

The minimum value may not be less than if the real estate were valued as undeveloped land.

Special Cases of Developed Real Estate (§ 147 Valuation Act)

Developed real estate that is not rented out and for which it is impossible to establish a comparable rent must be valued by a method other than the gross rental method. This includes, in particular, typical commercial or industrial sites such as:

- buildings for specific manufacturing processes
- buildings with special uses
- buildings with specific technical installations that cannot be put to a different use, or only at considerable expense

real estate value = value of land (size of land x standard land value x 70%)
+ value of the building (= value for income tax purposes on the effective date)

**Heritable Building Rights (§ 148 Valuation Act)/
Buildings Located on Third-Party Land (§ 148a Valuation Act)**

The value of plots encumbered with heritable building rights or buildings located on third-party land is based on the total value of the developed real estate. The value of the land is allocated to the owner (of the land), the value of the building(s) to the holder of the heritable building right or the owner of the building. If the heritable building right expires within less than 40 years and if a compensation has been precluded, the value of the building must be divided between the owner and the holder of the heritable building right.

New Regulations Affecting Real Estate Value

Following the ruling of the Federal Constitutional Court according to which the inheritance and gift tax law as in force in 2006 infringed upon the equal rights enshrined in the constitution, new rules on real estate values were adopted by the legislature for inheritance and gift tax law purposes, but not for real estate transfer tax purposes. The principle of valuation as and when required (*Bedarfsbewertung*), which continues to be applicable for real estate transfer tax purposes, is regarded as unconstitutional by the Federal Tax Court (BFH), which referred the issue to the Federal Constitutional Court for decision on 2 March 2011.

Value-Added Tax

The tax rate is 19% (reduction to 7% as appropriate).

Real Estate Transactions

Sale of a business as a going concern, § 1 (1a) VAT Act

This applies if the essential assets (wesentliche Betriebsgrundlagen) of a business or separately managed unit (branch of activity) are transferred to a purchaser for purposes of the purchaser's business. In particular, all essential business assets (such as rents or leases) must be transferred, and the continuation of the business must be possible without major financial efforts. The sale of a business as a going concern is not subject to VAT; it results in the continuation of the adjustment period according to § 15a VAT Act by the purchaser. Moreover, the rules and regulations regarding the liability of the acquirer of a business (§ 75 Tax Procedure Law, AO) apply.

Taxable sale of land (§ 4 no. 9 lit. a, § 9 VAT Act)

To the extent that a sale of a business as a going concern cannot be assumed, the transaction is, as a rule, deemed to be a VAT-exempt supply of land pursuant to § 4 no. 9 lit. a VAT Act. This is subject to the proviso that the transaction is governed by the RETT Act. Transfers of movable assets and permanently installed equipment are not governed by the RETT Act even if they are mentioned in the

contract for sale. Such transfers are always subject to VAT. Where the transaction is a VAT-exempt supply of land, the exemption from the VAT liability can be waived (so-called VAT option). It is required, amongst other things, that the waiver is agreed in a contract notarized by a civil law notary in accordance with § 311b (1) German Civil Code. The option may be limited to particular parts of the plot. If the option is used, the reverse charge mechanism applies. VAT is then owed by the purchaser. VAT liability of the recipient of the service must be indicated on the invoice. An invoice without VAT must be issued. Even if agreed in the contract that RETT is owed solely by the purchaser, RETT does not increase the assessment basis for VAT.

Renting out of real estate

The renting out/leasing of real estate is generally tax-exempt under § 4 no. 12 lit. a VAT Act.

Exceptions from tax-exempt renting out

- letting of living and bedrooms for the purpose of short-term accommodation of guests (7% VAT).
- short-term letting of camping sites (7% VAT)
- renting out of sites for parking vehicles (may however be an ancillary service related to tax-exempt renting out)
- letting of permanently installed equipment (business fixtures)

The recipient is liable to pay VAT where transactions are subject to RETT and the recipient 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, because, according to Federal Tax Court ruling and the tax authorities, RETT is owed by the purchaser solely.

VAT option pursuant to § 9 VAT Act

The exemption from the VAT liability can be waived (so-called VAT option). This applies where the sale is made to an entrepreneur for business purposes. In addition, the waiver is only permissible to the extent that the tenant makes use of or intends to make use of the plot of land for transactions that do not preclude the deduction of input tax. This does not apply to legacy cases (buildings that were completed prior to 1 January 1998 and whose construction commenced prior to 11 November 1993). Limited use for VAT-exempt purposes does not affect the possibility to make use of the VAT option (threshold 5%).

