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REAL ESTATE TAX GUIDE

GERMANY



QUICK OVERVIEW OF GERMAN REAL ESTATE

Preliminary considerations

Individuals that carry out rental activities in Germany are subject to income tax, whereas corporations are subject to corporate tax.

Additionally, the rental activities can be subject to a so-called 'trade tax'. The tax is imposed by local communities and tax rates vary from municipality to municipality.

If the rental activity in Germany is carried out through an individual, the income is only subject to trade tax if the income is considered as 'business income'. This can be the case if the landlord provides additional services such as cleaning or a concierge service to his tenant. Apart from this, business income is generally assumed if the landlord acquires and sells more than three properties within five years. Although the trade tax may be partially offset against the income tax obligation, an effective tax burden will remain in most cases.

If the rental activity is carried out through a German-based corporation, the corporation itself will be subject to trade tax since German based corporations are always considered to receive business income. If among other prerequisites, the landlord does not provide additional services such as cleaning or concierge service to his tenant and if the property is sold at the end of the year, the corporation may benefit from a trade tax exemption for the rental activities as well as the capital gain. A trade tax liability cannot be offset against a corporate tax liability.

A substantial reform of the land transfer tax is currently planned, which is expected to apply to transactions from 1 January 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.

Rental income and capital gains of German real estate

It is assumed that no income is subject to trade tax.

| Taxpayer | Basis of tax | Tax levied | Tax rates (2019) |
|-------------------------|----------------------|-----------------------|------------------|
| Resident individual | <i>Rental income</i> | Individual income tax | Up to 47.475% |
| | Capital gains | Individual income tax | Up to 47.475%* |
| Non-resident individual | <i>Rental income</i> | Individual income tax | Up to 47.475% |
| | Capital gains | Individual income tax | Up to 47.475%* |
| Resident company | <i>Rental income</i> | Corporate income tax | 15.825%** |
| | Capital gains | Corporate income tax | 15.825%** |
| Non-Resident company | <i>Rental income</i> | Corporate income tax | 15.825%** |
| | Capital gains | Corporate income tax | 15.825%** |

* Capital gains are only taxable if the period between selling and buying the property is less than 10 years.

** Additional taxes may apply at the shareholder level in case of profit distributions or the sale of shares. Partial tax exemptions and/or a reduced tax rate may apply depending on the particular type of income and the type of shareholder.

Rental income

Individuals

Introduction

Rental income is taxed as part of a taxpayer's annual income.

Liability to tax

Rental income received by individuals is subject to individual income tax.

Basis to tax

Individuals are subject to income tax on their total income from property rental and other sources (such as income from agriculture and forestry, business, independent services, employment, capital, other specific income such as capital gains).

The rental income is determined by the rent minus costs (such as maintenance, depreciation and administrative costs).

Individuals will be subject to income tax if their taxable income exceeds 9,168 Euro (in 2019). The marginal tax rate is 14% and increases progressively to 42% for individuals with a taxable annual income

of 55,961 Euro (in 2019). A 45% tax rate applies to taxable annual income in excess of 265,327 Euro (in 2019). For married couples, particular rules apply.

In addition to income tax, a solidarity surcharge will be levied at a rate of 5.5%. This results in an overall maximum marginal tax rate of 47.475%.

Trade tax

As previously mentioned, individuals can generate income from different sources. The so-called 'trade tax' is an additional tax imposed by local communities only on business income.

If the lease exceeds the pure asset management (e.g. because additional services such as cleaning or concierge service are provided by the tenant), it is classified as a commercial activity. In this case, the taxpayer generates business income rather than rental income. The business income will be subject to trade tax. Although the trade tax may be partially offset against the income tax obligation, an effective tax burden will remain in most cases.

