

CLIENT ALERT

Update on German RETT Reform

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On April 14, 2021, the Finance Committee of the Lower Chamber of the German Parliament approved a new law, to amend the German Real Estate Transfer Tax (“**RETT**”) Act. Both the Lower and Upper Chamber of the German Parliament still need to adopt the amendment, but since a political consensus on the amendment has been reached, such approval should be a mere formality. While the new law shall apply as of July 1, 2021, without taking retroactive effect, transactions prior to the date of effectiveness may nevertheless be relevant.

This alert serves to provide an overview of the most important aspects of the amendment and its practical implications, as approved by the Finance Committee of the Lower Chamber of the German Parliament. It may still be subject to (last-minute) changes by the legislators.

Overview on Amendments

Summary

Generally, the threshold for realizing RETT upon a share deal will be lowered from 95% to 90%. This will apply to (i) transactions due to which a person (or a group of related persons) directly or indirectly acquires shares in a company owning German real estate with the result that such person directly or indirectly holds at least 90% of the shares in that company (“**Unification Rules**”), as well as to (ii) the direct or indirect transfer of at least 90% of the interest in a partnership owning German real estate to new partners (*neue Gesellschafter*) within a certain time period (“**Transfer Rules**”).

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The period during which transfers are taken into account for purposes of the Transfer Rules, as well as the minimum holding periods for certain RETT exemptions (excluding the exemptions for certain intra-group restructurings) will be extended from five to 10 years.

The Transfer Rules will be extended to also cover the direct or indirect transfer of at least 90% of the shares in a real estate-owning corporation within 10 years to new shareholders. RETT under the Transfer Rules continues to be payable by the real estate-owning entity, i.e., the relevant real estate-owning partnership or corporation.

In order to mitigate the RETT exposures under the Transfer Rules for listed companies, transfers of shares in companies listed on a stock exchange in the European Union or the European Economic Zone or a stock exchange notified as equivalent by the European Commission are not taken into account for purposes of the Transfer Rules to the extent such transfers were executed on such stock exchange.

Application of the New Law

While the new law shall apply as of July 1, 2021, the 95% threshold will continue to apply after June 30, 2021 (i) for purposes of the Unification Rules, in case at least 90% but fewer than 95% of the shares in a real estate-owning company are attributable to a person or a group of related persons on July 1, 2021 and (ii) for purposes of the Transfer Rules, in case at least 90%, but fewer than 95% of the interest in a real estate-owning partnership were transferred to new partners within the five years prior to July 1, 2021.

Transfers of shares in real estate-owning corporations consummated prior to July 1, 2021, shall not be taken into consideration for determining the 90% threshold under the new Transfer Rules.

No grandfathering rules will apply for transactions that are executed after June 30, 2021, even if they are based on contractual agreements entered into prior to July 1, 2021.

Legislative Process – Next Steps

The Lower Chamber of the German Parliament is expected to adopt the new law next week.

If the draft law is not subject to further changes, the Upper Chamber of the German Parliament is expected to adopt the new law in May 2021.

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Impact on Future Transactions and Recommendations

RETT Blocker Structures

Generally, RETT blocker structures might still help mitigate RETT exposures in share deals, if the seller continues to hold more than 10% of the interest/shares in the real estate-owning partnership/corporation and guarantees that such shares will neither directly nor indirectly be transferred. However, such guarantees will be likely only to be obtained from individual sellers, sellers without shareholders (orphan structures) or professional co-investors (RETT blockers).

An existing RETT blocker structure might continue to be effective if the RETT blocker's shareholding in a real estate-owning corporation is increased to more than 10% prior to July 1, 2021.

Timing of Transactions

For transactions involving an acquisition by two unrelated purchasers with a split of one purchaser acquiring below 95% and the other acquiring above 5% of the shares in a real estate-owning corporation, there should be a review to determine whether signing and closing can be effected prior to July 1, 2021, in order for it to not be covered by the new Transfer Rules.

For transactions involving an acquisition of at least 95% of the shares in a real estate-owning corporation, there should be a review to determine whether signing can be effected after June 30, 2021. In that case, RETT would not be realized under the Unification Rules, but under the Transfer Rules with the result that such RETT would be payable by the real estate-owning corporation where it should qualify as a deductible business expense rather than by the seller or the purchaser of the shares where such RETT should either qualify as a transaction cost for a transaction that should basically be tax-exempt (seller) or should increase the acquisition cost (purchaser).

The German tax authorities take the position that no time limitation applies for indirect transfers under the Transfer Rules if and to the extent the entity owning the real estate is held by a corporation. It was originally proposed to clarify in the RETT Act that the general time limitations under the Transfer Rules shall also apply for indirect transfers, but such clarification is not included in the amendment of the RETT Act approved by the Finance Committee of the Lower Chamber of the German Parliament on April 14, 2021. If the draft amendment of the RETT Act were to be adopted as proposed, there is a risk that the German tax authorities may not only apply such interpretation of the Transfer Rules to real estate-owning partnerships, but may also apply it to real estate-owning corporations. While the better arguments should militate against the German tax authorities' view and support the position that no clarification is required by the legislators to arrive at a time limitation after five (or going forward, 10 years), it cannot be excluded that the German tax authorities could successfully defend an opposite position with respect to such indirect transfers.

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