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EY Real Estate Tax Alert - News on German RETT for so-called share deals

The decrees on the application of the stock exchange clause for German RETT purposes and the statement of the Finance Committee of the Bundesrat on the Annual Tax Act 2022 contain new important findings for so-called share deals.

Under certain conditions, the so-called stock exchange clause favours changes in shareholdings in real estate-owning corporations. The supreme tax authorities of the federal states have now commented on questions of application relevant to practice in an identical decree dated 4 October 2022 (published on 25 October 2022). In addition, the Finance Committee of the Bundesrat recommended in its opinion of 17 October 2022, inter alia, that the revocation of the notice pursuant to Sec. 1 (3) and (3a) German RETT Act in the event that the signing and closing do not occur at the same day should be subject to an application, whereby this should be linked to narrow conditions.

Decree on the stock exchange clause of Sec. 1 (2c) German RETT Act

In addition to the extension of the holding periods to 10 years, the lowering of the participation thresholds to 90 percent and the introduction of a new regulation for changes of ownership of shares in real estate corporations (Sec. 1 (2b) German RETT Act), the legislator has also created a so-called stock exchange clause (Sec. 1 (2c) German RETT Act) with the RETT reform. According to this clause, certain transfers of shares in corporations are to remain out of consideration.

Pursuant to Sec. 1 (2c) German RETT Act, share transfers are disregarded for the purposes of Sec. 1 (2a) and (2b) German RETT Act,

- ▶ which are admitted to trading on an organised market operated in Germany, in another Member State of the EU or in another contracting state of the EEA in accordance with Sec. 2 (11) German Securities Trading Act or a third-country trading venue recognised as equivalent,
- ▶ insofar as the transfer of shares takes place on the basis of a transaction on this market or a third trading venue or a multilateral trading facility within the meaning of Article 2 (1) No. 14 of Regulation (EU) No. 600/2014.

According to the new decree, Sec. 1 (2c) German RETT Act is to be applied in all open cases upon the entry into force of the RETT Amendment Act 2021 on 1 July 2021 (GLE 29.6.2021, BStBl. I 21, 1006, para. 1), i.e. taxpayers may also invoke the stock exchange clause for shareholder changes pursuant to Sec. 1 (2a) German RETT Act prior to 1 July 2021. There is no transitional provision for the stock exchange clause within the meaning of Sec. 1 (2c) German RETT Act.

The supreme tax authorities of the federal states have now commented in their identical decrees on several questions of application with regard to Sec. 1 (2c) German RETT Act. The main statements are presented below:

- ▶ The stock exchange clause applies to both the direct and indirect transfer of shares in a corporation holding real property (Sec. 1 (2b) sentence 1 German RETT Act). Thus, the transfer of shares in a corporation which directly or indirectly holds an interest in a real estate-owning partnership or corporation (Sec. 1 (2a) sentences 3 to 5 or Sec. 1 (2b) sentences 3 to 5 German RETT Act) is in principle also privileged under Sec. 1 (2c) German RETT Act.
- ▶ Corporations covered by Sec. 1 (2c) German RETT Act are the AG, the KGaA and comparable foreign corporations whose shares can be admitted to securities trading places, as these shares are usually stocks (e.g. Sec. 8 et seq. German Stock Corporation Act). In contrast, securities which merely refer to the stocks in a corporation without conveying ownership of these stocks are not shares within the meaning of Sec. 1 (2c) German RETT Act (e.g. American Depositary Receipts (ADR)).
- ▶ In Germany, the regulated market on a stock exchange constitutes a privileged organised market pursuant to Sec. 2 (11) German Securities Trading Act. Multilateral trading facilities (MTF) are not organised markets in this sense. In Germany, free trading constitutes an MTF (Sec. 48 German Stock Exchange Act).
- ▶ According to the interpretation of the tax authorities, the third-party trading venues recognised by the EU Commission within the meaning of Sec. 1 (2c) German RETT Act are currently only regulated markets based in the USA, Hong Kong and Australia. This explicitly does not apply to stock exchanges in Switzerland, Great Britain and Northern Ireland. However, the decree points out that the group of privileged third-party trading venues can change and therefore the respective status for the relevant taxation date must always be checked.
- ▶ In addition, the initial issue of shares in a corporation in the case of an IPO, the issue of new shares as a result of a capital increase and the securities lending or the securities loan or the securities transaction are not transactions on a market and are therefore not privileged under Sec. 1 (2c) German RETT Act.