The distinction between rental and business income can sometimes be difficult. If the landlord provides additional services such as cleaning or concierge service to his tenant, the activities will often be treated as commercial business income. For example, an individual that has a hotel will be deemed to receive income from business, whereas a landlord that rents an unfurnished flat usually is treated as receiving rental income. Similarly, if a landlord acquires and sells more than three properties within five years, this will be treated as 'commercial property trading' and will be taxed as business income, even if the landlord does not provide additional services.

The trade tax rate in Germany is determined by each municipality and averages to approximately 14%.

Companies

Introduction to company taxation in Germany

In Germany, the principles of separation and transparency are the focal points of company taxation.

If the rental is conducted through a corporation, the company itself is taxed at a flat tax rate of 15%. A so-called 'solidarity surcharge' will be levied at a rate of 5.5%. This results in an overall tax rate of 15.825% on corporate income. Additionally, distributions to the shareholders or the sale of shares are subject to income taxation on the shareholders.

Partnerships are not subject to corporate or income taxation due to the principle of transparency. The income is only determined on the level of the partnership, which is then attributed to the individual shareholders or co-entrepreneurs. The shareholders/partners are then subject to income tax or corporate tax on the income. If the partnership generates business income, the partnership itself is subject to trade tax.

Trade tax

Generally, corporations with unlimited tax liability in Germany can only generate income from business (and not a rental income). Therefore, they are always personally subject to trade tax.

If the lease does not exceed the pure asset management and if other strict requirements are met, the corporation may benefit from a trade tax exemption. Avoiding a trade tax obligation is crucial for minimising tax exposure when conducting rental activities in Germany.

Capital gains

Individuals

Introduction

If an individual receives 'rental income' from German property, capital gains realised by selling the property are only subject to personal income tax if the period between acquisition and disposal does not exceed ten years.

Liability to tax

The current rental income of an individual can either be qualified as 'rental income' or, in rare cases, as 'business income'.

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. In this case, the income from capital gains is considered as 'other specific income'.

If the rental activities have been qualified as 'business income' instead, capital gains are always subject to income tax as ordinary business income.

Basis of tax

The taxable capital gain, in both cases, is determined as the difference between the selling price and the acquisition costs less depreciation. Transaction costs may also be subtracted.

'Other specific income' and 'business income' are subject to the progressive income tax rates.

Trade tax

If the rental activity qualifies as 'business income', the capital gain may, in certain cases, be subject to trade tax. Care should be taken to ensure a trade tax obligation is avoided.

Companies

Introduction

Capital gains realised by companies are subject to corporate income tax.

Liability to tax

Business income is taxed at a rate of 15.825%.

Exemptions

Companies can defer taxation on realised capital gains by creating a reinvestment reserve if certain criteria are met.

Trade tax

Generally, corporations are subject to trade tax. If among other prerequisites, the lease does not exceed pure asset management and the property is sold at the end of the year, the corporation may benefit from a trade tax exemption for the capital gain as well.

German VAT & transfer taxes

| Taxpayer | Basis of tax | Tax levied | Tax rates (2019) |
|-------------------------|-------------------------|-----------------|------------------|
| Resident individual | <i>Rental income</i> | Value Added Tax | 19%* |
| | Transfer of real estate | Transfer Taxes | 3.5% – 6.5% |
| Non-resident individual | <i>Rental income</i> | Value Added Tax | 19%* |
| | Transfer of real estate | Transfer Taxes | 3.5% – 6.5% |
| Resident company | <i>Rental income</i> | Value Added Tax | 19%* |
| | Transfer of real estate | Transfer Taxes | 3.5% – 6.5% |
| Non-Resident company | <i>Rental income</i> | Value Added Tax | 19%* |
| | Transfer of real estate | Transfer Taxes | 3.5% – 6.5% |

* If there is no sale of business as a whole and if VAT has been opted for.

Value-Added Tax**Individuals***Introduction*

Value-added tax is a tax based on the increase in value of a product or service at each stage of the supply chain.

Liability to tax

If a company performs commercial or professional activities in Germany, it will be in principle subject to VAT. Individuals are generally considered as 'companies' for VAT purposes when they rent out premises against payment.

