

REAL ESTATE TAX GUIDE - GERMANY

QUICK OVERVIEW OF GERMAN REAL ESTATE TAXATION

Preliminary German Tax Considerations

The principal taxes applicable to real estate related businesses and companies in Germany are individual income or corporate income tax, municipal trade tax and value added tax (VAT). For individuals with private owned property only individual income tax is applicable.

In case of commercial partnerships, taxation is split between the partnership and the partners. While partnerships are liable for municipal trade tax and VAT, the partners are assessed to income or corporate income tax. Other taxes like real estate tax and real estate transfer tax are also relevant for real property investments. There is no tax on corporate capital and no branch remittance tax, excess profits tax or alternative minimum tax.

The anti-tax avoidance directive (ATAD) is a directive published by the European Union (EU) and will be implemented by all countries in the EU. ATAD contains certain restrictions that may affect investors in real estate.

Corporate Taxation

The corporate income tax rate is 15%, plus a 5.5% solidarity surcharge, which results in a combined rate of 15.825%. Combined with trade tax the effective corporate income burden in major cities (including the solidarity surcharge and trade tax) typically ranges between 30% and 33%. Resident corporations are taxed on their worldwide income. However, tax treaties may exclude foreign-source income from German taxation. Nonresident companies are taxed on certain German source income, such as income from a German permanent establishment (PE) or real property investments.

Capital gains from sale of shares of domestic and foreign corporations are effectively exempt from corporate income tax and trade tax up to 95%. If the owning corporation holds at least 10% of shares, dividends are also effectively 95% corporate income tax exempted. If the corporation holds at least 15% of shares of the distributing corporation, dividends are also effectively 95% trade tax exempted.

With regard to real property and other specific assets, German tax law provides a special tax free reserve for profits from the sale of these assets (such as real property), which means that the realised proceeds of the sale, including the hidden reserves, can be used under certain circumstances in full to finance a new investment, thus protecting the liquidity position. This rule applies also to business assets of individuals or partners of a partnerships liable for individual income tax.

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Trade Tax

Municipal trade tax is levied by the local authorities typically at rates between 14% and 17%, although in some cities it can be as high as 19%. All entrepreneurs with commercial activities carried out through a subsidiary or a nonresident's commercial permanent establishment in Germany are liable for trade tax. Corporations resident in Germany are generally deemed to carry on commercial trade or services, regardless of their actual activities. Individuals, alone or in partnership, are not liable for trade tax on income from professional or other independent services, unless the activities are deemed to be commercial under the income tax law. This is e.g. for property owners the case if the individual or partnership provides additional services such as cleaning or a concierge service to the tenant.

Trade tax is based on taxable income as calculated for corporate or individual income (business income) tax purposes with some modifications (e.g. a 25% add-back of interest expense, a 6.25% add-back of royalty payments, a 5% add-back of rental payments for movables and a 12.5% add-back of rental payments for immovables to the extent these add-backs in total exceed EUR 100,000). On the other hand, 1.2% of the unitary tax value (Einheitswert) of real property belonging to the business assets and not being exempted from real estate tax can be deducted from income for trade tax purposes. For individual income tax purposes, trade tax is generally deductible with a standardised calculation method.

Even if a taxpayer's activities are, in principle, regarded as business income and liable for trade tax, tax may be avoided under the following conditions. A taxpayer that merely holds and administers their own real estate may apply for a so-called 'extended trade tax deduction' (Erweiterte Gewerbesteuer-Kürzung). Such a deduction is made from the tax base for trade tax purposes of income derived from merely passive rental activities, thereby reducing the tax base for such activities to zero and effectively leading to an exemption from trade tax. This exemption can also avoid trade tax on capital gains. A number of restrictions or prerequisites have to be considered in order to benefit from this exemption.

Partnerships are treated as transparent for income tax purposes and thus are not subject to income tax but liable for trade tax.

Individual Income Taxation

The individual income tax differentiates between an unlimited and limited tax liability in a similar way as explained for corporate taxation. If the individual is a resident or has a main residence in Germany, he/she is liable to pay income tax on the worldwide income. If the individual is not based in Germany, but generates domestic income, that income is subject to a limited income tax liability.

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The following income is subject to income tax:

- Income from agriculture and forestry
- Business income
- Income from independent services
- Income from employment
- Income from capital
- Income from rental and leasing
- Other specific income

The determination of a tax rate in Germany is based on a progressive income tax scale.