Deduction of Input VAT

Input VAT can be deducted provided the property or parts of it are used for taxable transactions.

Allocation of Input VAT

If input tax cannot be clearly allocated, it must be apportioned by estimate (§ 15 (4) VAT Act). In this case, the determination of the non-deductible portion of input tax based on the ratio of sales which do not entitle to the input tax deduction in relation to the sales which entitle to the input tax deduction is permissible.

The tax authorities have special requirements for input tax deduction where buildings are used partly for business purposes or in the case of mixed-use properties.

Input tax Adjustment according to § 15a VAT Act

If the circumstances for the deduction of input tax relating to a property held as fixed asset change within ten years of its initial use, an adjustment of input tax on a pro rata temporis basis is required. There is no statutory adjustment period for current asset real estate, so that an adjustment of input tax must be made when-

ever the circumstances change. Where goods become a direct part of the income-generating real estate, or services are performed on the income-generating real estate subsequently, or where subsequent acquisition or construction costs are incurred, these are each adjusted separately. The disposal or withdrawal of a plot of land can lead to a change in the circumstances originally determinative for the input tax deduction.

Further Relevant Aspects of Real Estate Taxation

Withholding Tax on Construction Work

If a provider renders construction work in Germany for

- an entrepreneur (Unternehmer) within the meaning of German VAT Law, or
- a legal person under public law, the recipient is required to withhold 15% tax on the consideration (payment including VAT) for the account of the provider.

Exceptions:

- The provider submits a valid exemption certificate to the recipient at the time payment is made.
- The recipient only carries out non-taxable transactions within the meaning of § 4 no. 12 sent. 1 VAT Act and the consideration is expected not to exceed €15,000 p.a.
- The consideration is expected not to exceed €5,000 p.a. in all other cases.
- Construction work for apartments, if the recipient rents out no more than two residential units.

If you have any suggestions or queries, please contact:

Stefan Schmidt
T +49 69 9587-2160
stefanschmidt@kpmg.com

Dr Stefanus Figgenger
T +49 69 9587-2103
sfiggenger@kpmg.com

Tobias Hoffmann
T +49 30 2068-4458
tobiashoffmann@kpmg.com

Marco Müth
T +49 69 9587-3347
mmueth@kpmg.com

Uwe Demel
T +49 221 2073-1935
udemel@kpmg.com

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German Real Estate Tax Card 2014/2015

Determination of Income

Tax Depreciation on Buildings

Straight line depreciation in accordance with German Income Tax Law

Provided a building constitutes a business asset, is not used for residential purposes and the application for the building permit was made after 31 March 1985, the depreciation rate for acquisition and construction costs after 31 December 2000 is 3% (for acquisitions and constructions before 1 January 2001: 4%). If this is not the case, the following applies:

completion after 31 December 1924	2%
completion prior to 1 January 1925	2.5%

Other tax depreciation regulations

- Declining balance depreciation may no longer be applied to new buildings (building application/executory contract on or after 1 January 2006).
- Depreciation on buildings in redevelopment and in urban development areas as well as on historical buildings may be accelerated under certain conditions.

Financing Costs

Interest and other financing costs are fully deductible as costs of earning non-business income provided there is a commercial nexus to the rental income. Where interest is incurred by a business (also applicable for a foreign corporation with domestic income), the so-called earnings stripping rules must be observed. The earnings stripping rules place an annual cap of 30% of EBITDA as calculated under tax law on the net interest expenses of any business taxable in Germany. EBITDA is the taxable profit prior to application of the earnings stripping rules plus interest expenses and tax depreciation less interest income. Unused deduction volumes may be carried forward to the following business years, however, such tax EBITDA carry forward is limited to a maximum period of five years. Non-deductible interest expenses may be carried forward to the following years (interest carry forward). There are certain exceptions to the earnings stripping rules. In particular, the earnings stripping rules do not apply where interest expense exceeds positive interest income by less than €3 million (de minimis threshold). However, the Federal Tax Court expressed serious doubts about the constitutionality of the earnings stripping rules.