Basis of tax

As a general rule, the supply and lease of immovable property are exempt from VAT. Thereby, the supplier can opt for a VAT-able supply or lease of the property, if the property is sold or leased to an entrepreneur who in turn carries out taxable outgoing sales. This choice should be carefully taken. The applicable VAT rate is 19%.

If a rented property is sold, the transaction may be considered a non-taxable sale of an entire business.

Companies

The same rules as for individuals apply.

Transfer Taxes

Individuals

Introduction

Transfer tax is a tax on the passing of real estate from one person or company to another. Rights of immovable property can qualify as real estate.

Liability to tax

If the owner of German property changes because of a purchase contract or similar transaction, a non-recurring real estate transfer tax arises. A change of shareholders of a company can also trigger real estate transfer tax.

Basis of tax

The tax rates are calculated individually by the German states and vary between 3.5% and 6.5% of the purchase price or value of the property.

Exemptions

Specific transactions are exempt from real estate transfer tax, for example, certain inheritances, donations and internal reorganisations.

Companies

The same rules as for individuals apply.

German Local property taxes

| Taxpayer | Basis of tax | Tax levied | Tax rates |
|-------------------------|--------------|---------------|----------------------------|
| Resident individual | n.a.* | Municipal Tax | Depend on the municipality |
| Non-resident individual | n.a.* | Municipal Tax | Depend on the municipality |
| Resident company | n.a.* | Municipal Tax | Depend on the municipality |
| Non-Resident company | n.a.* | Municipal Tax | Depend on the municipality |

*Several calculations are required to ascertain the tax amount. The tax base is usually significantly lower than the fair market value of the property.

Introduction

Every municipality levies an annual property tax on German real estate. This annual municipal tax is deductible from rental income.

Liability to tax

Properties within Germany, as well as land-based industries (agriculture and forestry), are subject to property tax. The amount of property tax is currently based on the condition and the value of the property.

Basis of tax

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 is 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. For agricultural and forestry businesses it is fixed at 0.6%. On 10th April 2018, the Federal Constitutional Court declared the determination of the tax basis to be unconstitutional and demanded a new regulation by the end of 2019.

German Net Wealth/worth taxes

A wealth tax is currently not levied in Germany.

Vehicles for German real estate

Commonly used vehicles for German real estate

Private Limited Liability Company (GmbH)

The so-called 'GmbH', the German limited liability company, is a frequently used vehicle for the ownership of German real estate. The equity is divided into shares and the shareholders of the GmbH are not personally liable for business debts.

Partnership (e.g. 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. 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 can be held personally liable.

Corporate Partnership (GmbH & Co. KG)

The GmbH & Co. KG is a special form of limited partnership with a GmbH as the general partner. The other members participate as limited partners. The general partners are usually responsible for managing the business and are represented by the managing director of the GmbH. Limited partners are excluded from managerial duties but are only liable to the extent of their contribution. Their limited liability is the main advantage of the limited partnership. It should be noted that the GmbH and the KG are two different company types and therefore require separate bookkeeping and incur separate expenses.

Please note, that partnerships are treated as transparent for income tax purposes and thus are not subject to income tax.

Trusts

German civil law does not know the legal form 'trust'. Accordingly, German tax law does not contain any provisions for trusts. Their taxation has to be carried out according to the general 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 by to what extent the so-called settlor 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 settlor and/or the beneficiary.

Foreign partnership

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.

Specific real estate vehicles

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. In particular, a private sale transaction may take place. They differ from open funds in the fact that the investment is limited from the outset to a real estate project to be acquired or constructed by the fund. If the subscription amount is reached, the fund is closed, and the issue of fund participations is discontinued.

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



ACQUIRING GERMAN REAL ESTATE

DIRECT PURCHASE OF REAL ESTATE

This section discusses the most important tax implications of the direct purchase of real estate. First, the impact for resident individuals and non-resident individuals is discussed. Thereafter, the impact on resident companies and non-resident companies is discussed.

