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Global Tax Alert

German Real Estate Transfer Tax reform plans for "share deals" unveiled

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In June 2018, the Conference of the German State Finance Ministers agreed to implement new rules to tighten the taxation of "share deals" in companies owning German real estate with the real estate transfer tax (RETT). The Federal Ministry of Finance (MOF) was asked to prepare a technical draft bill. On 13 September 2018, in the presence of an MOF representative, potential provisions of such a draft bill were discussed in a non-official public setting. According to the presentation, the three main elements of the bill would include:

1. **A decrease of the RETT trigger threshold from 95% to 90%**: Currently, RETT is triggered if 95% of the shares in a real estate owning corporation or partnership are "unified" in one entity or person. Likewise, RETT is currently triggered if 95% of the interests in a partnership have been transferred within five years to "new partners" (this can be one or more new partners). Under the proposal, the 95% trigger threshold would be lowered to 90%. ***The principal effect of this change is, that the presence of a minority interest or shareholder of 10% or less would not protect the taxpayer from a RETT event anymore, if all the other shares or partnership interests are directly or indirectly transferred***.
2. **Extension of the so called "partnership transfer rule" to transfers of shares in a corporation**: Current law taxes the transfer of shares in a German real estate owning corporation only if a single party acquires directly or indirectly 95% of the shares in that corporation. Under the

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proposal, a share transfer shall now be in addition taxable if 90% of the shares in that corporation were directly or indirectly transferred to multiple owners during a lookback period of 10 years. **Example**: Shareholder A owns 100% in real estate owning X GmbH. A transfers 80% of the shares to B on 1 January 2018, and 10% to C on 1 January 2019. The transfer of the 10% on 1 January 2019 triggers RETT, as during the look-back period of 10 years 90% of the shares were transferred to new shareholders. *One of the principal effects of this change is this that the acquisition of a minority interest by a new shareholder will no longer protect the occurrence of a RETT event if the other shares are concurrently transferred to any other new shareholders (or are transferred later during the "look-back" period).*

Rather complex rules will govern the transfer of indirect shareholdings in multi-tiered group settings. Note that the new provision will apply equally to third-party transfers and related-party transfers (e.g., in the context of an internal group restructuring), and does not include any exception for intra-group transfers. The presented rule makes no technical exception for publicly-traded entities which own directly or indirectly German real estate, however it is currently unclear how they would be applied in practice on ownership changes at the public shareholder level. The RETT, once triggered, would be imposed directly on the transferred property company.

3. **Extension of the so called "look-back period" to 10 years, effective date and transition rules**: Currently, for partnership interest transfers, transfers of the last five years are added together to determine, whether the threshold for a taxable event (95%, down to 90% under the proposal) is triggered. This "look-back" period shall now be increased to 10 years for both partnership and share transfers.

- *No grandfathering for the look-back period extension*: It is foreseen that this extension should have immediate impact for transfers occurring after the effective date.
- The expected date for the effective date of the new bill is **1 January 2019**, so all transfers occurring after 31 December 2018 would be subjected to the new law. However, it should be noted, that the earliest possible (alternative) effective day which could be used by the legislator is the day on which the technical draft bill is published and introduced in the legislative process. Currently that is not expected to happen prior to 8 November 2018.
- It is important to note that the 10 year look-back period shall also apply immediately for all post 2018 transfers. **Example**: A owned 100% in the real estate owning X GmbH, and transferred 80% of the shares to B on 2 January 2009. On 1 January 2019, A transfers another 10% to C. RETT is triggered on 1 January 2019, because 90% of the shares in X were transferred during the 10 year look-back period.

Under transition rules, transfers which occurred within the 10 year look-back period would not be counted for the 90% threshold as follows:

- Transfers which would have triggered RETT before 1 January 2019, had the new rules been already in place at that time.
- Transfers where the *signing* of the obligation to transfer occurred within one year ***prior*** to the date of introduction of the bill into the legislative process (currently expected to be early November) and where the closing of the transfer (i.e., transfer of legal title) occurred within one year ***after*** that date.
- As a consequence, a transfer completed prior or on 31 December 2018 should not trigger RETT, if not taxable under current rules, and no subsequent share transfers happen in 2019 or later. **Example**: A transfers 94% of X GmbH to B on 1 December 2018 and 6% to C. These transfers are not taxable under current law and will not become taxable retroactively under new law. However, the 6% transfer (and any other qualifying transfers within the 10 year look-back period) will be counted for the 90% threshold when additional transfers of X shares occur in 2019 and later.

Transitory rules would also prevent the non-taxation of an expansion of an ownership position between 90% and <95% to a 95% or greater ownership position for the next 10 years. **Example**: A acquired in 2018 (or earlier) 94% of X GmbH. In 2019, A acquires the remaining 6%. The acquisition of the 6% would trigger RETT in 2019, notwithstanding the fact that A already owned in 2019 a percentage share in the company (94%) which is above the then applicable trigger threshold of 90%.

The 10-year recapture period will also be extended to other recapture provisions of the *RETT Act*, which govern certain tax-exempted partner to partnership transfers of real property or real property companies. A 15-year recapture period is foreseen for certain exempt partnership to partner or partnership to partnership transfers.

It is important to note that: (i) the above information is not based on any official pronouncements; (ii) that a technical draft bill is not yet available; and (iii) that once a technical draft bill becomes available, it may have been modified and can also be amended during the legislative process. In particular, the absence of a grandfathering concept for the extension of the look-back period could be seen as problematic by legislators and accordingly subject to modifications. Given the substantial consequences of the anticipated reform for any direct or indirect restructurings, acquisitions or disposition of entities owning German real estate, the impact of the reform on planned 2018 and post 2019 direct or indirect transfers of such entities should be closely assessed and monitored. Existing split ownership structures which "block" RETT under current rules should be reviewed as to determine whether any amendments to this structure made prior to the introduction of the bill into the legislative process in November would allow the retaining of their functionality under new law.

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