5 years, i.e., after a total of 15 years following the initial acquisition.

## 5. Transfer of shares in a corporation

In the future, in case of a transfer of shares in a real estate holding corporation (cf. I. 2. above) the acquirer can only acquire 89.9% (instead of 94.9%) of the shares and the seller must retain the remaining 10.1% (instead of 5.1%) of the shares for at least 10 years in order not to trigger RETT. The simultaneous transfer of further 10.1% of the shares in the corporation to a co-acquirer not affiliated with the acquirer will no longer be possible in the future. It will only be considerable after the expiry of 10 years since the first transfer of the 89.9% shares to the purchaser. If however at least 90% of the shares are held by the initial acquirer (even after the expiry of 10 years), RETT will be triggered on 100% of the real estate held by the corporation without any tax exemption for the initial acquisition (under the new law max. 89.9%).

## 6. In particular: (Stock listed) Stock Corporations (including from other industries)

The draft law in the version of (BT-Drs. 19/13437) does not contain exceptions for listed corporations holding real estate. Nor does the draft law provide for any restrictions with regard to the status of the respective corporation as a real estate company in the strict sense or as an operating company in another sector which also holds real estate.

In the opinion of relevant market participants and interest groups, the new regulations

could therefore result in the large listed German companies being subject to RETT every 1.2 years on average with regard to their entire real estate holdings in Germany, because this is the average period in which 90% of the shares of a company change hands. In this respect, market participants argue in favor of following the Dutch model, in which only companies holding at least 50 percent of immovable property would be taxed, albeit at significantly lower thresholds.

However, the proposals and recommendations made by the Federal Council in its statement concern in particular the inclusion of an exemption for listed corporations.

Specifically, the Bundesrat proposes to insert a so-called stock exchange clause in § 1 (2a) sentence 7 RETTraft and § 1 (2b) sentence 7 RETTA-Draft, which limits the effect of the supplementary circumstances in a targeted and appropriate manner. In order to prevent an unjustified exploitation of this stock market clause, however, it should only apply if the shares admitted to trading represent the majority of the capital.

The prerequisite for the use of the stock exchange clause shall be that the shares in the corporation are admitted to trading on an organized market pursuant to Section 2 (11) WpHG or an equivalent third-party trading venue. Whether a third-party trading venue is regarded as equivalent shall depend on whether the relevant trading venue has been declared equivalent by the European Commission pursuant to Article 25 (4) (a) of Directive 2014/65/EU. Organised markets offer the best possible guarantee that they will not be abused.

In view of the Federal Government's counter-statement, according to which the Federal Government agrees with the goals pursued by the proposed amendment, but considers that the concrete form of the proposal is accompanied by an in-depth need for examination, it is to be hoped that a sensible solution will be worked out within the framework of the legislative procedure. Further developments remain to be seen.

#### 7. In particular: Restructuring within the Group

Further changes to the draft law proposed by the Federal Government in the version of BT-Drs. 19/13437 - and possibly beyond - could also result from the proposals put forward by the Bundesrat in its comments on the government draft to strengthen the possibilities of RETT-neutral implementation of restructuring measures within groups.

In this respect, the Bundesrat considers that the current provisions of § 6a RETTA currently only favor certain restructuring measures between affiliated companies, but that even the simplest conceivable situation, a sale of land between subsidiaries, is not covered by the provisions of § 6a RETTA and is therefore subject to RETT. Here, the Bundesrat asks for an examination as to whether transfers of land within groups could not generally take place in a tax-neutral manner and suggests that restrictions on sensible restructuring measures should be removed in a practice-oriented manner, without this giving rise to potential structuring possibilities.

In view of the rather sybillinic reaction of the Federal Government, which announces that it intends to comply with the request for examination and at the same time refers to the forthcoming decisions of the Federal Fiscal Court on Section 6a of the RETTA, market participants should not, however, place too much hope in this.

### **IV. Effective date and temporal scope of application of law changes**

#### 1. Entry into force

The government draft passed by the Federal Cabinet provides that the aforementioned amendments to the law are to come into force on 1 January 2020.

#### 2. Temporal scope of application

Furthermore, the government draft provides for transitional regulations the relevance of which for the structures explained above can essentially be summarised as set out herein below (for details on the transitional regulations, see Deloitte Tax-News).

