

Extended trade tax deduction - New legal provisions on e-mobility, electricity for tenants, and miscellaneous landlord services

ON 22 APRIL 2021, THE BUNDESTAG PASSED A MODIFICATION TO THE EXTENDED TRADE TAX DEDUCTION WITH RESPECT TO THE SUPPLY OF ELECTRICITY USING RENEWABLE ENERGIES, THE OPERATION OF E-CHARGING STATIONS, AND MISCELLANEOUS LANDLORD SERVICES FOR TENANTS

Executive summary

- In the future, “supplying” electricity from renewable energies will not prevent the application of the extended trade tax deduction (“*erweiterte gewerbsteuerliche Kürzung*”) as long as the corresponding revenues do not exceed 10% of annual rental income.
- Furthermore, “supplying” electricity for charging stations for e-vehicles and e-bikes likewise will not prevent the application of the extended trade tax deduction provided that the corresponding revenues, together with any income pertaining to the supply of electricity from renewable energies, do not exceed 10% of annual rental income.
- “Supplying” electricity using other generation methods (such as a cogeneration plant) and other services provided by a landlord to a tenant, such as including operating facilities within a lease agreement, will no longer prevent an application of the extended trade tax deduction in the future provided the corresponding revenues do not exceed 5% of annual rental income.
- Approval from the Bundesrat, Germany’s second legislative chamber, is still pending.

Legal provisions up to now

Trade tax (“*Gewerbesteuer*”) fundamentally applies for deemed commercial partnerships (such as a “standard”

GmbH & Co. KG) as well as corporations that maintain a permanent establishment in Germany as defined under German trade tax law.

In order to prevent a disadvantage compared to individuals and asset-managing partnerships, parties who are potentially subject to paying trade tax have the possibility of minimizing their corresponding tax burden, and can even reduce it to zero. Yet the prerequisite to that end is that the companies subject to the trade tax are exclusively managing and utilising their own real estate (or, additionally, their own capital assets); or, additionally, that they build and sell single-family homes, semi-detached homes, and freehold flats.

An application of the extended trade tax deduction has only been possible to date if the company is **exclusively** active in asset management. So far, only “housing-related” activities have not prevented an application of the extended trade tax deduction, although those activities are themselves subject to trade tax. In particular, the extended trade tax deduction is completely unavailable in general when a lease agreement includes operating facilities or when other (commercial) activities are being carried out, such as the generation and supply of electricity. The extent of the activity giving rise to the “prevention” is fundamentally irrelevant.

New legal provisions regarding the supply of electricity

The new legal provisions provide that real estate companies will be permitted to generate electricity using renewable energies, too, and to supply that electricity.



However, the electricity generated in this manner will have to be fed into the general electrical grid or supplied to tenants of the real estate company. This does not apply for the generation and supply of electricity via a cogeneration plant because that kind of system does not represent renewable energy under the relevant legal provisions.

Moreover, in the future, a real estate company will be permitted to generate and supply electricity for charging stations for electric vehicles and electric bicycles. This kind of electricity may be generated or purchased using a renewable energy system and by means of a cogeneration plant.

Self-consumption of self-generated electricity likewise does not prevent the application of the extended trade tax deduction. However, the new legal provisions do require that a real estate company's revenue from the aforementioned activities during the fiscal year under assessment does not exceed 10 percent of the income from leasing the property (earning from rentals / leases). This limit applies to the cumulative revenues from both the supply of electricity and the operation of e-charging stations.

However, trade tax will be assessed on the income which a real estate company generates from these activities, which will be subject to preferential tax treatment in the future. The difference now is that these kinds of services will no longer prevent for the application of the extended trade tax deduction with respect to income such as property rental.

New legal provisions regarding miscellaneous services

Moreover, the application of the extended trade tax deduction will no longer be prevented when a lease agreement includes operating facilities and/or other (commercial) services which did prevent an application of the extended trade tax deduction in the past and are performed by a real estate company for tenants. Yet the revenues from these kinds of (direct) contractual agreements with tenants may not exceed 5 percent of the

income generated from the property's leasing (earnings from rentals / leases) in the respective fiscal year.

These new legal provisions now make it possible for real estate companies to also include, to a marginal degree, operating facilities within a lease agreement with a property's tenants. Furthermore, other (ancillary) services pertaining to pure leasing activity - such as cleaning services for tenant spaces or concierge services, etc. - will no longer automatically prevent an application of the extended trade tax deduction.

Under the new legal provisions, even the generation and supply of electricity to tenants or to third parties via a cogeneration plant will not prevent an application of the extended trade tax deduction provided the respective revenues, together with the revenues from all other services provided by the landlord to the tenant, do not exceed 5 percent of the income from leasing the property.

If non-preventing ancillary services are being provided, then they, too, likely will not count as income falling under the 5-percent trade tax threshold. The original legal situation will likely remain intact to such end.

However, the revenues generated from other non-preventing activities will likewise be subject to trade tax. Yet these kinds of services will not prevent an application of the extended trade tax deduction overall.

As a general rule, however, the future exemption will not include the sale of operating facilities because the corresponding income does not originate from direct contractual relationships with the tenant.

All of the envisaged changes shall already apply for the 2021 tax assessment period.

Summary

These planned modifications to the Trade Tax Act represent an important decision by the legislature for the real estate sector. The future possibility of including operating facilities in a lease agreement without having to



fear - as has been the case to date - a massive trade tax burden is a highly welcome development. Additionally, this move means the legislature is (in part, at least) removing a disadvantage for real estate companies compared to domestic investment funds. Investment funds already had access to a trade tax exemption in the past when their revenues from so-called active entrepreneurial management ("*aktive unternehmerische Bewirtschaftung*")¹ amounted to less than 5 percent of the aggregate income, and now a generally similar "buffer" applies for real estate companies as well.

It is also good to see the legislature making a clear commitment to sustainable energy and e-mobility with the new provisions on the generation and supply of energy. It was not clear why the previous tax provisions needed to make it more difficult for real estate companies along their journey to a climate neutral property portfolio.

However, in order to effectively comply with the 10- and 5-percent thresholds in the future, it will be important to exercise diligence in calculating and monitoring the revenues yielded from the corresponding activities. Accordingly, a precise breakdown should be performed for the pertinent income.

From the perspective of practice, however, it is frustrating that the inclusion of operating facilities in a sale can prevent a claim for the extended trade tax deduction in the future as well. That means it will be important to place greater focus on the details when it comes to tax efficiency in (exit) structuring.

As of today, approval from the Bundesrat, Germany's second legislative chamber, remains pending.

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¹ In the case of real estate funds, additional or ancillary services provided by a landlord to a tenant within the scope that is customary for long-

term leases in line with regional and national practices, i.e. in general, miscellaneous (commercial) activities which, to date, did prevent an application of the extended trade tax deduction.



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