Real Estate Transfer Tax Amendment Act

("Grunderwerbsteuer-Novellierungsgesetz – GrEStNG")

Tax Zoom

24 July 2023

In the recent past, companies with real estate property holding affiliates have been faced with enormous practical challenges due to constantly changing framework conditions on the application of the German Real Estate Transfer Tax ("RETT") rules. Legal uncertainty is growing, complexity is increasing, and questions around the application of the RETT rules are rising. A reform of the real estate transfer tax is now intended to remedy this. However, the chances of the implementation remain uncertain for the time being.

Need of a reform

Seven supplementary provisions ("Ergänzungstatbestände")
With the reform of the German Real Estate Transfer Tax Act ("German RETT Act") (BGBl. I 2021 dated 17.05.2021, p. 986) inter alia the holding period as well as the thresholds for the so-called share deal taxation have been extended to 10 years, respectively reduced to 90 percent. Furthermore, a new provision for shareholder changes at the level of real estate holding corporations as well as a stock exchange clause (sec. 1 para. 2b, 2c German RETT Act) have been introduced. In addition to this, legally a continuation of sec. 1 para. 2a German RETT Act in the version applicable until 30.06.2021 (RETT Act-Old Version) until 30.06.2026, as well as a continuation of sec. 1 para. 3 and 3a German RETT Act-Old Version has been foreseen. Thereby, the continued application of sec. 1 para. 3 and 3a German RETT Act-Old Version shall even apply without a temporary limitation. In total there are currently seven provisions on the taxation of share deals that are applicable in parallel. This side by side of the new and old provisions, the implementation of a new supplementary provision as well as the introduction of the stock exchange clause were flanked by several questions around the application of the RETT rules. Particularly questions about the order and parallel application of these provisions as well as the procedurally treatment of the taxation at Signing and Closing falling apart were of enormous relevance in the tax practice and are still relevant. The German tax authorities have commented on this current legal situation with their fiscal decrees dated 10.05.2022 (BStBl. 2022 I p. 801). >>

Double taxation at Signing and Closing

The contractual obligation ("schuldrechtliches Verpflichtungsgeschäft") (Signing) and the legal transaction ("dingliches Rechtsgeschäft"), i.e. the transfer of the shares in rem (Closing) are in the view of the German tax authorities two separate RETT relevant events outlined in their above mentioned fiscal decrees. This is particularly of relevance in cases of a share unification according to sec. 1 para. 3 No. 1 or No. 3 or para. 3a German RETT Act and share transfers according to sec. 1 para. 2a respectively para. 2b German RETT Act, where the moment of the taxation of both provisions are falling apart and thus, not taking place at the same time. While sec. 1 para. 3 No. 1 or No. 3 or para. 3a German RETT Act shall be already triggered at Signing and, hence, at the time upon justification of the contractual claim to the transfer of the shares, sec. 1 para. 2a respectively para. 2b German RETT Act shall only be triggered upon Closing and, hence, upon the actual transfer of the shares. Thus, in the view of the German tax authorities, RETT has to be assessed according to sec. 1 para. 3 No. 1 or No. 3 or para. 3a German RETT Act at the time of Signing and at the time of Closing according to sec. 1 para. 2a respectively para. 2b German RETT Act. The RETT assessment pursuant to sec. 1 para. 3 No. 1 or No. 3 or para. 3a German RETT Act shall be annulled or amended, as soon the tax assessment according to sec. 1 para. 2a respectively para. 2b German RETT Act has been issued and to the extend an identity of the underlying real estate property is given. For the annulment and amendment of the tax assessment a new rule for the correction of tax assessments has been implemented with the Annual Tax Act 2022 in form of sec. 16 para. 4a and para. 5 sentence 2 German RETT Act (BGBl. I 2022 dated 20.12.2022, p. 2294). According to this new rule the tax assessment will only be annulled or amended as far as the respective RETT relevant event has been disclosed to the tax authorities in a timely and in relation to all facts completely manner. That means that Signing as well as Closing have to be disclosed in a timely manner, i.e. within two weeks after the involved persons get knowledge of the notifiable process. The deadline is extended to one month for taxpayers not resident in Germany. This rule was effective with the day after the announcement (21.12.2022). As there is a lack of provisions about the application of this new rule, legal uncertainty is given on whether the rule is retroactively applicable in all cases where Signing has taken place before 21.12.2022 and based on the lack of knowledge of the taxpayer about the requirements of the new rule, logically no RETT notification according to sec. 1 para. 3 and para. 3a German RETT Act has been filed. This now creates considerable legal uncertainty to the effect that it is feared that the tax assessment will not be annulled or changed after the Closing date due to the lack of a notification at the time of the Signing and that there is therefore a risk of double taxation with RETT. In single cases the German tax authorities take even the view that sec. 16 para. 4a and para. 5 sentence 2 German RETT-Act shall also be applicable provided both Signing and Closing has taken place before 21.12.2022 although the taxpayer in such cases had no knowledge about this new rule. Such a far-reaching retrospective application of the new regulation mentioned seems questionable in view of the constitutional limits on the prohibition of retroactive application of tax laws. Irrespective of this, the requirements for timely and complete notification, both at the time of Signing and at the time of Closing, are very difficult to fulfill in practice due to the tight deadlines.