Preliminary considerations

A substantial reform of the land transfer tax is currently planned, which is expected to apply to transactions from 1 January 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.

Resident individuals

Transfer taxes

Individuals that acquire German real estate are subject to transfer taxes. The parties involved in the acquisition process are considered to be the taxpayers. Normally, it is specified in the contract that the buyer is obligated to pay the tax liability resulting from the transaction. The tax rates are calculated individually by the German states and vary between 3.5% and 6.5% of the purchase price of the property.

Value-added tax

Generally, the supply of immovable property is exempt from VAT. Thereby, the supplier can opt for a VAT-able supply of the property if the property is sold to an entrepreneur who carries out taxable outgoing sales. The applicable VAT rate is 19%. The seller of the property may wish to opt for VAT, otherwise he may have to reimburse input tax amounts claimed in the past.

If a rented property is sold, the transaction may be considered a non-taxable transfer of an entire business. In this case, the transaction itself is not taxable. If the portion of VAT attributable to exempt

leases increases after the transaction, the purchaser may be obliged to repay some of the input VAT claimed by the seller in previous periods. The buyer should be aware of this risk.

Deductibility of costs

The acquisition costs for the German property do not directly reduce the taxable base. Instead, they can be claimed over time by means of depreciation.

INDIRECT PURCHASE OF REAL ESTATE

This section discusses the most important tax implications of the indirect purchase of real estate (i.e. through purchasing shares in a company that owns real estate). First of all, the impact for resident individuals and non-resident individuals is considered. Thereafter, the impact for resident companies and non-resident companies is considered.

The focus of this section is the taxation on the shareholder level. It is assumed, that the shareholder acquires shares in a company holding real estate, which has the legal form of a corporation (not a partnership). Additionally, it is assumed that the company is managed and controlled in Germany. Explanations regarding the taxation of the company holding real estate are made in this chapter only if necessary. Regarding transfer tax, reference is made to partnerships as well.

Resident individuals company holding real estate

This section considers the position of resident individuals purchasing shares in a German company holding real estate.

Transfer taxes

If 95% or more of the shares of a property-owning partnership are transferred to one or more parties within five years, real estate transfer tax imposed. In addition, if 95% or more of property-owning corporation or partnership shares are either unified in a single shareholder's hand or transferred to a single shareholder, taxes are due. Indirect changes of ownership need to be taken into consideration as well. Currently, a tightening of the legal situation is being considered. Transfer tax will be levied on the property value.

The tax rates are calculated individually by the German states and vary between 3.5% and 6.5%. Tax exemptions may apply under certain conditions (e.g. donations of shares of a property holding partnership).

Personal income tax

The purchase of shares should have no direct tax implications. However, the purchase price is important for calculating the capital gain when the shares are sold.

Losses – Carry back/ forward

The unused tax losses of a German company can be carried forward to offset future taxable income of the company. However, relief for carried forward losses may be denied where a new shareholder or a group of new shareholders holds more than 50% of the shares after the acquisition. In certain cases, the retention of losses carried forward may be requested due to counter-exceptions.





HOLDING REAL ESTATE

DIRECT HOLDING OF REAL ESTATE

This section discusses the most important tax implications of the direct holding of real estate. First, the impact on resident individuals and non-resident individuals is discussed. Thereafter, the impact for resident companies and non-resident companies is discussed.

Resident individuals

Personal income tax

Individuals are subject to income tax on their total income from rental, leasing and other sources (such as income from agriculture and forestry, business, independent services, employment, capital, other specific income such as capital gains).

Individuals will be subject to income tax if their taxable income exceeds 9,168 Euro (in 2019). The marginal tax rate is 14% and increases progressively to 42% for individuals with a taxable annual income of 55,961 Euro (in 2019). A 45% tax rate applies to taxable annual income in excess of 265,327 Euro (in 2019). For married couples, particular rules apply.