The marginal tax rate is 14% and increases progressively to 42% for a taxable annual income of 57,052 Euro in 2020 and 114,104 Euro for married couples in 2020. Starting from a taxable annual income of 270,501 Euro in 2020 and 541,002 Euro for married couples in 2020, the highest tax rate of 45% applies for any additional income. A 5.5% solidarity surcharge is also levied on individual income tax in 2020. Also, a church tax of 9% (8% in Bavaria and Baden-Württemberg) can be levied in the income tax if the individual (resident or non-resident) has not resigned its church membership.

Upon request for partners of partnerships and individual entrepreneurs, retained earnings are subject to a separate income tax rate of 28.25%. If retained earnings are withdrawn in subsequent years, they are taxed at a rate of 25%. Retained earnings distributions of corporations, such as dividends, are subject to withholding tax at a uniform rate of 26.375% including surcharge tax.

In most cases, income from private savings and capital investments and connected capital gains are taxed separately at a flat rate of 25% (26.375%, including the solidarity surcharge), mostly via withholding at source. Where a shareholding of at least 1% has been held at any time during the five years prior to a sale, 60% of the capital gain is taxed at the regular (progressive) rate. This also applies to dividends and capital gains when the underlying assets qualify as business assets.

If an individual receives rental income in respect of a German property, capital gains realised on the disposal of that property are only subject to personal income tax if the period between acquisition and disposal does not exceed ten years and the property was held as private property. In case the real property was privately used at least in the disposal year and the two previous years, the capital gain is tax exempted. If the rental activities have been qualified as 'business income instead, capital gains are always subject to income tax as ordinary business income.

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Real Estate Transfer Tax (RETT)

Real Estate Transfer Tax (RETT) is imposed on the transfer of real estate located in Germany and on certain transactions that are deemed to constitute such a transfer. This includes the direct or indirect unification of 95% of the shares in a corporation or partnership that owns real property and the transfer of 95% or more of the shares in such a corporation or partnership. Also, the 95% direct or indirect change of the partners in a partnership owning domestic real estate within a period of five years will trigger RETT. The tax also applies to any transaction that results in an entity directly and/or indirectly owning a 95% economic share or interest in a company owning real estate. The economic share or interest approach requires looking through intermediary companies and adding the direct and indirect participations.

The tax rate depends on the federal state in which the real estate is located and ranges between 3.5% and 6.5% of the consideration (or alternative tax base, i.e. the assessed value). In 2020 a tax rate of 3.5% applies for real estate located in Bavaria and Saxony, 4.5% in Hamburg, 5.0% in Baden-Wuerttemberg, Bremen, Lower Saxony, Rhineland-Palatinate and Saxony-Anhalt; 6.0% in Berlin, Mecklenburg-Western Pomerania and Hesse, and 6.5% in Thuringia, Schleswig-Holstein, Saarland, Brandenburg and North Rhine-Westphalia.

Exceptions to RETT apply for certain intragroup restructurings and for transactions between related persons or transfers by way of inheritance.

RETT is levied on the agreed consideration – in most cases the purchase price. A separate real property evaluation is required based on the German Valuation Act in a number of special transactions. In detail, this valuation basically applies to transactions where no consideration can be determined, such as group reorganisations, contributions in exchange for shares, unification of shares or interest and other transactions based on statutory agreements. The regulations of RETT apply, irrespective of whether the transaction itself is also subject to VAT. VAT is not part of the consideration for RETT purposes.

A substantial RETT reform is intended but not finally agreed. It is expected to be finalised 2020. The proposed changes are not included in this tax guide and will be incorporated into the next version, once the legislative process has been completed.

Value Added Tax (VAT)

Value added tax (VAT) is levied on supplies of goods and services at each stage of the production and distribution chain. In order to be subject to VAT, the supply must be carried out by an entrepreneur in the course of the business, and the taxable supply, acquisition or receipt must take place (or is deemed to take place) in Germany. In the chain of entrepreneurs, VAT generally should be tax neutral at each stage until the goods or services reach the final customer (or are used for tax exempt supplies).

The standard rate of VAT in Germany is 19%, with a reduced rate of 7% applying to certain consumer goods and basic services

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In principle, services supplied in connection with real properties fall within the scope of VAT but most of these transactions are, however, exempt under German VAT law. Renting out and leasing of real estate is generally tax exempt. However, it is possible to opt for VAT. A waiver is only permissible if the tenant makes use of or intends to make use of the plot of land, or parts of it, for transactions that entitle him to the deduction of input VAT. Letting of living and bedrooms for the purpose of short-term accommodation of guests, sites for parking vehicles or camping, tennis courts and permanently installed equipment (business fixtures) are subject to VAT.