Automatic violation of the retention periods according to MoPeG
In addition, the abolition of the concept of a joint ownership under the company law, which is crucial for the RETT relief provisions pursuant to sec. 5, 6, and 7 para. 2 German RETT Act, by "The Act on the Modernization of Partnership Law" (MoPeG) with effect from 01.01.2024, creates significant legal uncertainty. While maintaining the current legal situation, there is a concern that with the entry into force of the MoPeG on 01.01.2024, and the consequent elimination of the joint ownership concept under company law, the retention periods in sec. 5 and 6 German RETT Act could automatically be deemed to be violated, resulting in a retroactive taxation of a past realized and originally intended protected transaction. Even if there is no actual subjective/intended violation from the taxpayer due to a change in the law, given the impending automatic violation of the retention periods in sec. 5 and 6 German RETT Act, there is an urgent need for legislative action, at least for the purpose of clarification.

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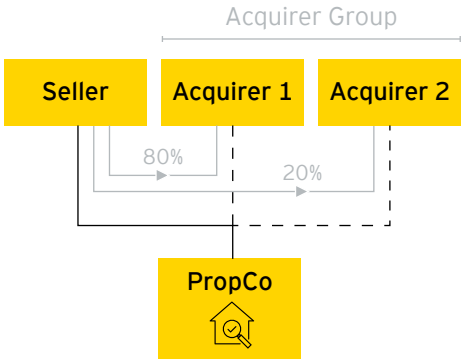
In response to this, the Federal Ministry of Finance ("Bundesministerium für Finanzen") has also reacted and proposed a comprehensive reform of the German RETT law with a discussion draft of the Real Estate Transfer Tax Amendment Act (GrEStNG), which was published in early July. The GrEStNG is primarily based on the Modernization Model ("MoMo") proposed by the Working Group on Real Estate Transfer Tax and represents the so-called „big solution." Considering the urgent need for legislative adjustments due to MoPeG, a medium and small solution are also being discussed. The medium solution envisages a legal form-neutral expansion of the existing relief provisions, while the small solution – similar to the "Brexit solution" – aims to ensure that there will be no automatic violation of the retention periods with the entry into force of MoPeG.

One supplementary provision ("Ergänzungstatbestand")
The GrEStNG provides for the abolishment of the existing supplementary provisions of sec. 1 para. 2a to 4 German RETT Act ("Ergänzungstatbestände") as well as the continued application of sec. 1 para. 2a to 3a German RETT Act- Old Version (sec. 23 para. 20 to 22 German RETT Act) and their replacement with a legal form-neutral provision of sec. 1a German RETT Act-draft). The previous concept of deadlines and share ratios shall explicitly not to be maintained. Instead, the discussion draft proposes acquisitions via share deals are to be taxed only when the entirety of shares (100 percent) in a real estate company or an intermediary company is unified. The design of special tax structures, especially so-called RETT-blocker, shall be prevented through the concepts of the acquirer group ("Erwerbergruppe"), which covers coordinated share acquisitions, and the concept of the serving interest ("dienendes Interesse") (shares being held or acquired on behalf of others). Additionally, the draft includes a new sec. 1b German RETT Act-draft, aiming to include German contractual-type funds ("Sondervermögen") in the taxation alongside the capital management companies as legal owners.