In addition to income tax, a 'solidarity surcharge' will be levied at a rate of 5.5%. This results in an overall marginal tax rate at a maximum of 47.475%.

Deductibility of costs, interest and depreciation

Buildings are normally depreciated at a rate of 2 – 3 % each year, based on the acquisition costs. Maintenance costs incurred within three years of the acquisition of the building are considered as acquisition costs if they exceed 15% of the original acquisition cost of the building. Improvement costs may be considered as acquisition costs. Land is not depreciable.

Losses – carry back/forward

If interest costs and depreciation costs are higher than rental income, losses may be generated. The losses can generally be offset against other income. In addition, losses can be carried forward and

carried back in certain circumstances. It is possible to carry back up to €1m of losses for an unmarried individual. Brought forward losses can be used in a year to relieve €1m of profits plus 60% of the income exceeding €1m. If the lease activity gives rise to permanent losses, the tax authorities may refuse to recognise them for tax purposes due to a 'missing intention of achieving profits'. This may also apply if there are plans to realise losses for tax purposes.

Trade tax

If the lease exceeds pure asset management, it is classified a commercial activity. In this case, the rental income will be subject to trade tax as well. The trade tax may be partially offset against the income tax obligation. A trade tax liability should in principle be avoided by tax structuring.

Non-resident individuals

Generally, non-resident individuals are treated in Germany in the same manner as resident individuals. However, losses can only be offset against other German taxable income. Furthermore, non-resident individuals will not be granted the so-called basic allowance of 9,168 euros (2019), that is exempt from tax.

The German right of taxation on rental income is in principle not restricted, even in the event of the existence of double taxation agreements.

Resident companies

Corporate income tax

If the lease is made through a corporation (rather than a partnership), the company holding real estate itself is taxed at a flat tax rate of 15%. A solidarity surcharge will be levied at a rate of 5.5%. This results in an overall tax rate of 15.825% for the corporation. Additionally, the shareholders will be subject to income tax on distributions made by the corporation.

Deductibility of costs, interest and depreciation

Companies can deduct interest costs and depreciation costs from the tax base. Buildings are normally depreciated at a rate of 2 – 3 % each year, based on the acquisition costs. Maintenance costs incurred within three years of the acquisition of the building are considered as acquisition costs if they exceed 15% of the original acquisition cost of the building. Land is not depreciable.

Interest deduction limitation rule

The aim of the legislators was to limit the possibility of companies who have international capital inflow into Germany to conduct a full tax deduction of interest expenses in Germany. If interest expense exceeds the allowance of 3,000,000 Euro, the excess interest expense is deductible up to the amount of interest income accrued during the year. If the net interest expense exceeds the interest income, the interest expense is only deductible up to 30% of the tax EBITDA. In certain cases, a full interest deduction may be requested due to counter-exceptions.

Anti-tax avoidance directive

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

estate. The German foreign tax law may be amended occasionally on the basis of the ATAD requirements.

Losses – carry back/forward

Losses may arise if deductible interest and depreciation allowance exceed rental income. The losses can generally be offset against other income. It is possible to carry back up to €1,000,000 of tax losses to offset profits in the previous year. Brought forward losses can be used in a year to relieve €1m of profits plus 60% of the income exceeding €1m.

Fiscal unity

Fiscal unity for corporate tax purposes

If a company owns the majority of the voting rights in the subsidiary and a profit and loss transfer agreement has been concluded for a minimum of five years, a fiscal unity can be formed for tax purposes. The income for each subsidiary is determined separately. Therefore, a sale of property from one company of the tax group to another may lead to profit realisation.

One advantage of the fiscal unity is the possibility of offsetting profits and losses within the fiscal unity (i.e. via group relief).

Fiscal unity for VAT purposes

The prerequisites for a fiscal unity for VAT and income tax purposes are not identical. A fiscal unity for VAT purposes is mandatory if the controlling company holds the majority of the voting rights in the subsidiary company (financial link), the management in both companies is e.g. made up of the same persons (organisational link) and there is economic interdependence between the companies (economic link). Where a fiscal unity for VAT purposes exists, internal services are not subject to VAT. Identifying a fiscal unity for VAT purposes is important as its application is mandatory.

