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## German Real Estate Transfer Tax – Now It's Getting Serious

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### I. Status of the Legislation Process

On 8 May, the tightening of the German Real Estate Transfer Tax ("RETT") Act became more concrete, and the key elements of the new tax legislation are now foreseeable. The Federal Ministry of Finance published a draft act that, *inter alia*, contains provisions regarding the amendment of the RETT Act ("Draft RETT Amendment Act"), including

- the extension of the Change of Ownership Rules to companies;
- the extension of the Cooling Period from five to ten years (and in some cases also to 15 years); and
- the reduction of the Equalization Threshold from 95% to 90%.

### II. Extension of "Change of Ownership Rules" to Companies

Currently, property holding partnerships and property holding companies are treated differently. If, in a partnership, ownership of at least 95% of the partnership interests directly or indirectly changes within a period of five years (the "Cooling Period"), RETT will be triggered (the so-called "Change of Ownership Rule"), whereas for companies, a sale of the entire share capital in a company does not trigger RETT, provided that each new shareholder owns less than 95% of the shares in the company.

According to the Draft RETT Amendment Act, it is intended to extend the application of the Change of Ownership Rules also to companies; i.e., RETT will be triggered if a certain percentage of the issued shares in the company directly or indirectly change hands within the Cooling Period.

### III. Extension of the Cooling Period from Five to Ten Years

Currently, the Cooling Period is five years. According to the Draft RETT Amendment Act, it is intended to extend the Cooling Period generally to ten years and if, e.g., a partner unifies its interests in a real-estate-owning partnership, even to 15 years after such partner stepped into the partnership.

### IV. Reduction of "Equalisation Threshold" from 95% to 90%

The underlying intention of German RETT law is to tax the acquisition of real estate—irrespective of whether the real estate is acquired directly (i.e., via an asset deal) or indirectly (i.e., via a share deal). Therefore, RETT applies where an investor acquires 100% of the shares in a real estate holding company.



In addition, the current legislation provides a threshold for share deals at or above which the shareholder is treated for RETT purposes as if it owned 100% of the shares; this threshold is currently 95%. Above this threshold, the investor is obliged to pay RETT on the full tax value of the real estate, even if it indirectly owns less than 100%.

The Draft RETT Amendment Act intends to lower this threshold from 95% to 90%, in which case RETT will be triggered if at least 90% of the partnership interest in a partnership or of the shares in a company will be transferred within the Cooling Period. As a result, if more than 90% of the partnership interest or the shares change hands within the Cooling Period, the partnership or company is obliged to pay RETT.

## **V. Grandfathering Provisions**

Principally, the new legislation shall apply for transactions realized (closed) after 31 December 2019; i.e., the new legislation shall not apply to transactions completed prior to 31 December 2019. However, the Draft RETT Amendment Act contains complex grandfathering provisions:

- If the purchase agreement has been concluded within one year prior to the introduction of the Draft RETT Amendment Act into the German Parliament and will be completed within one year following such introduction, the current regime under the RETT Act will apply (also if completion will occur after 31 December 2019).
- The Draft RETT Amendment Act deals with shareholders that already own an interest in a German real-estate-owning entity below the existing and above the new Equalization Threshold (i.e., interest/shares between 90% and 95%). This is to avoid that these investors could increase their interest after 31 December 2019 to 100% without ever having to pay RETT. The Draft RETT Amendment Act therefore provides in certain cases the continuation of the existing Equalization Threshold of 95%.

## **VI. Outlook**

Currently, there should still be a time window within which share deals can be realized without triggering RETT by using the well-known acquisition structures. If the RETT Act is tightened as described above (which seems very likely to us), future investments in German real estate via share deal might become less attractive. In addition, existing investments should be carefully reviewed to avoid pitfalls.

The grandfathering provisions increase the complexity of the RETT Act. At least for several years, the RETT consequences of any transaction will have to be carefully analyzed under the current and then-existing (new) RETT regime. In the event that a purchase agreement was concluded in Q1 or Q2 2018 but has not yet been completed, the situation should be analysed in detail as soon as possible in order to find a tax-optimal solution prior to the introduction of the Draft RETT Amendment Act into the German Parliament.

The new provisions shall also apply for listed companies. Investors should take into account that in the event that more than 90% of the shares in a listed company change hands within the ten-year Cooling Period, RETT will be triggered and must be paid by the listed company. The Draft RETT Amendment Act does not provide for an exemption for listed companies. We would expect the legislators to consider such an exemption during the parliamentary discussion. However, it is uncertain whether such an exemption rule will be implemented in the final amended act.

According to sources close to the process, the Federal Minister of Finance intends to introduce this draft act into the German Parliament either prior to the parliamentary summer break or shortly thereafter. The further development of the legislative process should be monitored.



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