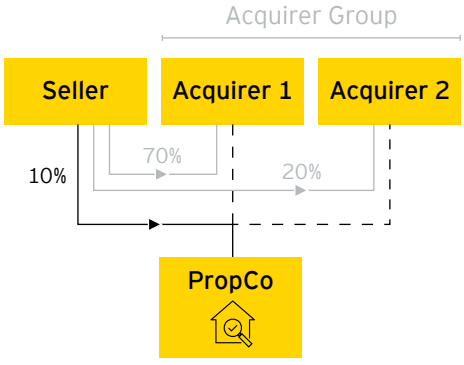


Acquirer Group ("Erwerbergruppe")
First and foremost, with the taxation of acquirer groups it is intended to prevent RETT blocker structures. According to the draft, an acquirer group shall exist when at least two persons acquire, directly or indirectly, the entirety of shares in a real estate company through coordinated legal transactions or coordinated transfers of ownership. A coordination shall be deemed to exist when:

1. the legal transactions were jointly planned before the first transaction or when such planning commenced;
2. there is an agreement on the planning; or
3. there is a joint control of the real estate company being pursued.

As a general rule, coordination shall be presumed when the legal transactions or transfers of ownership are connected by a factual or temporal relationship.

Companies that were already involved in the last acquisition process and were not part of the coordinated legal transactions or transfers of ownership in the real estate company, and whose participation does not increase, shall not be considered as members of the acquirer group.



The unification of shares amounting to 90 percent is subject to real estate transfer tax. The retained shares amounting to 10 percent are not to be considered when determining the entirety of shares, as they are held in the serving interest of the seller.

Serving Interest ("Dienendes Interesse")
Blocker structures shall continue to be prevented in the draft by not considering the affected shares in cases of a so-called serving interest when determining the entirety of shares. Shares held in a serving interest shall refer to shares in the real estate company and intermediary companies that are held or acquired by individuals who do not belong to an acquirer group, in the interest of the acquirer or at least one member of the acquirer group. A serving interest of a person shall typically be presumed to exist, among other criteria, when the fair value of the shares held by that person is lower than the potential real estate transfer tax, the shareholder rights of that person are restricted, the person receives only a fixed or minimum remuneration, or when the person can be significantly influenced by the acquirer/acquirer group.

This is intended to ensure a taxation in cases where an acquirer or an acquirer group unifies less than 100 percent of the shares, but other shares are held or retained in their interest, so that economically, they have a similar position as if they had unified the entirety of shares. In these cases, an exception shall be made from the principle of 100 percent unification of the assets of the partnership or corporation.

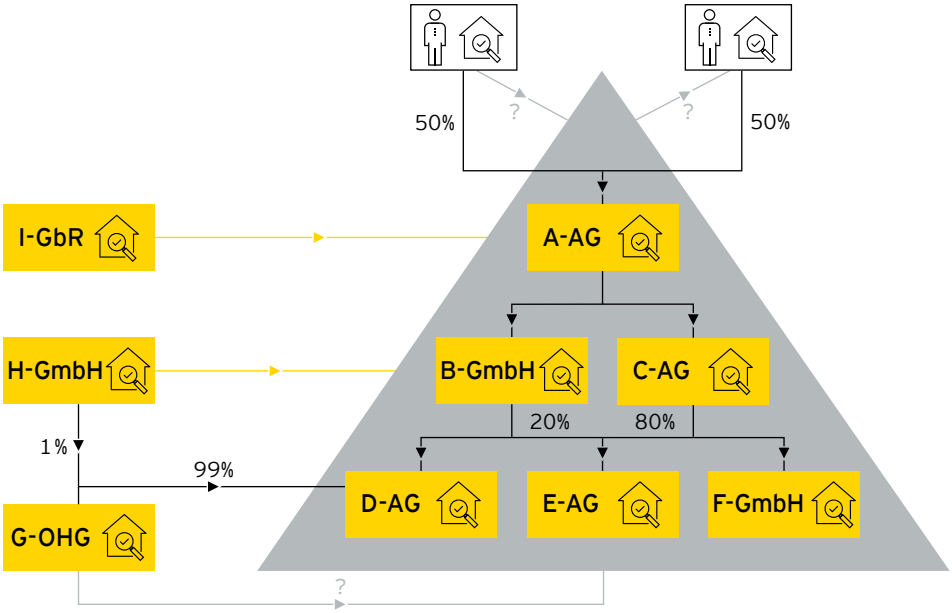
Tax relief provisions

The existing tax relief provisions in sec. 5, 6, and 7 para. 2 German RETT Act related to the joint ownership under company law concept are to be legally abolished as of 01.01.2024. The same shall apply with respect to the previous group restructuring exemption (sec. 6a German RETT Act). The aforementioned tax reliefs shall be replaced by a new tax relief rules (sec. 5 German RETT Act-draft).