An application for a fiscal unity is not necessary.

Non-resident companies

Non-resident companies are treated similar to resident companies. Although German real estate held by a foreign company and rented to third parties is not considered to be a permanent establishment in Germany, the income is still subject to corporate tax. The income may not be subject to trade tax due to the lack of a permanent establishment in Germany.

The German right of taxation on rental income is in principle not restricted, even in the event of the existence of double taxation agreement.

INDIRECT HOLDING OF REAL ESTATE

This section discusses the most important tax implications of the indirect holding of real estate (i.e. through purchasing shares in a company that owns real estate). First of all, the impact on resident individuals and non-resident individuals is discussed. Thereafter, the impact for resident companies and non-resident companies is discussed.

Resident individuals

Personal income taxation of the shareholder

Dividend distributions to shareholders domiciled in Germany are subject to withholding tax of 25% (flat tax) plus solidarity surcharge at a rate of 5.5% (uniformed tax rate of 26.375%).

How the shareholder is taxed depends on the circumstances:

- If the shares are held as private assets, the withholding tax becomes a final flat tax charge.
- Upon application, a change to the personal income tax rate on capital income is possible due to the so-called 'favourable' test. The tax office examines whether taxation with the personal progressive tax rate is 'favourable' for the taxpayer. This will usually be the case for individuals with low income. In this case, the withholding tax can be offset against the individual's income tax liability.
- For shareholders who hold at least 25% of the shares in the company, or those who work in the management of the company and hold at least 1% of the shares, the partial income procedure is used. Under the partial income procedure, only 60% of the dividends are taxed at the personal income tax rate. If the individual possesses the shares as business assets, the partial income procedure applies as well. The withholding tax can be offset against the income tax liability.

Deductibility of costs, interest payments

The deductibility of costs depends upon which of the above alternative is applicable. In alternative A and B none of the expenses are deductible. In alternative C 60% of the costs (such as interest) can be deducted.

Non-resident individuals

Non-resident individuals are treated in a similar way as resident individuals. The applicable tax treaty usually limits the German rights of taxation to a certain percentage.

Resident companies

Corporate income tax

If the parent corporation holds at least 10% of shares in the company paying the dividend, dividends are effectively up to 95% corporate-income-tax-free. If the corporation holds at least 15% of shares, dividends are deemed to be effectively up to 95% trade-tax-free. In other words, if the corporation holds at least 15% of shares in the company paying the dividend, dividends are effectively up to 95% tax-free with regard to corporate and trade tax. This beneficial treatment is called 'Schachtelprivileg'.

Deductibility of costs, interest payments and depreciation

Interest and other costs that relates to the shares are deductible. Depreciation of the shares is not tax-deductible.

Non-resident companies

Non-resident companies are generally treated in a similar manner as resident companies. The tax treaty (if applicable) usually limits the German rights of taxation for dividends to a certain percentage. Secondly the EU parent-subsidiary directive has to be considered.

Fiscal unity for corporate tax purposes

Fiscal unity for VAT purposes

A fiscal unit for VAT purposes may be possible under the aforementioned requirements. However, the effects of the fiscal unit are limited to internal services between the parts of the company located in Germany.





SALE & TRANSFER OF REAL ESTATE

DIRECT SALE OF REAL ESTATE

Preliminary considerations

A substantial reform of the land transfer tax is currently planned, which is expected to apply to transactions from 1 January 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.

Resident individual

Capital gains

In general, capital gains realised by individuals are only subject to personal income tax if the period between acquisition and disposal does not exceed ten years.