- ▶ Since share transfers within the meaning of Sec. 1 (2c) German RETT Act are not to be taken into account when determining the relevant 90% threshold, there is no obligation to notify the authorities due to the fact that Sec. 1 (2a) and (2b) German RETT Act do not apply, provided that the relevant threshold of 90% is not reached.
- ▶ The identical state decree is applicable to all open cases and, in particular, does not contain any provisions for the protection of legitimate expectations with regard to restrictive interpretations by the tax authorities.

Our recommendation: Considering the strict requirements of the financial administration for the application of the stock exchange clause of Sec. 1 (2c) German RETT Act, the documentation of share transfers on the stock exchange remains a major challenge. Suitable (digitalised) processes must be set up for this purpose.

Double taxation at signing and closing?

In its opinion, the Finance Committee of the Bundesrat addresses, among other things, the controversial relationship between the application of Sec. 1 (2a) and (2b) German RETT Act on the one hand and Sec. 1 (3) and (3a) German RETT Act on the other, which may result in double taxation of the same legal transaction in the event that signing and closing do not occur at the same day. The reason for this is that Sec. 1 (3) and (3a) German RETT Act are already fulfilled with the signing, whereas Sec. 1 (2a) and (2b) German RETT Act are only realised in the course of the closing. Thus, the statutory priority of Sec. 1 (2a) and (2b) German RETT Act only applies in these cases after the closing.

In its new decrees on Sec. 1 (2a) and (2b) German RETT Act of 10 May 2022, the tax authorities did not expressly comment on the correction provisions with regard to the assessment under Sec. 1 (3) no. 1 or no. 3 or (3a) German RETT Act. It remained unclear, for example, whether the assessment should be made subject to review and whether it should be revoked again after the assessment has been made pursuant to Sec. 1 (2a) or (2b) German RETT Act, insofar as there is identity of the real property.

On the recommendation of the Finance Committee of the Bundesrat, the procedure is now to be legally standardised in the new Sec. 16 (4a) German RETT Act and the cancellation of the assessment pursuant to Sec. 1 (3) no. 1 or no. 3 or (3a) German RETT Act is to be made subject to application. However, the entitlement to file an application is to be linked to the following narrow conditions:

- ▶ „The provision of subsection 4a shall not apply if one of the acquisition transactions referred to in Sec. 1 (3) no. 1 or (3) or in Sec. 1 (3a) or in Sec. 1 (2a) or (2b) was not notified in due time and in its entirety (Sec. 18 to 20).“

The introduction of an expiry suspension is intended to prevent the expiry of the deadline for the assessment pursuant to Sec. 1 (2a) and (2b) German RETT Act (Sec. 16 (4a) sentence 2 German RETT Act).

The recommendation of the Finance Committee of the Bundesrat thus represents a significant tightening of the German RETT Act for so-called share deals. The already tight notification period of Sec. 19 (3) German RETT Act (2 weeks for domestic taxpayers and 1 month for foreign taxpayers) is usually a challenge in practice. Against this background, the proposed rule would result in a significant risk of double taxation of the same legal transaction.

We expressly point out that changes may still occur in the course of the legislative process. The present comments are based on the opinion of the Finance Committee of the Bundesrat of 17 October 2021 (BR-DS 457/1/22). Based on past experience, the final adoption in the Bundestag and Bundesrat remains to be seen.

Our recommendation: Against the background of the possible effects of the legal changes, planned transactions should be closely examined and the development of the legal situation monitored. In order to comply with the notification requirements in due time, these should be prepared at an early stage.

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