Repair and Maintenance Expenses – Acquisition-Related Construction Costs

Regarding the distinction between immediately deductible repair and maintenance expenses and subsequent costs of construction that are only deductible by way of depreciation, German tax rules stipulate that expenses for repair and modernization carried out within three years of the purchase of the building also fall under acquisition-related construction costs, if the expenses exclusive of VAT exceed 15% of the original acquisition costs of the building. Otherwise, they are deemed repair and maintenance expenses, for example, where regular annual maintenance is concerned.

Trading in real estate is deemed to be commercial where purchase and sales activities exceed the limits of private asset management. It results in the taxation of profits from the sale of real estate irrespective of the period of ownership and leads to a trade tax burden on rental income. Corporations and partnerships who are qualified as property traders cannot claim the extended trade tax reduction (§ 9 no. 1 sent. 2 Trade Tax Act). Furthermore, where trading in real estate is commercial, no ordinary depreciation on the value of buildings is permitted since the real estate represents current assets held for trading. The sale of up to three properties within a five-year period (in the case of members of the industry: ten-year period) must in principle be regarded as private asset management (except for, inter alia, ‘big tickets’).

Offsetting of Losses

Up to a maximum of €1 million, losses can be carried back to the immediately preceding assessment period. Loss carry forwards are not limited in time, but where a base amount of €1 million is exceeded, only up to 60% of the portion of adjusted combined net income that exceeds €1 million can be deducted. For trade tax purposes, losses can only be carried forward; here, too, the 60%-limit and the €1 million base amount apply.

Private Sales Transactions

Profits from the sale of land are subject to tax if the time elapsed between purchase and sale is less than ten years. Exceptions apply where the property is owner-occupied. The profit or loss is the difference between the selling price and the cost of purchase or construction, less depreciation, write-offs and selling costs.

Taxation of Alternative Investment Funds

According to the Capital Investment Act real estate investors can invest in several different Alternative Investment Funds (AIF) like the German open-end AIF (Sondervermögen), the closed-end Investmentkommanditgesellschaften with fixed capital (InvKGs), the Investmentaktiengesellschaften with fixed capital (InvAGs) and foreign investment vehicles. The taxation of the AIF is regulated by the Investment Tax Act with three different regimes for the taxation of investment funds, the taxation of partnership-type investment companies and the taxation of corporation-type investment companies.

Taxation as Investment Fund

Open-ended AIFs which, according to the principles of risk diversification, invest only in certain asset types such as real estate, etc. and are controlled by the supervisory authority, can in principle qualify as investment funds. Apart from other requirements that must be met, the AIF must observe certain financing limits and there may be no active entrepreneurial management of the assets. AIFs are considered to be ‘open-ended’ if investors have the right to redeem their shares at least once a year. Taxation as investment fund follows the transparent regime, but only to a certain extent (eingeschränktes Transparenzprinzip), as laid down by the Investment Tax Act, i.e. income generated by the fund is taxed at the level of the investor, with the tax being levied irrespective of whether profits are distributed or retained. Domestic investment funds are exempt from corporate income tax and trade tax. Under income tax law, distributed and retained earnings of real estate investment funds are treated as investment income for the investor (§ 20 Income Tax Act). AIFs which do not meet the requirements stipulated for investment funds are treated as investment companies.

Taxation of Partnership-Type Investment Companies

Investment companies in the legal form of a German investment partnership (Investmentkommanditgesellschaft, InvKG) or a comparable foreign legal form are subject to the transparent taxation regime applicable to partnerships. Depending on the structure of the AIF, investors generate income from rental or usufructuary leasing (§ 21 Income Tax Act), income from capital investment (§ 20 Income Tax Act) or commercial income (§ 15 Income Tax Act).

Taxation as Corporation-Type Investment Company

Investment companies that are not investment partnerships are investment corporations. Investment funds and comparable foreign AIFs are treated as investment corporations if they fail to qualify as investment fund. Investment corporations are fully subject to corporate income and trade tax. Distributed earnings of investment corporations are treated as investment income (§ 20 Income Tax Act) for the investor.

