Real Estate Tax Newsletter

Issue 2, 2025

Contents

Dear Real Estate Community,

I am delighted to welcome you to the second edition of the RE Tax Newsletter of 2025.

In this edition, you can expect exciting and relevant content that will help you to keep an eye on tax development in the Real Estate Sector. We have compiled practical specialist articles for you that will provide you with valuable insights and recommendations for action.

I hope you enjoy reading.

With kind regards,

Stefan Kunze
Head of Real Estate Tax

01

European Commission increases pressure on Germany

Can foreign real estate investors benefit from deferred taxation of capital gains?

The sale of a property can lead to a taxable gain. However, the legislator allows a deferral of taxation, which shifts taxation to the future. This option is currently denied to foreign real estate investors. For this reason, the European Commission recently decided to take Germany to the ECJ. The European Commission is thus continuing infringement proceedings that began in 2019.

A. Background

1. Investment structures affected

Investments in German real estate are often made through foreign investment structures. Investors make use of an indirect investment, which is regularly made through a Luxembourg S.à r.l. or Dutch B.V. as the property holding entity. This investment structure is popular, as the special purpose vehicles are subject to German corporate income tax (section 2 no. 1 KStG in conjunction with section 49 para. 1 no. 2 lit. f) EStG). However, the property holding entities are not subject to German trade tax. Trade tax is levied on business operations conducted in Germany (section 2 GewStG). If the special purpose vehicles do not establish a permanent establishment in Germany, there is no business operation for trade tax purposes.

In practice, these investment structures are referred to as the „no-PE model". Income from the lease of German properties and any capital gains of German properties are income from business operations. However, this is only a legal fiction for determining income. In the absence of an actual standing business operation in Germany, this income is subject exclusively to corporate income tax, but is calculated on the basis of a comparison of business assets.

2. Tax deferral pursuant to section 6b EStG

Legislation provides for deferred taxation of capital gains from real estate in accordance with section 6b EStG. Assets eligible for tax relief include land and buildings. It is therefore possible to transfer hidden reserves from the sale of land and buildings to newly acquired or constructed land or the building on it.

The transfer of hidden reserves from the year of disposal to the future is achieved by either reducing the acquisition costs of a reinvestment property in the year of disposal. On the other hand, the shift can be achieved by creating a tax-exempt reserve in the amount of the capital gain (so-called „section 6b EStG reserve"). Subsequently, the reserve can be transferred to a reinvestment property in which the acquisition costs are reduced by the amount of the reserve.

However, the transfer of hidden reserves through the "section 6b EStG reserve" must take place within four years. If a reinvestment is not made within this period, there is a risk that the reserve will be reversed. In addition, taxpayers would be charged interest on the reserve. The reversal through the profit and loss statement is linked to an interest charge of six percent per financial year.

The conditions for deferral of taxation are set out in section 6b para. 4 EStG. Specifically, the deferral of taxation can only be applied for if:

- the taxpayer determines the profit by comparing business assets,
- the assets sold have been part of the fixed assets of a domestic permanent establishment for at least six years without interruption at the time of the sale,
- the purchased or manufactured assets (i.e., the reinvestments) are part of the fixed assets of a domestic permanent establishment,
- the gain arising on the sale is not excluded from the calculation of the domestic taxable profit and
- the deduction or creation and reversal of a reserve can be tracked in the accounts.

B. Application of section 6b EStG for foreign special purpose vehicles

These requirements also show why foreign special purpose vehicles (i.e., Luxembourg S.à r.l. or Dutch B.V.) are not permitted to apply section 6b EStG. Application would always fail due to the requirement that both the disposal object and the reinvestment object must be allocated to a domestic permanent establishment. This is not possible for foreign special purpose vehicles if the investment is made under the no-PE model. The fixed assets cannot be allocated to a domestic permanent establishment if there is only one permanent establishment abroad (e.g., management office in the state of residence).

1. Potential violation of fundamental European freedoms

However, in this case, there are good reasons to argue that foreign taxpayers are being disadvantaged in a way that is not compatible with European fundamental freedoms. For this reason, the European Commission has also initiated the next step in the infringement proceedings against Germany.

The freedom of establishment (Art. 49 Treaty on the Functioning of the European Union, "TFEU") and the free movement of capital (Art. 63 TFEU) come into consideration. The distinction between these fundamental freedoms can be difficult. While the freedom of establishment extends to activities directly related to the (self-)establishment, the free movement of capital focuses on the taxpayer's capital investment or capital transfer decision. The distinction must be made on the basis of the subject matter of the regulation concerned. The abstract scope of application of the regulation is therefore decisive.

The application of section 6b EStG always fails in the no-PE model due to the requirement that the real estate and reinvestment properties sold must always be allocated to a domestic permanent establishment. In this respect, the lack of a permanent establishment in Germany triggers a disadvantage compared to domestic real estate companies as a comparative pair. The scope of application of the freedom of establishment therefore appears to be affected.

The legislator grants comparable (domestic) corporations a tax deferral even though their activities and overall situation are comparable. This disadvantage is likely to make establishment in other European countries less attractive.

The Munich tax court has already dealt with the case outlined here (Munich tax court, judgment of 30 April 2019, 6 K 1185/18). Although this judgment denies the violation of the freedom of establishment, the judgment is not convincing on several points. In particular, the Munich tax court chooses a comparison group without taking comparable activities into account. As a result, the Munich tax court weighs up the advantages of the no-PE model against the disadvantages of the trade tax burden on domestic corporations. This approach is not convincing, as comparable domestic corporations can make use of the extended trade tax reduction for the income resulting from German real estate pursuant to section 9 no. 1 sentence 2 GewStG and are therefore generally not subject to trade tax.

2. Recommended action for foreign property holding entities

In this respect, it is not surprising that the European Commission wishes to continue the infringement proceedings even after Germany has issued its opinion. It remains questionable whether foreign property companies could already benefit from the ongoing proceedings.

The ECJ's decision only has a direct effect on the member state concerned. Nevertheless, affected special purpose vehicles should review the application of section 6b EStG. If the application - apart from the allocation of permanent establishments - comes into consideration, it would be conceivable to lodge an appeal against the assessment. Pending a decision by the ECJ and potential new legislation, appeals and legal proceedings would have to be suspended (section 363 para. 1 AO, section 74 FGO).

