LEGAL UPDATE
Tax Law
Cologne, 3 November 2021

GÖRG
IHRE WIRTSCHAFTSKANZLEI

The German real estate transfer tax after the reform of 2021 - how do share deals work under the tightened regulations?

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With effect as of July 1, 2021, the German legislator has tightened the Real Estate Transfer Tax Act ("**GrEStG**") with respect to share deals relating to companies owning real estate in Germany (or real estate equivalent rights such as hereditary building rights). The legislator's goal was to close certain loopholes, which had previously been exploited, in particular by larger market participants, to conduct real estate transactions without triggering real estate transfer tax. The previously applicable participation thresholds of 95% have been lowered to 90% and the five-year periods have been extended to ten years.

In addition, Section 1 para. 2b GrEStG introduces a completely new provision applicable to corporations. As it was previously only the case for partnerships, the mere change of shareholders of a corporation beyond the thresholds is now also liable to trigger real estate transfer tax for the respective corporations.

The basic principle

Real estate transfer tax is not only imposed on transactions in which a real estate itself is the targeted object (asset deals), but also on certain transfers of shares in real estate owning companies.

With regard to such transfers of shares, usually structured as share deals, it has so far been possible to distinguish between two main provisions:

The first provision (Section 1 para. 2a GrEStG) only applies to partnerships, i.e. in practice mainly to limited partnerships (including GmbH & Co. KG). In the case of a change in the structure of partners in the partnership, real estate transfer tax was previously triggered if there was a direct or indirect change in partners of at least 95% within a period of five years. This is intended to subject such situations to real estate transfer tax in which practically a "new" partnership is involved due to the extensive change in the structure of partners and, contrary to a corporation, the generally accepted principle that the partners are the essential characterizing elements to the partnership. As a consequence, the respective legal transaction is considered to concern the real estate itself. It is irrelevant to how many new partners the 95% relate to; i.e. also a distribution to any number of new partners triggers real estate transfer tax without one of them having to hold a certain minimum participation.

The provision of Section 1 para. 2a GrEStG does not apply to corporations. This means that for example in the case of a limited liability company (GmbH), no real estate transfer tax is triggered by a mere change in the structure of shareholders (provided that there was no unification of shares).

The second provision (Section 1 para. 3 GrEStG), however, applies not only to partnerships but also to corporations. According to this provision, previously real estate transfer tax was triggered if (simplified) 95% or more of the interests in a partnership or the shares in a corporation were unified in the hands of one purchaser. In contrast to Section 1 para. 2a GrEStG, it was not necessary for this unification of shares to take place within a certain period. The same principle applies to cases of economic participation (Section 1 para. 3a GrEStG).

The new provision

The most important change is the introduction of the new Section 1 para. 2b GrEStG.

Under the same conditions as for the already existing Section 1 para. 2a GrEStG, which only covers partnerships, the new Section 1 para. 2b GrEStG now also triggers real estate transfer tax for corporations if the structure of shareholders changes within a period of ten years in such a way that at least 90% of the shares are transferred to new shareholders.

This means that the widely known co-investor models, in which a main investor acquired the shares just below the shareholding threshold and a co-investor simultaneously acquired the remaining shares (club deals), are now excluded.

In order not to trigger excessive taxation Section 1 para. 2c GrEStG contains a so-called stock exchange clause. This clause exempts certain transfers of shares executed via a

qualified stock exchange, an equivalent third party trading venue or another multilateral trading facility (MTF) subject to Regulation (EU) No. 600/2014 (MiFIR).

Additional tightening provisions

In addition, the certain existing provisions underlying the basic principle have been tightened.

In the past, it was possible not to trigger Section 1 para. 2a GrEStG by extending the change of participation of 95% over a period of more than five years.

The new provision has now extended this five-year period to ten years and lowered the 95% threshold to 90%. These thresholds also apply in the new Section 1 para. 2b GrEStG.