The sale of land is also generally VAT-exempted. However, if the sale is made to an entrepreneur for business purposes, the exemption from the VAT liability can be waived in the notarised purchase agreement. In this case the buyer is liable to pay VAT under the reverse charge procedure where transactions are subject to RETT and the buyer operates a business. Where the sale of a plot of land is treated as a taxable transaction, RETT does not increase the assessment basis for VAT. The aforementioned applies if a sale is made to another enterprise for purposes of the latter's business, regardless of whether the buyer is entitled to recover input VAT (VAT option).

The sale of a whole business or an independent part (Geschäftsveräußerung im Ganzen) to an entrepreneur is, in general, not subject to VAT. Even the disposal of one piece of real estate can fall into this category, if it represents the main business asset. A whole business or an independent part is sold if the essential basis of a business or independent part of a business is transferred to a purchaser for purposes of the purchaser's business. Rights to use property, and/or receivables, service contracts, business contacts, etc. that constitute part of the essential basis of the business must also be transferred to the purchaser if they are necessary for the continuation of the business. For purposes of input VAT adjustment, the purchaser replaces and 'succeeds' the seller. The input VAT adjustment period of ten years is not interrupted.

Real Estate Tax

Every municipality levies an annual real estate tax on German real estate. This annual municipal tax is deductible from rental income. Properties within Germany, as well as land-based industries (agriculture and forestry), are subject to real estate tax. The amount of real estate tax is currently based on the condition and the value of the property.

Several calculations are required to ascertain the tax amount. The tax authority will determine the tax base by comparing similar units or replacement values of the property and will notify the respective municipality. The tax base was usually significantly lower than the properties market value. Next, the municipality adopts its individual assessment rate at the tax base and assesses the property tax. In general, the property tax rate ranges between 0.26% and 1% of the tax base. On 10 April 2018, the German Federal Constitutional Court declared the determination of the tax basis to be unconstitutional and demanded a new regulation by the end of 2019. A reform was finalised in November 2019 and will be applicable from 1 January 2025 onwards.

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In future the calculation consists still of three steps. First, real property located in Germany is assigned a value for real estate tax purposes. Then, this value is multiplied by a uniform factor (known as the basic federal rate, or *Steuermesszahl*). Finally, what is known as the multiplier (*Hebesatz*) is applied. While the basic federal rate is set by federal law and is the same across all of Germany, the multiplier – and therefore the amount of tax ultimately due – needs to be determined by the local authorities until the reform is applicable.

German Net Wealth/worth taxes

A wealth tax is currently not levied in Germany.

Legal Forms - Vehicles for German real estate

Germany provides numerous legal forms for establishing a business and holding real estate. The choice of the legal form depends on many different factors, including liability, taxation and accounting. A real property investor is not locked into a specific legal form after making his initial selection. Fortunately, as the business evolves, the German law allows a change of the legal forms. To assure that the proper and most beneficial legal form for the investment is selected, it is advised to seek the joint advice of a tax expert and corporate lawyer. In the following sections, we introduce the common legal forms for real property investments in Germany.

Civil Law Partnership (Gesellschaft bürgerlichen Rechts – GbR)

Investments in real estate are often done on a collective basis by entities and/or individuals. The Civil Law Partnership (in German: 'Gesellschaft bürgerlichen Rechts') is a partnership commonly used. In order to establish a Civil Law Partnership, it is required to have at least two separate parties. The partnership agreement may be oral, written or conclusive. However, it is highly recommended that a partnership agreement is formed in writing. In addition to the assets of the partnership, a partner has an unlimited personal liability. There is no start up or registration fee with the commercial register if a Civil Law Partnership is formed, unless the business activity considered a commercial enterprise. In this case, a registration at the local trade office is required. There are no limits for Civil Law Partnership's activities.

Limited Liability Partnership (GmbH & Co. KG)

The GmbH & Co. KG is a special form of partnership. At least two partners are required in order to establish a GmbH & Co. KG: A GmbH (see below) as general partner and at least one limited partner. The general partner is usually responsible for managing the business and is represented by the managing director of the GmbH. Limited partners are regularly excluded from managerial duties but are only liable to the extent of their contribution. Their limited liability is the main advantage of the limited liability partnership. It should be noted that the GmbH and the KG are two different company types and require separate bookkeeping and incur separate expenses.

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The GmbH & Co. KG usually operates as a commercial entity. The KG must be formulated and certified by a notary before the entry is submitted to the Commercial Register. Appointment and retirement of a limited partner must be reported to the Commercial Register. With the entry of new limited partners, the GmbH & Co. KG is able to raise capital. It should be noted that the GmbH and the KG are two different company types and therefore require separate bookkeeping and incur separate expenses.