In addition, taxpayers could also work towards ensuring that the tax authorities do not assess a tax deferral, but that the taxes are provisionally assessed on the basis of the ongoing proceedings (section 165 AO). The assessment with a provisional assessment notice would be expedient as, on the one hand, taxpayers would be relieved of the need to file their own appeals. On the other hand, the provisional assessment only allows the assessment period to be kept open at certain points.

If the ECJ ruling is in the taxpayers' favor, taxpayers may be entitled to extensive interest claims. These claims for interest include a claim arising directly from EU law and the national claim for interest due to the change in the tax assessment. If, on the other hand, a decision is made in favor of Germany, the taxpayers would not suffer any direct disadvantages as a result. This is because the tax assessment in these cases was already made without the transfer of hidden reserves. In this respect, no additional tax payment is possible.

Facts

The deferral of taxation in accordance with section 6b EStG is a sensible measure by the legislator to encourage economically reasonable reinvestment decisions. These decisions can be made by both foreign property holding entities and domestic property holding entities. Nevertheless, foreign real estate investors are currently at a disadvantage. In this respect, the ECJ's decision can be followed with interest. Although the wheels of justice grind slowly, foreign taxpayers could already take advantage of the proceedings.

Andreas Patzner
Partner
Lawyer, Tax Advisor
Financial Services Tax

Stefan Schönhöffer, LL.M.
Assistant Manager
Tax Advisor
Financial Services Tax

02

Relief from German capital gains tax for inbound structures

The new German Federal Central Tax Office Guidance-Note (status 03/2025): Relaxation of the substance criteria pursuant to Section 50d (3) GITA

In the case of a foreign corporation, the withholding tax relief to which it is entitled - on the basis of a Double Tax Treaty (DTT) or the Parent-Subsidiary Directive (PSD, Section 43b German Income Tax Act hereinafter: GITA) - with regard to dividend payments from Germany is linked to the substance criteria of Section 50d (3) GITA. The wording of Section 50d (3) GITA is subject to interpretation and dispute. This is aggravated by the fact that there is hardly any case law on the current version of the provision and no issued letter from the Federal Ministry of Finance (i.e. BMF-Schreiben). It is therefore all the more pleasing that the current Guidance-Note from the Federal Central Tax Office (as of 03/2025) addresses the interpretation of the substance criteria from the perspective of the tax authorities, who have partially relaxed their view.

Wording of Section 50d (3) GITA and relaxations due to the new German Federal Central Tax Office Guidance-Note

The wording of Section 50d (3) sentence 1 GITA is worded negatively and includes an „and link". Accordingly, a foreign corporation is not entitled to relief, to the extent that its shareholders would not be entitled to this claim if they realised the income directly and – to put it simply – where the entity does not carry out any active economic activity of its own. Section 50d (3) sentence 2 GITA also states that section 50d (3) sentence 1 GITA does not apply if the foreign corporation proves that none of the main purposes of its involvement is to obtain a tax advantage or that it is listed on a stock exchange.

For the legal practitioner, it is easier to read § 50d (3) sentence 1 GITA positively, i.e. under which conditions the foreign corporation is entitled to relief.[1] The „and-linkage" then becomes an „or-linkage". The link with section 50d (3) sentence 2 GITA then results in a total of four alternative options for the foreign corporation to prove a claim for relief.[2]

Accordingly, a foreign corporation is entitled to relief from German withholding tax on the basis of a DTT/EU Directive, provided that

- their shareholders would be entitled to this claim in the event of an imaginary direct receipt of income from Germany (so-called "hypothetical relief claim" of the shareholders pursuant to section 50d (3) sentence 1 no. 1 GITA, while also taking into account the requirements of section 50d (3) GITA at their level) or
- the source of income from Germany, i.e. in the case of dividends, the shareholding in the corporation, has a substantial connection with its economic activity (so-called own active economic activity of the foreign corporation as the applicant pursuant to Section 50d (3) sentence 1 no. 2 half-sentence 1 GITA). The mere generation of income, its transfer to shareholders (so-called "passive holding activity"[3]) as well as an activity, insofar as it is carried out with a business operation that is not appropriately set up for the business purpose, is deemed to be a passive holding activity pursuant to Section 50d (3) sentence 1 no. 2 half-sentence 1 GITA. Section 50d (3) sentence 1 no. 2 half-sentence 2 GITA does not qualify as an economic activity, or
- there is significant and regular trading in the main class of shares on a recognised stock exchange (so-called "stock exchange clause" pursuant to section 50d (3) sentence 2 alt. 2 GITA) or
- it succeeds in proving that none of the main purposes of its involvement is to obtain a tax advantage (so-called "proof to the contrary" or "principal purpose test" pursuant to Section 50d (3) sentence 2 alt. 1 GITA, in order to ensure that the provision complies with European law).[4]

---

1 *See also the German Federal Central Tax Office Guidance-Note on the interpretation of Section 50d (3) GITA, as of 3/2025.*
2 *See also the German Federal Central Tax Office Guidance-Note on the interpretation of Section 50d (3) GITA, as of 3/2025.*
3 *So-called pure conduit companies within the meaning of ECJ case law, judgements of 26 February 2019 - C-116/16, C-117/16 „T-Danmark and Y-Denmark.*
4 *Cf. RegE to the AbzStEntModG, BT-Drucks. 19/27632 S. 60.*

Relaxation of the "hypothetical relief claim" of the shareholders:

The wording of Section 50d (3) sentence 1 no. 1 GITA „insofar as their shareholders would be entitled to this claim in the event of an imaginary direct receipt of income from Germany" essentially permits the following two interpretations:

Strict interpretation in the sense of the explanatory memorandum („all-or-nothing principle"):[5]

According to the explanatory memorandum, the shareholder must, in deviation from the previously applicable version of the law[6], according to „the same entitlement provision" be entitled to discharge.[7] This is not the case even if the shareholder has the same amount of relief, but the entitlement arises from a different DTT.[8] Furthermore, Section 50d (3) GITA should also be applied at shareholder level, i.e. they must also be actively involved.[9] If, according to these criteria, there is no hypothetical claim for relief on the part of the shareholders, the claim should be denied in full. Only the complete denial of the claim for relief would prevent the incentive to engage in „experimental" tax structuring abuse.[10]

The relaxed interpretation within the meaning of the new Guidance-Note („insofar as interpretation"):[11]

According to the explanations in the new Guidance-Note, it is now only necessary to check whether there is an entitlement to relief on the merits, i.e. irrespective of the legal basis on which this entitlement to relief is based. In future, the entitlement to relief will only be restricted in terms of amount if the parties involved would have a lower entitlement to relief. This applies to both direct and indirect shareholdings. However, Section 50d (3) GITA should continue to be taken into account at the shareholder level insofar as corporations have a stake in the applicant.

