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EY Real Estate Tax Alert - Real Estate Transfer Tax Reform

Agreement in the German Bundestag on Share Deals

The German Bundestag adopted the long-discussed reform of the Real Estate Transfer Tax Act on 21 April 2021. The Bundesrat is expected to finally approve the reform by the end of May. The new rules shall come into effect on 1 July 2021.

In October 2019, the Finance Committee of the German Bundestag held a public hearing on share deals. Substantial criticism of the draft law was raised during this hearing, which was subsequently withdrawn by the coalition factions for further consultations. Now that the German Federal Parliament (Bundestag) adopted the bill on 21 April 2021 after its Finance Committee had agreed on a slightly amended bill a week earlier (BT-DS 19/28528). The law is expected to be finally passed by the Bundesrat (Upper House) until end of May. The content of the bill as agreed upon in the Bundestag is very similar to the government draft of 19 July 2019 though:

- Introduction of the new provision Sec. 1 para. 2b RETT-Act, which works similar to Sec. 1 para. 2a RETT-Act for partnerships and taxes an (indirect) transfer of 90% of the shares to new shareholders within a 10-year period. As regards this new provision transfers that take place after the date of entry into force, i.e. presumably transfers as of 1 July 2021, are counted for.

- Reduction of the participation threshold also in the other relevant RETT provisions of Sec. 1 para. 2a RETT-Act, Sec. 1 para. 3 RETT-Act and Sec. 1 para. 3a RETT-Act from 95% to 90%.

- The relevant period of consideration under Sec. 1 para. 2a RETT-Act is extended from 5 to 10 years. This also applies accordingly within the scope of Sec. 1 para. 2b RETT-Act.

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- In principle, there is no grandfathering rule for purposes of Sec. 1 para. 2a RETT-Act. In this respect, for the determination of the 90% threshold, share transfers in a 10-year period prior to the amendment of the law are also to be 'counted' for.

- During a transitional period of 5 years, i.e. until 30 June 2026, the previous regulation in Sec. 1 para. 2a RETT-Act (95%) will continue to apply in parallel. In addition, the previous limit of 95% in Sec. 1 para. 3 RETT-Act and Sec. 1 para. 3a RETT-Act will continue to apply indefinitely in order to prevent a tax-neutral increase after 'growing into' an existing unification of shares under the new law.

- Extension of the holding periods from 5 to 10 years (Sec. 5 and 6 RETT-Act) or even 15 years in the case of subsequent share unifications, which were previously already partially tax-exempt after 5 years.

- Mandatory valuation of real estate based on the German Valuation Act for real estate sales in the retroactive period of mergers and other corporate reorganizations to prevent group internal real estate sales below the fair market value.

A notable change compared to the legislative draft is the introduction of a stock exchange clause. For the new regulation, certain transfers of shares in corporations are to remain out of consideration. Accordingly, Sec. 1 para. 2a sentence 1 RETT-Act and Sec. 1 para. 2b sentence 1 RETT-Act shall not apply to corporations where the shares are admitted to trading on an organized market operated in Germany, in another Member State of the European Union or in another Contracting State to the Agreement on the European Economic Area pursuant to Sec. 2 para. 11 of the German Securities Trading Act (Wertpapierhandelsgesetz) or a third-country trading venue that has been declared equivalent by the European Commission pursuant to Article 25(4)(a) of Directive 2014/65/EU. However, it remains to be seen whether the amendment to Sec. 1 para. 2c RETT-Act will apply to all open cases. Due to the restriction to EU and certain other markets a number of listed companies with significant real estate holdings in Germany will not be able to make use of this exemption (e.g. entities listed in Switzerland).

The introduction of a proportional system for the taxation of share transfers in landowning companies as well as a reduction of the relevant share threshold from 95% to 75% for agricultural enterprises, which was discussed in the committees of the Bundesrat, has not been included.

The following regulations have also not been included in the current draft:

- Correction of the tax authorities' view on Sec. 1 para. 2a sentence 4 RETT-Act (so-called "eternity clause"). Sec. 1 para. 2a sentence 4 RETT-Act will not be amended to the effect that only changes of shareholders within a period of 10 years, and not for an unlimited period, are decisive for determining the new shareholder status of a corporation participating in a partnership. In doing so, the legislator misses the opportunity to put a stop to the systematically incomprehensible view currently taken by the tax authorities.

- Adjustment of the group clause (Sec. 6a RETT-Act): Neither an adjustment of the currently applicable 95% limit nor an adjustment of the five-year holding periods is planned. However, the extension of the clause discussed in the Bundesrat was not implemented either. According to the idea of the committees of the Bundesrat, it should have been examined whether property transfers taking place in an association could not in principle be made tax-neutral.

- The previously contained transitional provision for Sec. 1 para, 2a RETT-Act and especially for Sec 1 para. 2b RETT-Act was deleted without replacement. The regulation provided that share transfers whose share purchase agreement was signed within one year before the bill was forwarded to the Bundesrat in summer 2019 and which are legally fulfilled within one year thereafter are exempt from the new regulation. This means that certain forward transactions where closing will occur after 1 July 2021 may trigger RETT.

- Introduction of a land transfer tax allowance: The recommendation of the committees of the Bundesrat regarding the granting of a personal land transfer tax allowance for the first acquisition of an owner-occupied property was not implemented.

- The originally envisaged abolition of the limitation for late payment surcharges was removed from this legislative procedure. It was already implemented as part of the Annual Tax Act 2020.

These comments are based on the bill as adopted by the German Bundestag on 21 April 2021 (BT-DS 19/28528). Based on past experience, the final adoption in Bundesrat (Upper House) remains to be seen.

Recommendation for action: Against the background of the possible effects of the RETT reform, planned direct and indirect share transfers should be examined and the development of the reform monitored. Existing structures should be examined immediately for any need for adjustment. In a number of cases, an adjustment of existing structures should only be possible until the first application of the new law, i.e. currently probably until 30 June 2021.

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