If the individual received 'rental income', capital gains realised by individuals are only subject to personal income tax if the period between acquisition and disposal does not exceed ten years. Otherwise, the capital gain is not taxable. Exemptions exist for self-occupied residential property. The capital gain is calculated as the difference between the selling price and the acquisition costs less depreciation. Transaction costs may be subtracted as well.

If the rental activities have been qualified as 'business income' instead, capital gains are always subject to income tax as ordinary business income.

A reinvestment reserve may be used for the neutralisation of gains (i.e. rollover relief). In this case, the gains are not taxed when the property is sold. Instead, a reinvestment reserve is formed equal to the amount of capital gains. The company must make a reinvestment within four years. In the case of a reinvestment in a new build property, the deadline is extended to six years. If another building is bought, the value of the reinvestment reserve can be deducted from the purchase price of the new property. As a result of this, the future depreciation costs are lower, resulting in higher taxable income.

The income from capital gain is subject to the progressive income tax rate up to 47.475%.

Losses

Losses from private sales transactions (i.e. with connected parties) may only be offset against gains from private sales transactions. Loss carry forwards and carry backs are possible under certain conditions.

Trade tax

If the rental activity qualifies as 'business income', the capital gain may, in certain cases, be subject to trade tax. A trade tax obligation should be avoided by tax structuring.

Non-resident individual

Non-resident individuals are treated in a similar manner to resident individuals. However, losses arising from the sale of German real estate can only be offset against other German taxable income. Furthermore, they will not be granted the so-called basic allowance of 9,168 euros (2019), that is exempt from tax.

The German right of taxation for rental income is in principle not restricted, even in the event of the existence of double taxation agreements.

Trade tax

If the individual received 'business income', trade tax might not be due on the capital gain due to the lack of a permanent establishment in Germany.

Resident company

Capital gains

Business income is taxed at a rate of 15.825%. The corporate income tax on capital gains is based on the difference between the net sales proceeds and tax book value.

Companies can defer taxation on realised capital gains by creating a reinvestment reserve.

Trade tax

Generally, corporations are subject to trade tax. If the lease does not exceed pure asset management and if the property is sold at the end of the year, the corporation may, in certain circumstances, benefit from a trade tax exemption for the capital gain as well.

Non-resident company

Non-resident companies are treated similarly to resident companies. Although German real estate held by a foreign company and rented to third parties is not considered to be a permanent establishment in Germany, the capital gain is still subject to corporate tax. The income may not be subject to trade tax due to the lack of a permanent establishment in Germany.

The German right of taxation for rental income is in principle not restricted, even in the event of the existence of double taxation agreements.

INDIRECT SALE

Resident individuals

Capital gains

If an individual owns at least 1 % of the share of the company holding real estate, the so-called 'partial income method' is applied for the sale. In principle, only 60% of the loss or gain is subject to income the individual tax. The same applies if the shares qualify as business assets.

If the shares are qualified as business assets, the companies may defer taxation on realised capital gains by creating a reinvestment reserve. The taxable capital gains (60%) are not taxed at the moment of selling but a reinvestment reserve will be formed for the amount of the capital gains. A reinvestment in shares or property needs to be done within a certain time frame (two or four years depending on the kind of reinvestment) and is limited to €500,000.

If an individual owns less than 1% of the shares and they do not qualify as business assets, the sale is generally taxed at a uniformed tax rate of 26.375%. Losses may only be netted with other capital income.

Non-resident individual

Non-resident individuals are generally treated in the same manner as resident individuals.

If a double taxation agreement exists with the shareholder's country of residence, the German right to taxation is usually rejected. However, certain double taxation agreements might provide different rules for the sale of shares in German property corporations.

Resident company

Capital gains

Capital gains from the sale of shares of domestic and foreign corporations are effectively exempt from corporate income tax and trade tax up to 95%. Losses arising do not reduce the tax base.

Non-resident company

Non-resident companies are treated in a similar way to resident companies. The tax treaty usually limits the German right of taxation in respect of capital gains from shares in a German corporation. However, certain double taxation agreements might provide different rules for the sale of shares in German property corporations.

