# German RETT reform underway

**Last week, the German Federal Ministry of Finance unveiled a long-awaited draft bill for a reform of the German Real Estate Transfer Tax (RETT) Act.**

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Under the draft bill, the scope of the German RETT provisions regarding the taxation of share deal transactions would be substantially broadened. Under the law as it currently stands, share deals concerning real estate holding companies trigger RETT in particular in the following cases:

1. transfer of at least 95% of the shares in a real estate-holding partnership (but not a corporation) within five years to (any number of) new shareholders upon completion of the transfer ("*New Partnership Rule*");
2. unification of at least 95% of the shares in a real estate-holding company (partnership or corporation) in the hands of a single owner or a group of related shareholders already upon signing ("*Unification Rule*");.
3. holding of an economic participation of at least 95% in a real estate-holding company (partnership or corporation) in the hands of a single owner ("*Economic Participation Rule*").

All of these rules do not encompass only cases in which shares in a real-estate owning entity are being directly transferred, but also indirect share transfers (for instance, in the parent entity of the relevant real estate owning entity) can trigger RETT.

Still, the current law is viewed as being prone to circumvention. The New Partnership Rule can be avoided by having the purchaser initially acquire a 94.9% interest, while the selling partner remains in the partnership with its 5.1% partnership interest until the expiry of the five years watching period. The Unification Rule and the Economic Participation Rule can be avoided by simple co-investment structures in which there is – next to the main investor which acquires a share of up to 94.9% - an unrelated co-investor which acquires the remaining 5.1%.

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## Envisaged changes to the RETT law

These perceived loopholes are, according to the draft bill, to be closed by a variety of legislative measures. Main changes are:

— Generally, the relevant threshold of currently 95% will be lowered to 90% for the New Partnership Rule, the Unification Rule and the Economic Participation Rule alike.

— The general watching period of currently five years will be extended to ten years. This applies to the New Partnership Rule but also to restructuring exemptions for partnerships.

— There will be a new provision which is modeled after the Partnership Rule and extends its scope to corporations. As a consequence, in the future a direct or indirect transfer of at least 90% of the shares in a real estate-holding corporation within ten years to (any number of) new shareholders will trigger RETT ("*New Corporation Rule*"). The threshold of 90% for indirect transfers is generally calculated by simple multiplication of share/interest percentage. However, there is one notable exception: If there is direct change of at least 90% of the shares in a corporation holding shares in the real estate-holding corporation, then 100% of the shares held by the shareholder corporation would be deemed as transferred.

Due to the New Corporation Rule, an exchange of the shareholder base of property-owning corporations of at least 90% of the company's capital within a period of 10 years will trigger RETT, even if there is not one single shareholder or group of related shareholders who eventually control the real estate owning company. Hence, a full divesture of a property-owning corporation to an investor and a (new) co-investor would no longer be possible without triggering RETT. The seller would have to remain in the company as a shareholder with more than 10% of the shares, provided that the seller qualifies as a so-called "old" shareholder in the first place. Effectively, only the old shareholder could fulfill the role of the "RETT blocker". The New Corporation Rule will also be difficult to be monitored by and enforced with respect to real estate owning subsidiaries of publicly listed companies whose shareholder base is subject to constant change. The real estate-holding corporation itself (and not the shareholder whose sale or purchase exceeded the threshold) will owe the RETT and will also be obligated to file a notification with the tax office if such direct or indirect change of ownership occurred. This raises constitutional issues and is subject of vocal criticism from listed companies and legal practitioners alike.

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## Temporal scope of the new RETT law

Good news is that the amended rules shall take effect only as from 1 January 2020 onwards.

However, there is no grandfathering in respect of the ten years-watching period which is to be observed under the New Partnership Rule and the New Corporation Rule, meaning that generally also transfers of interests or shares that have occurred prior to 2020 will count for purposes of the calculation of the 90% threshold. The outcome can be quite harsh. RETT could be triggered, for instance, if since 2011 89.9% of the shares in a real estate owning company have been transferred to new shareholders and in 2020 only a tiny 0.1% share is being transferred to a new shareholder. Cases in which a shareholder who, at the end of 2019, already held between 90.0% and 94.9% of the shares in a real estate owning company acquires after 2019 further shares and thus exceeds the 95% threshold shall remain taxable pursuant to the old rules. There are, however, mitigating transitional rules for staggered transactions. Under these rules, no RETT shall be due pursuant to the New Corporation Rule and the amended New Partnership Rule if the underlying purchase agreement was signed within one year before the legislative procedure was formally initiated by submitting the draft bill to the parliament, provided the transaction will be completed within one year thereafter.

## Outlook

It remains to be seen how these draft measures will progress through the legislative procedure. For the time being, however, the draft bill should form the basis of any tax planning considerations and in light of the temporal scope it might be worthwhile accelerating envisaged transactions in order to still come under the current, more beneficial rules. For the New Corporation Rule, this would require not just the signing but also the closing of the transaction.

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