Previously the unification of shares in Section 1 para. 3 GrEStG did not apply if a 94.9% investor jointly acquired all shares in a real estate owning limited liability company with a 5.1% investor. Only the subsequent acquisition of the remaining 5.1% (now 10.1%) after a period of five (now ten) years triggered real estate transfer tax in relation to the purchase price for the remaining shares. The insertion of Section 1 para. 3a GrEStG a couple of years ago had already introduced an economic unification of shares as a taxable event. Under the new provision, its 95%-threshold has been lowered to 90%, too.

The new thresholds are to be applied in principle to transactions realized as of July 1, 2021. Hence, acquisition structures established on the basis of the old participation thresholds should no longer result in transactions free of real estate transfer tax, provided that the previous five-year period has not yet expired.

Furthermore, the old regulations with the threshold of 95% continue to apply on a subsidiary basis for a limited number of cases. This is intended to prevent shareholding in a real estate owning corporation from being increased from the current level of 94.9% to 100%, for example. For partnerships, the principle of the protection of legitimate expectations applies, if the previous five-year period has already expired by July 1, 2021.

There are numerous legal uncertainties with regard to the new provisions. Unlike Section 1 para. 3 and 3a GrEStG, Section 1 para. 2b GrEStG does not, for example, contain a subsidiarity rule according to which Section 1 para. 2a GrEStG is to be applied with priority. For certain transactions both provisions might apply. Since the offsetting provision of Section 1 para. 6 GrEStG is also not applicable to the two provisions, the question arises as to whether real estate transfer tax could technically be triggered several times by the same transaction.

Consequences for the (consulting) practice

Conventional club deals and RETT blocker structures are no longer possible.

The consequences of the new regulation for the Corporate/M&A transaction practice are immense. The introduction of Section 1 para. 2b GrEStG means that an immediate sale of the entire shares in a real estate owning corporation (i.e. an exit of 100%) is no longer possible without triggering real estate transfer tax. The previous practice of club deals and RETT blocker structures, i.e. the acquisition of 94.9% of shares by the main investor and the acquisition of the remaining 5.1% of shares by a "brought along" co-investor, is no longer possible due to the introduction of Section 1 para. 2b GrEStG.

Now, avoidance of real estate transfer tax on share deals is only possible if – due to the lowering of the threshold from 95% to 90% – a maximum of 89.9% of the shares/interests in the real estate owning company are sold and an anchor investor qualifying as existing shareholder who holds the remaining 10.1% in the real estate owning company remains. For a further ten years, there must not be an (indirect) change in the structure of shareholders of more than 90%. Long-term investors, e.g. natural persons or foundations, may be suitable as anchor investors. The seller might be considered as an anchor investor if he retains 10.1% of the shares in the real estate owning company for at least ten years. A new market or an entirely new class of investors might emerge here.

As regards the project development sector, it may be advisable to participate the subsequent purchaser in the project company as early as possible before the real estate is actually acquired.
It is also likely that transactions within the real estate sector will increasingly be carried out via asset deals. If the triggering of real estate transfer tax cannot be avoided anyway, it could be an option for the purchaser to perform a simpler asset deal without having to carry out a (usually more extensive) due diligence for the share deal, and without having to buy in legal risks entailed in a share deal.

In addition, the reform results in increased declaration and monitoring obligations for corporations owning domestic real estate. Depending on the shareholder structure, monitoring the relevant (indirect) share transfers can be extremely costly, complex and perhaps even impossible.

Even outside the real estate sector (e.g. in internationally structured groups with a non-listed foreign holding company), group restructurings might lead to the triggering of real estate transfer tax without the relevant foreign group or its German (real estate holding) subsidiary being aware of it.

While a certain level of structuring potential will remain in the case of real estate transactions, it is not unlikely that the real estate transfer tax becomes a real corporate tax even for companies outside the real estate sector.

Note

This overview is for general information only and does not substitute for specific legal advice in individual cases. Please contact the authors if you have any questions. Information on the authors can be found on our homepage www.goerg.de.

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