Trade tax may not be due if the shareholder has no permanent establishment in Germany.

DIRECT TRANSFER INTRA CONCERN (GERMAN REAL ESTATE TO GERMAN COMPANY)

Please note, that in the following only the special rules for intra concern transaction will be discussed.

Resident Company as the seller of the property

Capital gains and Fiscal unity

If the conditions for a fiscal unity for corporate tax purposes are met, the capital gain is still taxable because the income is determined separately for the subsidiary and the controlling entity.

The realisation of capital gains may be avoided if the German Tax Reorganisation Act is applicable. Certain requirements need to be met.

VAT

If the conditions for a fiscal unity for VAT purposes are met, the transaction is not taxable.

Transfer tax

If the property is transferred intra-group, the tax exemption for intra-group transactions may apply. However, strict requirements have to be met.

If the property is transferred to a subsidiary company in the legal form of a partnership, there is, in principle, a tax exemption in the amount of the participation quota in the partnership. In this case certain holding periods must be considered.

Non-resident company as the seller of the property

Non-resident companies are treated in a similar manner to resident companies. Under the provision that the shares of the selling company are not attributed to a German permanent establishment, a fiscal unity for corporate tax purposes may not be possible.

A fiscal unity for VAT purposes may be possible. However, the effects of the fiscal unity are limited to internal services between the parts of the company located in Germany.

INDIRECT TRANSFER INTRA CONCERN (GERMAN REAL ESTATE TO GERMAN COMPANY)

Resident company as the seller of the shares

Capital gains and fiscal unity

If the conditions for a fiscal unity for corporate tax purposes are met, the capital gain is still realised because the income is determined separately for the subsidiary and the controlling entity. However, the capital gain is effectively tax exempted up to 95%.

The realisation of capital gains may be avoided if the German Tax Reorganisation act ('Umwandlungsteuergesetz') is applicable. Certain requirements need to be met.

Transfer tax

The transfer of shares may attract transfer tax.

If the property is transferred intra-group, the tax exemption for intra-group transactions may apply. However, strict requirements have to be met.

Non-resident company as the seller of the shares

Non-resident companies are treated in a similar manner as resident companies. Under the provision, that the shares of the selling company are not attributed to a German permanent establishment, a fiscal unity for corporate tax purposes may not be possible.

The realisation of capital gains may be avoided if the German Tax Reorganisation act is applicable. Certain requirements need to be met.

DIRECT TRANSFER INTRA CONCERN (GERMAN REAL ESTATE TO FOREIGN COMPANY)

Resident company as the seller of the property

Capital gains and fiscal unity

Even in the unlikely event that the conditions for a fiscal unity for corporate tax purposes are met, the capital gain is still taxable because the income is determined separately for the subsidiary and the controlling entity.

The realisation of capital gains may be avoided if the German Tax Reorganisation act is applicable. Certain requirements need to be met. Specific advice should be taken.

VAT

In the unlikely event that the conditions for a fiscal unity for VAT purposes are met, the transaction will not be taxable.

Non-resident company as the seller of the property

Non-resident companies are treated in a similar manner as resident companies. It is very unlikely that the conditions for a fiscal unity are met.

The realisation of capital gains may be avoided if the German Tax Reorganisation act is applicable. Certain requirements need to be met.

INDIRECT TRANSFER INTRA CONCERN (GERMAN REAL ESTATE TO FOREIGN COMPANY)

Resident company as the seller of the shares

Capital gains

Even in the unlikely event that the conditions for a fiscal unity for corporate tax purposes are met, the capital gain is still realised because the income is determined separately for the subsidiary and the controlling entity. However, the capital gain is effectively tax exempted up to 95%.

Non-resident company as the seller of the shares

Non-resident companies are treated in a similar manner as resident companies. A fiscal unity for corporate tax purposes may not be possible.

The realisation of capital gains may be avoided if the German Tax Reorganisation Act is applicable. Certain requirements need to be met.

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