Example:

- The applicant is a passive EU corporation that does not carry out any active economic activity of its own pursuant to Section 50d (3) sentence 1 no. 2 half-sentence 1 GITA and is also not itself listed on a stock exchange within the meaning of Section 50d (3) sentence 2 alt. 2 GITA. It holds a 100% interest in a German corporation that distributes dividends.
- Its sole shareholder is an actively operating corporation that is domiciled in a third country and, according to the DTT concluded with Germany, would only be entitled to 5% tax relief if the dividends were received directly from Germany. In turn, only natural persons are involved in the shareholder.
- According to the strict interpretation in the sense of the explanatory memorandum („all-or-nothing principle") described above, Section 50d (3) sentence 1 no. 1 GITA would not be relevant, as the shareholder would not be entitled to relief under the same standard (DTT vs. MTR).
- There would also be a risk that the applicant would not be able to successfully provide evidence to the contrary pursuant to Section 50d (3) sentence 2 Alt. 1 GITA. Due to the difference in the amount of relief, it could be argued that one of the main purposes of its involvement is to obtain a tax advantage.
- There would be a withholding tax deduction with offsetting effect in the full amount (26.375%).
- According to the new relaxed interpretation, the applicant is entitled to 5% relief.

Relaxation of the stock exchange clause:

Pursuant to Section 50d (3) sentence 2 half-sentence 2 GITA, the stock exchange clause requires that the main class of shares in the applicant is traded substantially and regularly on a recognised stock exchange. According to the explanatory memorandum regarding the law[12], the stock exchange listing of a shareholder is only sufficient if the shareholder is entitled to relief under the same provision or is resident in the same country as the applicant.

5 *E.g. Wagner, in: Brandis, Commentary GITA, Status: 174th Supp. vol. November 2024, Section 50d (3) margin no. 74, with further references.*
6 *§ Section 50d (3) GITA in the version of the Recovery Directive Implementation Act of 7 December 2011, BGBI 2011 I p. 2592, introduced with effect from 1 January 2012.*
7 *Cf. RegE to the AbzStEntModG, BT-Drucks. 19/27632 S. 58.*
8 *Cf. RegE to the AbzStEntModG, BT-Drucks. 19/27632 S. 59.*
9 *Cf. RegE to the AbzStEntModG, BT-Drucks. 19/27632 S. 58.*
10 *Cf. RegE to the AbzStEntModG, BT-Drucks. 19/27632 S. 58.*
11 *For example, Loschelder, in: Schmidt, GITA, 44th ed. 2025, Section 50d (3) margin no. 22.*
12 *Cf. RegE to the AbzStEntModG, BT-Drucks. 19/27632 S. 61.*

This view is further relaxed by the new German Federal Central Tax Office Guidance-Note. The prerequisite is that all intermediate companies also have an identical or higher claim to relief compared to the applicant and hold a 100% stake. Conversely, an indirect stock exchange listing is not sufficient if there is no continuous 100% shareholding chain or if an intermediate company would have a lower entitlement to relief compared to the applicant.

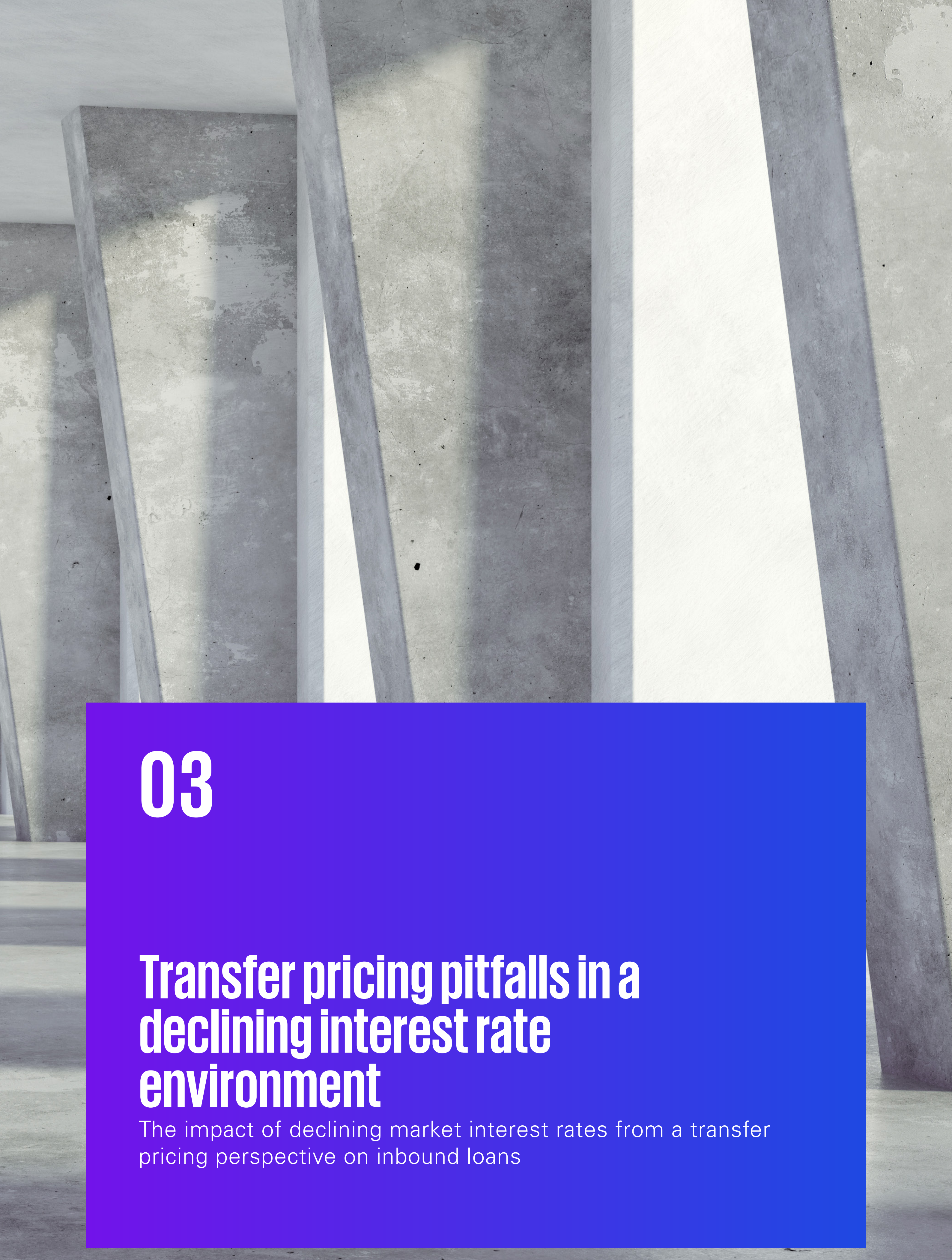
Example:

