German Real Estate Transfer Taxes: An Update

September 2013
In Germany, changes to the Real Estate Transfer Tax (RETT) Act and increases to transfer tax tariffs, have recently occurred. This newsletter aims to provide you with an outline of the latest amendments to the German RETT Act and their impact on RETT efficient transaction structures.

Real Estate Transfer Tax

Generally, whenever real estate located in Germany is traded, the acquisition is subject to RETT. It is common that the purchaser bears the full tax amount, although the RETT Act is not specific about it. Also, the tax law does not differentiate when it comes to the use of the underlying asset.

Up until September 2006, German real estate transactions were charged with a uniform nationwide tax rate of 3.5% of the purchase price. New regulations were then set, allowing every federal state to change the RETT rate individually. The government anticipated the federal states would reduce RETT in order to attract new citizens and encourage companies to settle. However, the opposite occurred. Federal states did not reduce the tax rate, and many have imposed significant increases.

In the first years following 2006, the applicable RETTs ranged from 3.5-4.5%. Today, only Bavaria and the state of Saxony remain at this level. The other states have increased the taxes – some more than once – with rates in some cases now reaching 5.5%.

In the last few weeks, announcements have indicated that yet another round of increases are forthcoming. Next year, Schleswig-Holstein will become the first federal state to break through the 6% mark when it raises RETT from 5% to 6.5%. The Senate of the State of Berlin agreed in June to increase the RETT from 5% to 6% as of January 2014. The State of Bremen and Lower Saxony intend to apply 5% in the near future.

Source: Avison Young
German Real Estate Transfer Tax Act

The German RETT Act originally provided the ability to set up tax-efficient transaction structures by allowing so-called “RETT Blocker Schemes” which were mostly beneficial to commercial real estate transactions. However, amendments to the law enacted on June 7th, 2013 now limit the use of tax-free structures.

We have set out below a brief summary of the changes.

Before June 7th, 2013:

“RETT Blocker Schemes” could be used in share deal structures by acquiring the property company through an incorporated limited partnership, “Kommanditgesellschaft” (KG).

Until June 7th, no RETT was triggered in transactions where the purchaser acquired less than 95% of the property company directly, e.g., in cases where 94.9% of the company was purchased directly by the investor and the remaining 5.1% by the incorporated KG. It is important to note that the purchaser could fully own the KG. From a tax perspective, the 5.1% shareholder was seen not to be affiliated with the property company, and no RETT was triggered.

Now:

According to the new regulations, if the investor owns the KG acquiring the 5.1% share, the investor is considered to have purchased 100% of the property company. The German RETT Act now treats the KG as an affiliate of the property company and RETT is therefore triggered.

While prior to amendments to the Act, RETT could also be avoided if the seller retained 5.1% of the KG for at least five years, post transaction, RETT is now triggered immediately. Even if the seller transfers the remaining shares to the purchaser in year six, this transfer is treated as an economic participation in the transaction.

RETT-exempt structures now only apply if the limited partnership is fully owned by a third-party partnership absolutely independent of the investor.
Outlook

In the first half of this year, the total of all transactions in Germany exceeded last year's first-half numbers by more than 30%. In total, properties amounting €13.1bn have been traded in the first half of 2013, €6bn alone in the second quarter (Q2 2012 was slightly above €4bn). This trend is expected to continue in the second half and a total investment volume of €27bn is anticipated for 2013.

Foreign investors, especially from the US and Canada, but also increasingly from the Middle East (Israel) and Asia (South Korea) have shown a continuous interest in larger properties or portfolios in Germany. These investors alone accounted for 30% (€4bn) of the total invested capital in the first half of 2013 – the same level as the first half of 2012. The share of transactions by foreigners for all of 2012 was 40%.

Amendments to the German tax law minimize the options to reduce transaction costs by the usage of tax-efficient structures. However, the impact of regulation changes on investor appetite has yet to be determined.

Despite significant changes taking place in the RETT regulations this summer, they do not appear to have dampened the enthusiasm of foreign investors contemplating the purchase of real estate investments in Germany.