

SHARE DEAL RULES UNDER THE GERMAN REAL ESTATE TRANSFER TAX ACT TO BE TIGHTENED FROM 1 JULY 2021

After drawn-out discussions, the German legislator will tighten the real estate transfer tax rules for share deals. Essentially, the prospective changes are those which have long been in the pipeline:

- reduction of the threshold for taxable transfers from 95% to 90% participations;
- extension of the holding and observation periods from five to ten or in some cases fifteen years;
- application of the movement rule also to corporations (previously only applicable to partnerships);
- a small ray of hope: the introduction of a stock exchange clause (albeit restricted);

This newsletter outlines the key impacts of the upcoming changes in the Real Estate Transfer Tax Act (Gründerwerbsteuergesetz, GrEStG; RETT Act) on the most common share deal scenarios.

TIGHTENING OF TAX RULES FOR TRANSFERS OF PARTICIPATIONS IN PARTNERSHIPS HOLDING REAL PROPERTY

Currently, an obligation to pay real estate transfer tax is triggered if 95% or more of the interests in a partnership holding real property are transferred (directly or indirectly) to one or more new partners within a period of five years.

The threshold is due to be reduced from 95% to 90% and the relevant period increased from five to ten years with effect as of 1 July 2021. An obligation to pay real estate transfer tax will therefore be triggered if, within a period of ten years, 90% or more of the interests in a partnership holding real property are transferred to (one or more) new partners.

Key issues

- Tighter real estate transfer tax rules now also for corporations holding real property (section 1 (2b) German RETT Act);
- Reduction of the threshold for taxable transfers of participations from 95% to 90%:
- the previous 95% thresholds shall continue to apply if the new 90% threshold (but not the previous 95% threshold) is already reached or exceeded prior to 1 July 2021;
- no protection of persons relying on the principle of good faith in connection with the amended taxation of share transfers. The new 90% threshold covers all transfers of shares in a partnership/ corporation holding real property to new shareholders, provided that the closing of the transaction or the transfer in rem (both referred to as "dinglicher Vollzug" in German) occurred after 30 June 2021, regardless of whether the relevant parties already undertook before 1 July 2021 to transfer the shares.
- Extension of the previous five-year period to ten years.
- In the event of acquisitions of interests in a partnership holding real property made in stages over a longer period of time, the five-year period is even extended to fifteen years if, as a result, at least 95% or 90% of these interests are then all held by the party, or parties related to one another for RETT purposes, acquiring them. This extension shall not apply if the five-year period already triggered has expired, or will have expired, prior to 1 July 2021.

These revised provisions for partnerships holding real property (section 1 (2a) GrEStG) will apply to acquisitions of interests transferred in rem after 30 June 2021 (and reaching or exceeding the new 90% threshold). Any transfers of interests to new partners which took effect in rem within five years prior to 1 July 2021 will also be taken into account. Contrary to what the legislators intends with the new section 1 (2b) GrEStG (see below), past transfers of interests which occurred within the last five years have to be added to transfers of interests to new partners which will take place after 30 June 2021 during the extended period of ten years.

The existing version of section 1 (2a) GrEStG (i.e. providing for a 95% threshold and a five-year period) will still be applicable until 30 June 2026 to any cases where at least 90% of interests (but less than 95%) have been, or will have been, transferred to new partners by 30 June 2021 and where the relevant five-year period has not expired on 1 July 2021. Example: Transfer of 94.9% on 16 July 2016.

If an existing five-year period expires prior to or on 30 June 2021, it is not extended to ten years on 1 July 2021. This means that transfers after or on 1 July 2021 are not taken into account if they were already closed prior to 1 July 2016.

TIGHTENING OF RULES FOR THE EXERCISE OF CALL/PUT OPTIONS

Based on the current legal situation, it is possible in the case of property-owning partnerships to increase the existing interest of a partner to 95% or more after a five-year period has expired without triggering an obligation on the partner to pay the full amount of real estate transfer tax. This means that in the past it was common for the seller of a partnership holding real property to first sell only 94.9% of the interests and retain a 5.1% stake. After expiry of the five-year period, the buyer then also acquired the remaining 5.1% of the interests (by exercising a put/call option) and thus increased its holding to 100%.

This will still be possible in future – subject to other changes in law currently being discussed. However, in future the holding period is to be extended from five to fifteen years – provided the existing five-year period has not expired prior to 1 July 2021.

This may be problematic, particularly if, having sold 94.9% of the interests in the past five years, the seller has been granted a put option for the sale of the remaining 5.1% after expiry of the five-year period and this put option can be exercised after 30 June 2021. If the seller transfers its remaining 5.1% to the buyer using the put option, this triggers the obligation to pay the full amount of real estate transfer tax since the interests are now all held by one party, even though only 5.1% have been transferred at that later date.

Transactions where a put option for the remaining interests has not yet been exercised should be amended such that the remaining interests are transferred to a third party. It may also be wise to modify call options. Here, the buyer has control over whether an obligation to pay real estate transfer tax is triggered. Nevertheless, the buyer may not wish to have the seller involved any more.