- The applicant is a passive EU corporation that does not carry out any active economic activity of its own pursuant to Section 50d (3) sentence 1 no. 2 half-sentence 1 GITA and is also not itself listed on a stock exchange within the meaning of Section 50d (3) sentence 2 alt. 2 GITA. It holds a 100% interest in a German corporation that distributes dividends.
- Its sole shareholder is a listed corporation that is domiciled in a third country and, according to the DTT concluded with Germany, would be entitled to 0% tax relief if the dividends were received directly from Germany. In turn, only natural persons are involved in the shareholder.
- According to the new Guidance-Note, the stock exchange clause applies. The applicant is therefore entitled to full relief.

Facts

- The new Guidance-Note is to be welcomed from a practical point of view, as it partially relaxes the strict and controversial substance requirements of Section 50d (3) GITA with regard to the „hypothetical relief claim of shareholders" (Section 50d (3) sentence 1 no. 1 GITA) and the „stock exchange clause" (Section 50d (3) sentence 2 alt. 2 GITA) and in this respect provides more legal certainty.
- The publication of an announcement by the tax authorities as a Guidance-Note, which is only available on the German Federal Central Tax Office's homepage and is typically not published in the Federal Tax Gazette (Bundessteuerblatt), is atypical. The Guidance-Note has been agreed with the Federal Ministry of Finance and is helpful in practice. Nevertheless, the legal quality of a mere Guidance-Note is questionable. An official publication as issued guidance from the Federal Ministry of Finance in the Federal Tax Gazette (Bundessteuerblatt) - as is usually the case - would therefore be welcome in order to document a higher level of binding force in the application of the law.
- It is noticeable that the title of the new Guidance-Note refers to „relief from German withholding tax on capital gains", which likely means only to dividends. In my opinion, however, nothing else can apply to license payments.

Alexander Hahn
Senior Manager
Tax Advisor
Tax Services



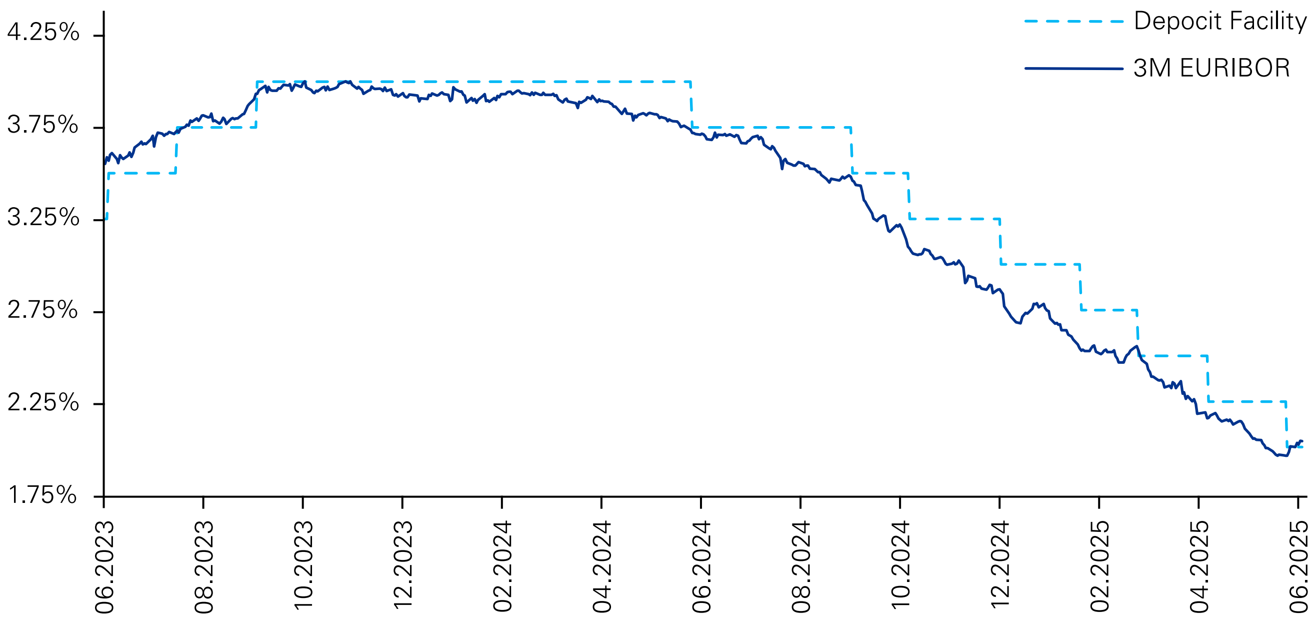
03

Transfer pricing pitfalls in a declining interest rate environment

The impact of declining market interest rates from a transfer pricing perspective on inbound loans

With the latest decision by the ECB, taxpayers are faced with a further decline in market interest rates, which has various implications on their intra-group financing relationships (e.g., shareholder loans). Borrowers increasingly need to consider whether refinancing existing liabilities could be a realistic option (or whether this might be assumed by the tax authorities during an external audit), while simultaneously ensuring that intra-group loan agreements are structured at arm's length.