The first provision shall replace the previous group restructuring exemption and is intended to be neutral to legal forms and cover all real estate transfer tax-relevant acquisitions provided the so-called dominant influence ("bestimmender Einfluss") over a property remains unchanged (sec. 5 para. 1 German RETT Act-draft). According to the rationale, in these cases, there is no taxable legal entity change. A person is deemed to have a dominant influence over a property if the property is attributable to them for real estate transfer tax purposes, or if the shares are unified directly or indirectly in their hands. A company is not considered to have a dominant influence if its shares are unified in the hands of another person, directly or indirectly.

Furthermore, the draft provides for a benefit in sec. 5 para. 2 German RETT Act-draft, stating that in the case of the transfer of a property from multiple co-owners or from a sole owner to a company, no tax shall be levied if the property had already been attributed to the co-owner or sole owner five years before the acquisition process and if the transfer does not result in a change of control over the property. On the other hand, sec. 5 para. 3 German RETT Act-draft is intended to favor the reverse case of the transfer from a company to multiple co-owners or a sole owner. In this situation, the draft stipulates the fulfillment of a retention period of 5 years by the owner or co-owners regarding the property.

In contrast of the former sec. 5 and 6 German RETT Act, this tax relief provision shall apply to both partnerships and corporations. Based on the wording of the provisions, a transfer of real estate to a group of companies as defined in sec. 5 para. 1 German RETT Act-draft may also benefit from a tax relief pursuant to sec. 5 para. 2 and para. 3 German RETT Act-draft, provided the additional requirements of these exemption rules are met.



All taxable acquisition processes within the so-called inverted funnel are covered by the favorable provision. All acquisition processes outside the inverted funnel are subject to taxation, except where the application of sec. 5 para. 2 and para. 3 German RETT Act-draft is applicable.

No violation of the retention period due to MoPeG
Furthermore, according to the discussion draft, the entry into force of MoPeG shall not result in a violation of the retention periods. Sec. 5, 6, and 7 para. 2 German RETT Act but shall continue to apply to favored, already realized acquisition processes until the expiration of the deadlines. The rules shall thereby apply with the stipulation that the principle of company's assets within the meaning of MoPeG shall be relevant instead of the joint ownership concept which is currently applicable (sec. 23 para. 27 German RETT Act-draft).

Signing and Closing
The rule for the correction of tax assessments introduced recently with the Annual Tax Act 2022 in sec. 16 para. 4a and para. 5 sentence 2 German RETT Act for cases in which the Signing and Closing are falling apart, shall be eliminated in accordance with repealing the provisions of sec. 1 para. 2a to 4 German RETT Act.

Further changes
The intended reform of real estate transfer tax rules by the Federal Ministry of Finance ("Bundesministerium für Finanzen") is accompanied by new regulations concerning the taxpayer, personal and material liability, and other procedural provisions. According to the discussion draft, the notification period, which currently stands at two weeks or one month, is to be uniformly extended to one month. Additionally, the draft proposes that in cases involving multiple parties, there should no longer be a requirement for multiple notifications; instead, when one party files a notification, other obliged parties would be exempted from the duty to file a notification. Moreover, a mandatory electronic notification requirement is to be introduced.

As the enforcement of tax claims, particularly with foreign taxpayers, has proven to be challenging at times, the draft proposes that in addition to the taxpayers, the real estate company shall be held personally and the property shall be held materially liable for real estate transfer tax, if the taxpayers fail to notify the acquisition correctly and in its entirety within the specified deadline (sec. 13a German RETT Act-draft).

Furthermore, a state opening clause (sec. 11 para. 2 German RETT Act-draft) is included, granting the federal states of Germany the authority to impose a reduced tax rate on the acquisition of owner-occupied residential property and establish specific conditions for this purpose.

Application
The reform is set to come into effect on 01.01.2024 and will thus generally cover transactions realized after 31.12.2023.

Outlook

At present, it remains entirely uncertain how the further coordination process between the German Federal Government and the Federal states of Germany, as well as within the Coalition at the German Federal level, will be. It is questionable whether such a comprehensive reform of the RETT rules in this form accompanied by time constraints, has a chance of being implemented by the end of the year. It is also possible that only a small solution will be decided upon by 01.01.2024, addressing only the tax-related issues directly resulting from the MoPeG and the elimination of the joint ownership concept under corporate law.

Regardless, affected taxpayers should still familiarize themselves with the proposed changes, as it is not ruled out that the reform proposals, in the event of a possible failure of the reform due to urgent implementation needs, might experience other attempts in the near future. It is evident that the RETT law needs a reform, and legislative adjustments are necessary to create more legal certainty for both taxpayers and the tax authorities.

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