Here too, if the five-year period has already expired prior to 1 July 2021, it is not extended to fifteen years. This means, in such case, there is no rush to actually exercise an option before 1 July 2021 even if it is eligible for exercise.

TIGHTER REAL ESTATE TRANSFER TAX RULES NOW ALSO FOR CORPORATIONS HOLDING REAL PROPERTY (SECTION 1 (2B) GREStG)

The current provisions still apply to share deals closed by 30 June 2021. In this case, no obligation to pay real estate transfer tax is triggered if the main investor acquires less than 95% (e.g. 94.9%) of the shares in a corporation holding real property and the remaining shares (e.g. 5.1%) are acquired by a co-investor not related to the main investor in terms of real estate transfer tax regulations.

From 1 July 2021, what previously applied only to partnerships will also apply to corporations, namely that an obligation to pay real estate transfer tax will be triggered if, within a period of ten years, 90% or more of the shares in the corporation holding real property is directly or indirectly transferred to (one or more) new shareholders. In this case, it is the property-owning corporation which will be liable to pay real estate transfer tax. There will be no protection of persons relying on the principle of good faith in this respect, i.e. even with share purchase agreements already concluded prior to 1 July 2021, the only relevant point is whether they were closed (i.e. whether the shares will be legally transferred in rem) prior to 1 July 2021.

This means it will no longer be possible to transfer all of the shares in a corporation holding real property in one go without triggering an obligation to pay real estate transfer tax. To date, this was even possible for partnerships if their legal form was changed to that of a corporation prior to the transfer.

In future, the obligation to pay real estate transfer tax can only be avoided if the seller – or, more precisely, a seller qualifying as an "existing shareholder" – retains more than 10% of the shares for at least ten years (or for the appropriate longer period if up to 89.9% of the other shares are, in turn, to be partially or fully transferred to another party). It must be ensured that during this period there are no detrimental changes in the structure of this existing shareholder (indirect transfers of shares).

In cases where the purchase agreement on 95% or more of the shares in a corporation holding real property is concluded prior to 1 July 2021 but closing (and thus the transfer in rem of legal ownership in the shares) only takes place after 30 June 2021, there is a risk of double taxation, i.e. of real estate transfer tax being charged both to the buyer and the corporation holding real property. In such cases, closing should take place before 1 July 2021 if possible, or signing only after 30 June 2021.

INTRODUCTION OF A STOCK EXCHANGE CLAUSE FOR BOTH SETS OF SO-CALLED MOVEMENT RULES (SECTION 1 (2C) GREStG)

Based on the prospective exchange clause, share transfers will not count towards the 90% threshold in the context of the transfer tax rules provided two connected conditions are met:

- the shares in the company are admitted to trading on an organised market (e.g. in the Prime Standard or General Standard segments of the Frankfurt Stock Exchange, but not on the open market or scale segment for growth shares), and
- the share transfer takes place due to a transaction on such market or a multilateral trading facility (MTF) within the meaning of MIFID II / MIFIR.

The same applies for stock exchanges in third countries deemed by the EU Commission to have an equivalent status. Currently, only stock exchanges in the USA, Hong Kong and Australia fall into this category, but not for example the UK and Switzerland.

Indirect transfers of shares in shareholders of qualifying listed stock corporations (AGs) or partnerships limited by shares (KGaAs) are not excluded, even if the relevant shares of the stock corporation or partnership limited by shares holding real property are listed on one of the relevant stock exchanges. This means that when share transfers are assessed in the context of the movement rules, it is not enough to check up to the level of a shareholder which is a listed stock corporation or a listed partnership limited by shares. Rather, the assessment must include indirect shareholders. The assessment simply skips the level of the listed stock corporation or listed partnership limited by shares (provided the share transfer actually takes place on the qualifying exchange).

TIGHTENING OF THE RULES ON CONSOLIDATION OF SHARES (SECTION 1 (3) AND (3A) GREStG)

The threshold for a "consolidation of shares" (*Anteilsvereinigung*) is being reduced from 95% to 90% from 1 July 2021.

However, the previous 95% threshold will continue to apply for an unlimited period if as per the end of 30 June less than 95% but at least 90% of the shares in a corporation holding real property are all directly or indirectly held by the buyer – it is only the situation at the end of 30 June which counts here. In this scenario, an obligation to pay real estate transfer tax can even be triggered several times if, for instance, a holding initially increases to at least 95% after 30 June 2021, and is subsequently reduced to between 95% and 90%, to then be increased to 95% or more again at a later date.

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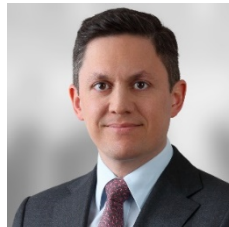
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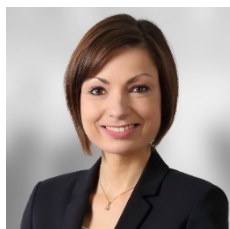
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