On June 05, 2025, the European Central Bank („ECB") decided to lower the deposit facility rate by another 25 basis points, bringing it down to the current level of 2.00 percent. The decision to further reduce the interest rate reflects the updated assessment by the ECB's Governing Council regarding current inflation dynamics as well as uncertainty regarding the trade policy measures.[1] Following the deposit facility rate, the main refinancing operations is currently at 2.15 percent, while the marginal lending facility stands at 2.40 percent[2]. The ECB's decision marks the fourth consecutive reduction in the key interest rate level and the seventh since August 2024. The following figure illustrates the development of the deposit facility and the 3-month Euribor over the past two years. It can be seen that the refinancing rate in the form of the 3-month Euribor and the deposit facility exhibit a high correlation, showing a negative trend since the end of 2023.[3]



1 *Cf. European Central Bank, press release dated June 05, 2025; Monetary policy decision*
2 *As of: June 23, 2025*
3 *The picture is similar for the €STR, which is regarded as an alternative to the Euribor.*

In the context of the arm's length principle, which must be considered for cross-border transactions between affiliated companies, intra-group financial transactions must take into account the current developments in the interest rate environment. This means, for example, that a shareholder loan granted at the beginning of 2024, ceteris paribus, bears a higher interest rate than an identical loan granted in January 2025.

Given the influence of the general interest rate environment on the interest rate for intra-group loan transactions, both borrowers and lenders are faced with interest rate risks in the absence of hedging transactions, with the allocation of risks depending on the type of interest rate. In real estate financing, which typically has a fixed interest rate, the risk of a decrease in the interest rate level lies with the borrower, while the risk of an increase in the interest rate level lies with the lender. In the case of a variable interest rate, the parties involved take the opposite position, with the risk of a decrease in the interest rate level being borne by the lender and the risk of an interest rate increase by the borrower.

Due to the fact that intra-group loans (especially shareholder loans) for real estate financing are regularly equipped with an early termination option – typically without prepayment penalties („PP") – and considering the currently declining interest rate environment, the borrower rationally has the option to repay already existing liabilities, for example, through external refinancing. The borrower would now have the option to receive a loan at a lower interest rate and thus repay the existing intra-group loan that was issued in a high interest rate environment. This would result in a decrease of future interest expenses and an increase of pre-tax earnings. German tax authorities regularly imply this behaviour in external tax audits covering fiscal years also with a declining interest rate environment especially from 2012 until 2019 for intra-group (inbound) loans, which were originally provided in a high rate interest rate environment, to enforce an adjustment (reduction) of the interest rate and thus increase the tax base. This behavior by the German tax authorities is also to be expected for tax audits of fiscal years starting from 2024.

Based on our experience, the tax authorities would, in addition to examining the interest rate in terms of its basis and amount according to sec. 1 para. 3d Foreign Tax Act[4] also assess whether it would be advantageous to exercise the early termination option without prepayment penalties, repay the loan, and take out a new one at a more favorable interest rate.

Example

- A shareholder loan of EUR 50 million was granted in December 2023 to finance a property at an arm's length interest rate of 6.5 percent, with a term of 10 years and an early termination option without PP, resulting in EUR 3.25 million in annual interest expenses.

- The tax audit now covers the period from 2024 onwards.

- The benchmark study to justify the interest rate and the debt sustainability analysis were fundamentally accepted.

- However, due to the fallen interest rate environment (assuming no change in the market value of the property), the arm's length interest rate for the same risk investment would now be 4.5 percent in June 2025, which is 2 percentage points lower.

- The tax authorities assume that a prudent and diligent business manager would have exercised the early termination option, refinanced at 4.5 percent, and thus paid 2 percentage points (i.e., EUR 1 million in annual interest expenses) less in the future.

- Consequently, the tax authorities would adjust the taxable income by EUR 1 million annually for the following years, typically leading to an additional cash tax burden (usually up to approximately EUR 300,000 per year).

Recommendations for action

For existing intra-group loans, the following recommendations can be identified:

- Check whether early repayment is contractually provided for and whether prepayment penalties would apply.

4 *Cf. John, Ronny & Mölleken, Christoph: Real Estate Tax Newsletter, 2nd edition 2024.*

- Examine whether, in the case of additional bank financing for the property, clauses in the bank loan agreement allow for early repayment of the intra-group loan.

- Determine the interest loss due to the decreased market interest rate environment (possibly considering a changed market value of the property) and thus identify the potential tax risk.

For new intra-group loans to be concluded:

- Conduct a transfer pricing analysis in accordance with se. 1 para. 3d Foreign Tax Act and the Administrative Principles on Transfer Pricing 2024.

- Agree on an early repayment option with prepayment penalties in the loan agreement.

- Include a clause for the arm's length determination of prepayment penalties in the loan agreement.

Facts

With its latest interest rate decision, the ECB has once again adjusted the interest rate level downward. The interest rate environment thus remains in a dynamic state, which has various implications for intra-group financial transactions. Borrowers should regularly check whether there is an opportunity for early repayment of intra-group liabilities and whether this would be advantageous from the borrower's perspective. If advantageous, this could potentially result in a tax risk that needs to be determined. At the same time, when concluding new intra-group loan transactions, in addition to an arm's length interest rate and debt sustainability analysis, it should also be ensured that an early termination option is included, and a prepayment penalty is agreed upon to address tax risks in the event of a further decline in the interest rate environment.

Ronny John
Partner
Tax Advisor
Financial Services Tax

Dr. Christoph Mölleken
Manager
Financial Services Tax

04

Residential portfolio and German inheritance/gift tax

Transfer of company property portfolios to successors on preferential rates or even tax-free where applicable

Extensive real estate portfolios are a major topic in inheritance and gift tax consulting, as the transfer of real estate assets can trigger large tax amounts and potentially force the acquirer to sell assets to pay the tax. However, under certain conditions, there is the possibility within the framework of a so-called housing company to transfer a business real estate portfolio to the successor with tax benefits or even tax-free. The housing company is subject to strict conditions, which the FG Münster addressed in a recent ruling dated October 10, 2024.

Why it could become increasingly difficult to meet the requirements of a housing company at this time and what implications arise for practice are outlined below.

