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German Tax and Legal News

RETT burden to increase

The Federal Constitutional Court has issued a decision that will have significant impact on RETT taxation.

Germany's Federal Constitutional Court has published a decision dated June 23, 2015 in which the court concluded that the provisions governing the assessment of the real estate transfer tax (RETT) based on a special tax value are unconstitutional and cannot apply as from January 1, 2009.

The RETT is triggered when there is a direct acquisition of German real estate and in the case of a share transfer or reorganization (e.g. merger, spin-off). Where German real property is purchased directly, the RETT is based on the purchase price. However, RETT triggered as a result of a transfer of shares in a German real estate-owning company is based on a "special tax value" established for RETT purposes.

The special tax value usually is based on the annual rent (excluding VAT and operating costs/utilities) paid for the property. The RETT base is 12.5 times the annual rent, reduced by certain amounts, depending on the age of buildings on the property. If the real estate-owning company does not rent out the property, the "common rent" must be considered when calculating the RETT base, but if the real estate-owning company does not rent out the property and a common rent cannot be determined, the RETT is based on a special value that consists of the tax book value of the buildings and 70% of the value of the land as determined by a public body. The RETT charge is calculated by applying the RETT rate on the tax base, with the rate depending on the state in which the property is located (rates range from 3.5% to 6.5%).

The Federal Constitutional Court now has concluded that the special tax value provisions violate the equality principle in the constitution and no longer can apply. According to the court, the special tax value must be close to the fair market value of the real property. Under the current rules, the special tax value is, on average, assessed in a range from below 50% to more than 100% of the fair market value of the property. As a result, the German legislature will have to enact a new law that applies retroactively as from January 1, 2009 and it has been asked to amend the law by June 30, 2016 at the latest.

This change in the rules will increase the RETT burden for RETT-triggering transactions such as share transfers and reorganizations, particularly since most of the federal states (except for Bavaria and Saxony) have increased their RETT rates from 3.5% up to 6.5%.

Since the new law must be enacted with retroactive effect from 2009, the Federal Constitutional Court decision will impact both past and future transactions. The legal position of past transactions is not fully clear and will depend on the tax assessment status of the relevant transaction. The German tax authorities are expected to issue clarifying guidance.

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