Trade Tax

Every operational business with a permanent establishment in Germany is subject to trade tax, which is an impersonal tax. Commercial real estate companies are also subject to trade tax. These companies may reduce their trade income by a flat rate of 1.2% of the assessed value of the real estate increased by 140% if the real estate constitutes part of their business assets. Real estate companies whose object is to manage or utilize their own real estate, or conduct ancillary activities having no detrimental effect, may, as an alternative to the flat-rate reduction of the taxable amount, make a higher reduction. The flat-rate reduction is in that case replaced by a reduction in the amount of the trade income allocated to the management and utilization of their own real estate. This is subject to the following provisions:

- asset management only (ancillary activities having no detrimental impact are the management and utilization of a company's own capital assets and the care of residential buildings, and the construction and sale of single-occupancy or duplex housing and owner-occupied apartments; the earnings from these ancillary activities are subject to trade tax)
- no utilization of the real estate within the business establishment of a shareholder
- no co-letting of permanently installed equipment and/or movable assets (so-called ‘business fixtures’) and no provision of ancillary commercial activities by the real estate company

Real Estate Tax

Like trade tax, real estate tax is an impersonal tax, i.e. the owner's personal circumstances are disregarded almost without exception. The taxable object is real estate (for example land and buildings). Real estate tax is computed as follows:

	assessed value (values as at 1 January 1964; new German federal states as at 1 January 1935 or substitute tax base)
x	basic federal rate (for agricultural and forestry undertakings: 6‰, otherwise old federal states: 2.6–3.5‰, new federal states 5–10‰).
=	base value
x	municipal multiplier (for example Düsseldorf as of 2008: 440%, agricultural and forestry undertakings: 156%)
=	real estate tax

At the moment, a case dealing with the question as to whether the valuation of real estate based on assessed values is constitutional is pending by the Federal Constitutional Court. Until a decision is handed down, assessed values of real estate are therefore only determined provisionally and may subsequently be amended officially by the financial authorities, if necessary.

Under certain circumstances, owners can apply for a partial waiver of 25% of the assessed real estate tax for the preceding calendar year by 31 March of the following year, provided the owner is able to prove that the gross profit generated by the property declined by 50% or more without the owner being responsible for the decline. In the event of a total loss of gross profit for which the owner is not responsible, 50% of the assessed real estate tax is waived.

Real Estate Transfer Tax (RETT)

The following transactions in particular are subject to RETT:

- contracts for sale and other legal transactions under which a party acquires a civil law right to the transfer of title to domestic real estate
- the highest bid in a sale by way of public auction ordered by a court
- legal transactions directed at the legal or economic exploitation of a plot of land
- the direct or indirect change of the partners in a partnership – holding real estate – within five years through the transfer of at least 95% of the partnership interest to new partners (change of partners rule)
- without time limit the transfer or unification of at least 95% of the shares in a company holding real estate, directly or indirectly
- legal procedures due to which a legal entity directly and/or indirectly holds – from an economic perspective – a minimum of 95% in a company holding real estate

The same status as real estate is accorded to the hereditary building right and to buildings located on third party land.

Exemptions – in particular

- the transfer of property by reason of death
- gifts inter vivos
- the purchase of real property making up part of a decedent's estate by joint heirs for the purpose of dividing the inheritance
- purchase by the seller's spouse or registered civil partner
- purchase by persons related in the direct line to the seller
- re-acquisition by the trustee on cancellation of the trust relationship
- transfer to and from a community of joint owners – pro rata exemption
- transformation from joint ownership to individual ownership
- certain privileged procedures in a group of companies based on the Reorganization Act or in case of contributions and other corporate level procedures – full exemption.

The tax is computed on the value of the consideration given or the value of the real estate. The tax rate is 3.5–6.5% depending on the German State in which the real estate is situated.

Real Estate Value

The values of domestic real estate and commercial property are to be established separately if so required for taxation purposes (for inheritance tax and gift tax as well as for RETT) (valuation as and when required). As of 1 January 2007, real estate valuations must take into account actual values and values on the effective date of taxation. Taxpayers may furnish proof of a lower market value as the actual value of the real estate.

Undeveloped Real Estate:

property value = size of land x standard land value x 80%. The standard land value is fixed by a local committee of valuation experts in accordance with the Town and Country Planning Code.

Developed Real Estate:

Developed real estate must be valued independently of its use (for example rented, owner-occupied) by the gross rental method.
real estate value = agreed annual rent at the effective date or local comparable rent x 12.5
– a value markdown of 0.5% per annum since the property was ready for use; max. 25%.
+ a markup of 20% for real properties accommodating no more than two residential units, in particular single-occupancy houses or duplexes used solely for residential purposes.