The Basic Benefit Rules

For real estate rented for residential purposes, inheritance and gift tax law grants a relief of 10 percent in § 13d ErbStG. This means that only 90 percent of the real estate value is considered in the valuation and subject to taxation.

For business assets, on the other hand, reliefs of 85 percent under the regular exemption or even 100 percent under the optional exemption may be possible. Compared to private assets, there is generally a higher tax exemption.

In exceptional cases, companies that own exclusively rented apartments can also claim the high benefits for business assets. However, this requires that the company does not have too much so-called harmful administrative assets. This harmful administrative asset regularly includes properties that are leased to third parties. This can be a problem for real estate companies, as a result of which a benefit and thus a tax relief are excluded.

But: The legislator works here with an exception, which states that properties leased to third parties do not belong to harmful administrative assets if a housing company exists. With this regulation, the legislator wants to spare commercially active companies that also employ workers.

Requirements for a Housing Companys

To benefit from this exception, all of the following three requirements must be met:

- The real estate belongs to a business asset,
- the main purpose of the business is the rental of apartments, and
- the activity requires an economic business operation.

The FG Münster had to particularly consider the third requirement and judge whether the operation of a housing company that provides certain additional services alongside rental requires an economic business operation or not.

Opinion of the FG Münster

The FG Münster decided that the requirements of the housing company must be interpreted narrowly and cannot be considered fulfilled simply because the leasing of properties is accompanied by offered, optional commercial services. It is rather important that the main purpose of the business is the rental of apartments, whose fulfillment requires an economic business operation. Accordingly, only services that the tenant must obligatorily use and for which they have no choice should be included.

As a result, it is not sufficient that the apartments are in the business assets of a commercially active company. For a commercial rental activity, the pure asset management – here the rental – must step back behind the commercial activity.

A commercial rental activity can be assumed in individual cases if the landlord provides unusual special services – e.g., cleaning, guarding the building, providing and monthly changing bed linen, or maintaining a sick room – or if a company organization is required due to constant tenant changes.

What follows from the judgment and for whom is it significant?

The judgment of the FG Münster goes beyond the previous case law on housing companies, as the previously required „original business character“ in the sense of a commercial enterprise was present in the case and yet a tax benefit was denied. Furthermore, the judges presented an even more restrictive interpretation, according to which the existence of a housing company „should only rarely be applied.“

The current judgment is of enormous importance for entrepreneurs who are considering (or have to consider) transferring a business that primarily leases residential properties. If the increasingly narrow requirements of the housing company cannot be met and the judgment of the FG Münster should stand before the BFH, only the number of rented apartments can enable a tax benefit.

Because the tax administration has bound itself by the regular presumption in the inheritance tax guidelines, according to which a housing company is assumed if the main purpose is the rental of residential space and more than 300 apartments are rented at the time of taxation. Even the current judgment should not change the binding effect, as in the judgment case, a company was explicitly transferred that comprised less than 300 apartments.

Facts

For possible transfers of potential housing companies, the number of rented apartments – up to and including 300 apartments or more than 300 apartments – remains a decisive factor. To ensure that you still have reaction options in the event of a possible rejection by the tax administration, you should therefore include corresponding reclaim rights in the gift contracts. Here, too, careful and forward-looking tax planning can be more than „half the battle“ to benefit from tax advantages.

Stefan Bethlehem
Partner
Tax Advisor
Corporate Tax Services

Falko Fiedler-Schliemann
Manager
Tax Advisor
Corporate Tax Services

05

Incorrect declaration of building area in property tax return

Correction of declared data can lead to significant savings

Although for most taxpayers the property tax reform has long been mentally completed, the extent of the reform is only now becoming apparent through the issuance of property tax notices by municipalities and cities. The sometimes significant increases in property tax are not always solely due to the system change and the revised calculation bases. It is only now becoming clear what material impacts incorrect information provided by taxpayers in their property tax returns can have.

The timely submission of all property tax returns posed significant challenges, especially for taxpayers with a large number of properties. Relevant data, such as the building area, was often not available in suitable quality. Additionally, depending on the assessment method and federal state, distinctions had to be made between gross floor area, usable area, and living area. Experience shows that many taxpayers, out of caution, lack of knowledge, and not least due to time constraints, declared an incorrect and often too large building area. It is precisely the building area that represents one of the largest value drivers of property tax.

In a recent practical case, the taxpayer declared the significantly higher gross floor area for his commercial property in Hesse, where the usable area according to DIN-277 should have been declared. The tax office assessed the data according to the taxpayer's information. The recently issued property tax notice shows that the annual additional burden resulting from the incorrect building area was almost €50,000.

Many property owners are currently asking whether the incorrect information in their property tax return can still be corrected, even if the tax office notice has long been issued and the appeal period has expired. Although a retroactive change is not possible in such a case, the incorrect determination can be corrected for future assessments according to § 222 Abs. 3 of the Valuation Act (analogous regulations in the state property tax laws). The so-called corrective notification is possible within the framework of a new property tax return. Therefore, it is advisable, especially in cases of high property tax burdens, to subject the declared values to a quality check again. In the aforementioned practical case, the property owner did this and is now pleased with significant annual savings on property tax.

Facts

The property tax reform has led to a significant increase in the property tax burden, especially for commercial real estate.

This is often due to inaccurate information provided by the taxpayer, particularly with regard to building areas.

By correcting the incorrect information, the property tax burden can be reduced for the future.

Jürgen Lindauer
Director
Tax Advisor
Corporate Tax Services

Jan Tietje
Manager
Tax Advisor
Corporate Tax Services

06

Real Estate Transfer Tax – Latest Court Decisions

New Federal Fiscal Court rulings on the real estate transfer tax treatment of shareholder changes (Section 1 (2a) and (2b) GrEStG)

Section 1 (2a) GrEStG stipulates that a transaction is subject to real estate transfer tax if at least 90% (until June 30, 2021: 95%) of the shares in the company assets of a land-owning partnership are transferred directly or indirectly to new shareholders within ten years (five years until June 30, 2021). The legislator only defined when an indirect transfer of shares to new partners exists in sentences 2 to 5 from November 6, 2015. The two rulings explained below clarify how these rules are to be understood and thus clarify when an indirect transfer of shares is deemed to have taken place.