The GmbH must have a minimum share capital of 25,000 Euro before registration can proceed. The limited partners are not required to make a contribution in this amount. To keep the liability of the general partner as small as possible, only the minimum capital contribution is used in practice. The partnership agreement includes resolutions regarding management and representation, profit and loss distribution, majority decisions and succession plans for the company.

Private Limited Liability Corporation (Gesellschaft mit beschränkter Haftung – GmbH)

The GmbH is the most popular business entity in Germany, because of the limited liability. The company must fund at least 25,000 Euro of equity in the form of a cash deposit, in kind capital contributions or a mixed deposit. The GmbH requires notarised Articles of Association and a registration in the Commercial Register by a notary. Until this registration is completed, the company is considered liable without limitation.

A GmbH is legally obliged to have at least one manager. Regulations for management and representation are defined in the Articles of Association. In addition to procedures regarding majority rulings, the Articles of Association must include basic company information such as name, place and purpose of the company. The most important aspect of the GmbH is the shareholders' meeting, where the shareholders meet and deliberate over the state of the company.

As previously mentioned, there is no personal liability for shareholders. Any profits may be distributed or retained. The regulations regarding the profit distribution (e.g. protection of minority shareholders) are also stated in the Articles of Association. Since the modernisation of the GmbH law in 2008, the opportunity to complete a foundation by a "Musterprotokoll" (a standardized governmental form) provides a faster and a simpler establishment.

Real Estate Investment Trust (REIT)

In 2007, Germany adopted the introduction of German real estate corporations with shares listed on the stock exchange (REIT). The REIT needs to have the legal form of a stock corporation (Aktiengesellschaft). The required minimum capital is €15m. Both the statutory seat established in accordance with the corporate articles and the actual seat of management must be in Germany. At least 15% of the shares in the REIT must be widely spread in a way that from these shares no investor must hold 3% or more ('small investor rule'). At the moment of listing, it is even required that 25% of the shares must be held widely spread. No individual shareholder must hold 10% or more of the REIT shares directly. Additional indirect holdings are possible to a certain extent. The ownership and transfer of REIT shares are supervised by the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin).

REITs are exempt from corporate income tax (including the solidarity surcharge) and trade tax if at least 90 % of the profit is distributed and at least 75 % of that profit is generated on real estate. Full taxation on income from shares in REITs is instead shifted to the investor level. For private investors, REIT distributions will be subject to final withholding tax at a rate of maximum 25 % (plus solidarity surcharge).

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The REIT is subject to annual certification by its auditors as per 31 December, confirming that it has complied with the REIT specific rules. Failure to obtain such certification triggers penalties in different degrees of severity at the level of both the shareholders and the REIT, starting from penalty payments up to a potential loss of the REIT status. 75% of the REIT's assets must consist of real property that is to be let, leased, or sold. Properties that are more than 50% let to residential tenants are non-eligible assets, unless they have been erected on or after 1 January 2007. Sale-and-lease-back arrangements are permissible without restrictions.

Real Estate Investment Funds

A fundamental distinction must be made between open and closed real estate funds.

Closed funds in Germany are regularly structured as asset-managing limited partnerships under civil law. The investors hold either a direct interest as shareholders in the partnership or indirectly through a trustee. The general provisions for the tax treatment of partnerships apply to closed real estate funds. They differ from open funds in the fact that the investment is limited to a real estate project to be acquired or constructed by the fund. When the subscription amount is reached, the fund is closed.

An open fund is a special fund from which certificate holders receive income from capital assets. Open investment funds are generally taxed in accordance with the provisions of the German Investment Tax Act (InvStG).

Foreign Trusts

The legal form 'trust' is unknown in German civil law. Accordingly, German tax law does not contain any provisions for trusts. The respective taxation has to be carried out according to the general principles and regulations. By means of a type comparison, it must be determined which domestic legal form is comparable to the foreign trust. The tax treatment in Germany will depend on this classification. It will be determined to what extent the trustees or the beneficiaries can influence the asset investment, and/or the income generated by the trust. If the administrator of the trust has a position corresponding to that of a trustee, the trust is generally not to be regarded as an independent taxable entity and the income is taxed at the level of the trustee and/or the beneficiary.

Foreign Entities

Foreign corporations and foreign partnerships can own real property in Germany. The real property is either allocated to the foreign entity directly or to a permanent establishment of the foreign entity in Germany. For partnerships established under foreign law, a decision needs to be made whether the company is recognised as a partnership or a corporation in Germany for tax purposes. The decisive factor is whether the foreign company is comparable to a partnership or corporation under German law. As described above, partnerships are treated as transparent for income tax purposes and thus are not subject to income tax but subject to trade tax if a permanent establishment is constituted in Germany.

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