#### 3. Acquisitions until 31 December 2019

In principle, transactions until 31 December 2019 will be treated according to the old law, so that such transactions can benefit from the more favorable share transfer thresholds and deadlines, provided that the corresponding share purchase agreements are concluded (signing) and completed (closing) by the end of the year. Furthermore, the old law is to remain applicable to share purchase agreements concluded within one year prior to the submission of the draft law by the Federal Government to the Upper House of the German parliament (effective date: 09 August 2019) and executed within one year after this effective

date.

#### 4. Acquisition of additional shares/participations

With regard to the acquisition of additional shares in a real estate owning partnership remaining with the seller, it must be taken into account that under the old law, after a period of 5 years from the first acquisition, an exemption from RETT is possible with respect to the initially acquired shares (cf. Section 6 para. 2 and para. 4 RETTA in its current version). The relevant transitional provision in the draft law provides that the aforementioned five-year period for an RETT exemption with regard to the initially acquired shares is to be replaced by the period of 15 years under the new law, unless the five-year period has already expired by 1 January 2020 (cf. Sections 6 para. 4 and Section 23 para. 24– of the RETTA draft law).

This means that when a share deal is still concluded and executed until the end of 2019 (or conclusion was before the effective date and execution occurs one year after the effective date, respectively), the favorable transfer thresholds and deadlines under the old law do apply. However, in case of a unification of all shares in a real estate holding partnership in the hands of the purchaser an exemption from RETT regarding the initial acquisition of shares can only be claimed 15 years after this initial acquisition. Shares in a real estate holding corporation can still be fully transferred to an acquirer and a co-acquirer without triggering RETT and needing to arrange with the seller for a period of 10 years.

#### 5. Further legislative procedure

In view of the ongoing debate about the essential regulatory content of the Bill, it remains to be seen whether the timetable from the Federal Government will be able to keep. Nevertheless, market participants should be prepared to ensure that essential parts of the proposed draft, supplemented if necessary by stock market clauses, will be drawn up in a timely manner and that their actions will be based on the entry into force of the planned regulations on 1 January 2020.

#### **V. Conclusion and recommendations for course of action**

The planned amendments to the RETT Act will entail considerable restrictions for share deals which have been usually performed in the past.

Companies and investors considering acquiring real estate located in Germany are advised to conclude and execute corresponding share purchase agreements before the end of this year.

In view of the fact that the new regulations - e.g., with regard to share unifications – will also apply to structures already existing at the time of their entry into force, market participants are additionally advised to reckon with the new regulations also with regard to existing structures and pending transactions.

This is especially relevant for real estate transactions in the form of forward deals, as in these types of transactions a considerable period of time lies between signing and closing.

Existing company structures (inter alia group structures) should also be examined in the light of the new regulations and possibly planned restructurings should be anticipated and realized in 2019.

Insofar as the relevant provisions are not mitigated in the further legislative process, it must be ensured that the company and ownership structures are sufficiently clear at all times. This applies in particular with regard to indirect shareholder changes, including those that take place abroad. Compliance tools, in particular tax compliance tools, must be adapted accordingly.

In order to avoid an unintentional incidence of RETT, statutes or articles of association must also be checked for any need for adjustment. Where necessary, approval requirements and regulations to avoid an automatic transfer of shares can be used to help ensure that threshold values are not inadvertently exceeded.

Corporations should particularly consider the inclusion of a clause in the articles of incorporation, according to which, if RETT is triggered by a transfer of shares, those shareholders who are responsible for the transfer of shares are obliged to reimburse the company for the RETT they have triggered.

Unless during the legislative procedure sensible solutions – along the lines of the proposals made by the Bundesrat – can be found, for companies listed on the stock exchange the new regulations would bring about a barely implementable and controllable need for action.

It remains to be seen whether the models developed in practice for avoiding or reducing the incidence of RETT can actually be regarded as "abusive" and whether the new regulations, which are not always entirely understandable and in some cases difficult to implement, will prove helpful for Germany as an investment location.

Beyond the heated political debate, it will remain questionable whether the percentage and amount of RETT allegedly "avoided" by the various arrangements, which even according to the most committed proponents of the amendments to the RETTA amounts to only about ten percent of the total revenue of RETT, justifies the introduction of the new regulations. The additional expense will certainly be passed on to tenants, consumers and insurance beneficiaries.

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