The rulings should also apply accordingly to land-owning corporations. This is because, as of July 1, 2021, the legislator introduced a correspon-ding rule for corporations with Section 1 (2b) GrEStG.

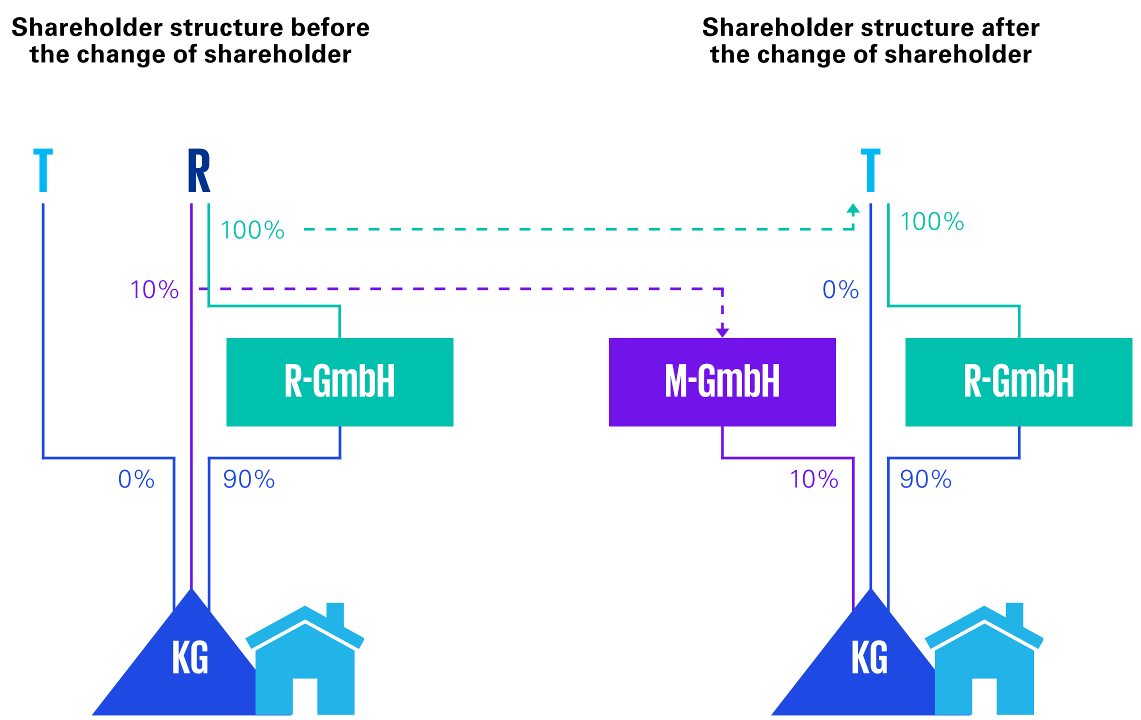
1. Change of shareholder who holds an interest in a land-owning partnership via a corporation (BFH ruling of July 31, 2024, II R 28/21):

The case occurred before July 1, 2021, so the old limits of 95% and five years still applied. However, it should be applicable accordingly for cases from July 1, 2021.

For more than five years, the shareholding structure in a land-owning limited partnership („KG") was as follows:

The general partner without an interest in the partner-ship assets was T. As limited partners, R held a 10% interest in the partnership assets and R-GmbH held a 90% interest. R held all shares in R-GmbH on a fiduciary basis for a third party.

With effect from December 31, 2016, R transferred his shares in R-GmbH to T, who continued to hold it on a fiduciary basis for the third party. At the same time, R transferred its direct limited partnership interest of 10% to M-GmbH. The following diagram illustrates the change of shareholders:



The tax office assessed real estate transfer tax against the KG, as all shares in the company's assets had been transferred to new partners as of December 31, 2016. This was because R's direct shareholding of 10% in the company's assets had been transferred to M-GmbH and R-GmbH's shareholding of 90% had been indirectly transferred to T.

The KG objected to this on the grounds that, although all shares in R-GmbH had been transferred, this was not an indirect transfer to a new shareholder. This was because T had already held a direct interest in the KG for five years and was therefore a so-called existing shareholder.

The BFH took a different view.

When assessing who is considered a new shareholder of a corporation that holds a stake in a property-owning partnership, only the corporation itself is to be taken into account, not the property-owning company.

This means that T became a „new shareholder" of R-GmbH as of December 31, 2016, as he had not previously held a stake in the company. The fact that T was a so-called existing shareholder of the property-owning KG is irrelevant.

R-GmbH's 90% stake in the KG was thus indirectly transferred to the „new" shareholder T. With the simultaneous transfer of R's 10% shareholding to the new shareholder M-GmbH, there was a complete change in the KG's shareholder structure on December 31, 2016, so that, in accordance with Section 1 (2a) sentence 1 GrEStG, the real estate transfer tax was correctly assessed against the KG in the opinion of the BFH.

2. Change of shareholder who holds an interest in a real estate-owning partnership via partnerships (BFH ruling of August 21, 2024, II R 16/22)

The facts of the case that the BFH had to decide on were as follows:

All shares in a land-owning KG's assets were held by a partnership. In turn, X-KG held an interest in this partnership.

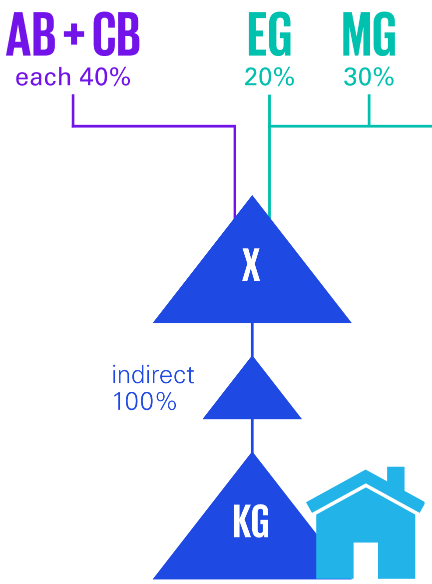
The shareholders of X-KG were AB and CB (20% each), EG (20%), MG (30%) and TG (10%). The following share transfers took place on December 17, 2015:

EG transferred 10% each to MG and TG. MG and TG then contributed their shares in X-KG to Y-Srl and Z-Srl (corporations under Italian law) respectively.

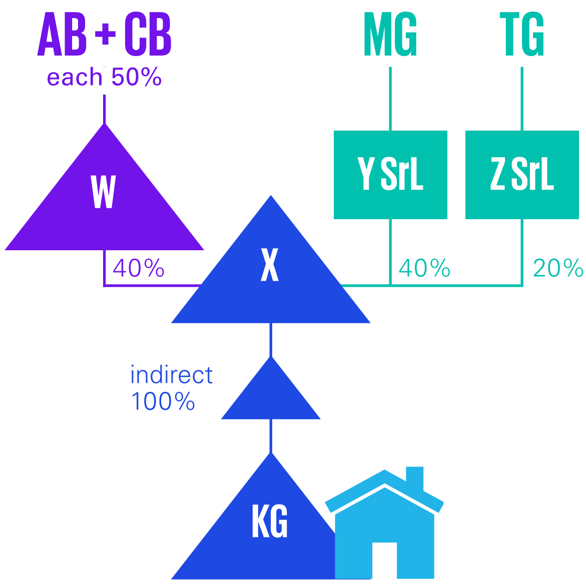
AB and CB contributed their shares in X-KG to the new W-KG.

The following diagram illustrates the change of shareholders:

Shareholder structure before the change of shareholders



Shareholder structure after the change of shareholder



In the opinion of the tax office, the conditions of Section 1 (2a) GrEStG were met because all shares in X-KG were transferred to the new shareholders W-KG, Y-Srl and Z-Srl. As a result, all shares in the land-owning KG were also indirectly transferred to new partners. The tax office based its decision on the identical decrees issued by the supreme tax authorities of the federal states on the application of Section 1 (2a) GrEStG in the version applicable in 2015. The current decrees on Section 1 (2a) GrEStG (BStBl 2022 I p. 801) contain a corresponding provision.

The BFH rejected the view of the tax office and expressly contradicted the administrative instructions.

Indirect changes in the shareholder structure of the partnerships participating in a partnership would be taken into account pro rata by multiplying the percentages of the shares in the partnership assets in accordance with Section 1 (2a) sentence 2 GrEStG. The BFH concludes from this, that the legislator considers partnerships to be transparent within the scope of Section 1 (2a) GrEStG, so that the persons behind them must be taken into account. Therefore, the W-KG should also be seen through.

According to the BFH, this rules out an indirect change of shareholder within the meaning of Section 1 (2a) GrEStG because at least AB and CB each continue to indirectly hold a 20% stake in the company owning the land.

The BFH only hinted at whether Y-Srl and Z-Srl are to be regarded as new indirect shareholders of the land-owning KG or whether the persons behind them should also be taken into account here, but did not expressly decide.

Facts

According to the BFH ruling of 31.07.2024 (II R 28/21), the question of whether a partner who holds an interest in a land-owning partnership via a corporation is an (indirect) old or new partner of the partnership only depends on how long they have held an interest in the corporation. Previous direct holdings in the land-owning partnership itself are – counter-intuitively – not taken into account. In this respect, the tax authorities and the BFH are in agreement.

However, if a partner holds an interest in a land-owning partnership via one or more partnerships, he can, in the opinion of the BFH[1], insert another partnership between himself and the partnerships without this having any relevance for the realization of Section 1 (2a) GrEStG[2]. The BFH thus contradicts the applicable administrative instructions. The tax authorities have not yet reacted to the ruling. The cases must therefore continue to be reported. It is possible that they will adhere to their opinion, tax the corresponding cases and thus force the taxpayer into legal proceedings.

The BFH has left open the question whether corporations can also be interposed above a chain of partnerships without a relevant transaction taking place. Based on indications in the ruling, this seems likely.

In certain constellations, the ruling of August 21, 2024 (II R 16/22) could also be applicable in favor of the taxpayer if a chain of companies consisting of partnerships and corporations exists between a partner and the partnership owning the real estate.

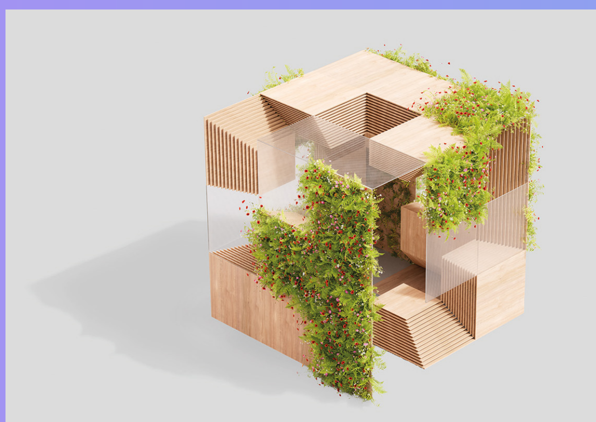
To the extent that the ruling is already used for structuring purposes, care must be taken to ensure that neither the newly interposed partnership nor another party holds 90% or more of the shares. Otherwise, there would be a taxable merger of shares pursuant to Section 1 (3) or (3a) GrEStG if no tax exemption applies. In this case, the BFH would also be take the position that this would result in taxation.

Both rulings should apply accordingly to land-owning corporations (Section 1 (2b) GrEStG).

Stephanie Keßner
Partner
Lawyer, Tax Advisor
Financial Services Tax

Marcus Stanzel
Senior Manager
Lawyer, Tax Advisor
Financial Services Tax

1 *BFH ruling of August 21, 2024, II R 16/22.*
2 *However, if the intermediary partnership holds 90% or more of the shares, this may trigger real estate transfer tax pursuant to Section 1 (3) GrEStG, insofar as no tax exemption is applicable.*



Contact

KPMG AG
Wirtschaftsprüfungsgesellschaft

Stefan Kunze
Head of Real Estate Tax
Partner, Tax Advisor
T +49 89 9282-6894
skunze@kpmg.com

Katrin Bernshausen
Financial Services Tax – Real Estate
Partner, Tax Advisor
T +49 69 9587-3172
kbernshausen@kpmg.com

Impressum

KPMG AG
Wirtschaftsprüfungsgesellschaft
Ganghoferstraße 29
80339 München