Real estate transfer tax on share deals – how to approach potential double taxation issues

THE RISK OF ECONOMIC DOUBLE TAXATION FOR SHARE DEALS AT BOTH SIGNING AND CLOSING HAS BEEN A TOPIC OF DISCUSSION SINCE THE REAL ESTATE TRANSFER TAX REFORM OF 2021. THE FOLLOWING GSK UPDATE DESCRIBES THE SITUATION AND OFFERS POSSIBLE REMEDIES.

Executive Summary

- According to the decrees issued by the German tax authorities on 10 May 2022, real estate-owning corporations and partnerships may have to pay real estate transfer tax (RETT) twice, both at the signing and at the closing of a transaction.
- However, there are procedural remedies to avoid this.
- The German tax authorities will only grant a complete RETT exemption on the signing if taxation on the closing can be expected within one year of the tax authorities being notified of the transaction.
- Firms need to bear this one-year period in mind, especially since the tax authorities have not yet commented on the specific correction or amendment provisions that apply, despite ongoing discussions among tax experts. In cases that become contentious despite the decrees, there should be considerable counter-arguments if real estate transfer tax is incurred twice. Furthermore, the tax courts are not bound by the tax authorities' decrees and can deviate from them – including to the detriment of the taxpayer.
- It is imperative that firms meet the deadlines for notifying the tax authorities of acquisition transactions (normally a two-week period) following both the signing and the closing.

Starting point

Since the real estate transfer tax reform as of 1 July 2021[1], Sec. 1 (2b) of the German Real Estate Transfer Tax Act (GrEStG) deems a transfer of real estate subject to RETT if at least 90% of the shares of a **corporation** owning real estate change ownership directly or indirectly within ten years.

Such a rule essentially already existed for **partnerships** in Sec. 1 (2a) GrEStG and has been maintained in a modified form as of 1 July 2021 by lowering the previous threshold of 95% to 90% and by extending the previous five-year holding period to ten years.

Under both rules, taxation is based on the transfer of shares, i.e. on the **closing**. The taxpayer is the **corporation or partnership** that holds the real estate.

In addition, the conclusion of a share purchase agreement, i.e. the **signing**, triggers an acquisition transaction that is subject to RETT as per Sec. 1 (3) no. 1 and no. 3 GrEStG[2] if a buyer[3] can claim direct or indirect ownership of – as of 1 July 2021 – at least 90% of the shares in a real estate-owning corporation or partnership (Sec. 1 (3) no. 3 GrEStG) or if the share purchase agreement establishes a claim to the transfer of shares in a real estate-owning corporation/partnership if these shares together with shares already directly or indirectly held by the buyer result in a

[1] Act Amending the Real Estate Transfer Tax Act of 12 May 2021, Federal Law Gazette (BGBl) I 2021, 986 et seq.

[2] The additional circumstance under Sec. 1 (3a) GrEStG, which is based on an economic interest, can also be triggered upon signing. Even though the issue of potential double taxation discussed above may also apply to cases of economic interest, this is not the subject of this GSK Update.

[3] In this instance and the following, a RETT-taxable entity on the buyer's side (defined as a legal person financially, economically and organisationally integrated into an enterprise according to the overall picture of the actual circumstances Sec. 1 (4) no. 2 GrEStG), is treated as equivalent to the buyer.

total of at least 90% of the shares in that corporation/partnership (Sec. 1 (3) no. 1 GrEStG). The person liable to pay RETT is in each case the **buyer**.

Prior to the real estate transfer tax reform as of 1 July 2021, it was largely undisputed that, based on the introductory sentence in Sec. 1 (3) GrEStG, Sec. 1 (2a) GrEStG, which applies to closings by real estate-owning partnerships, **takes precedence over** Sec. 1 (3) no. 1 or no. 3 GrEStG, which applies to the corresponding signing, **even if** the **signing and closing** of transfer of the partnership shares **occur at different times**. As far as can be seen, the tax authorities have not taken the view that the law provides for double taxation of both the signing and the closing.

Following the introduction of Sec. 1 (2b) GrEStG as of 1 July 2021, it was and still is argued with regard to real estate-owning corporations that **signings prior to 1 July 2021** may be taxed in accordance with Sec. 1 (3) no. 1 or no. 3 GrEStG, as the version of the law before that date did not yet contain a reference to Sec. 1 (2b) GrEStG taking precedence, as this was not introduced until 1 July 2021. If, in such a case, the subsequent **closing** takes place **after 1 July 2021**, **RETT** may be payable **a second time on the same share deal** because the closing is now covered by Sec. 1 (2b) GrEStG.

Example 1:

The share purchase agreement for 100% of the shares in a real estate-owning GmbH (corporation) is concluded on 1 May 2021 (signing). The shares are transferred on 1 August 2021 (closing).
While the signing in this example on 1 May 2021 triggers real estate transfer tax pursuant to Sec. 1 (3) no. 3 GrEStG for the buyer, the closing in this example on 1 August 2021 essentially triggers RETT a second time pursuant to Sec. 1 (2b) GrEStG for the GmbH.
Those who thought that the potential double taxation of signing and closing was only a temporary issue for real estate-holding corporations during the transitional period until 1 July 2021 were surprised to find that this also could potentially spill over to cases involving real estate-holding companies where **both the signing and the closing** took place **after 1 July 2021**.

Example 2:

The share purchase agreement for 100% of the shares in a real estate-owning GmbH is concluded on 15 September 2022 (signing). The shares are transferred on 1 April 2024 (closing).

While the signing in this example on 15 September 2022 triggers real estate transfer tax pursuant to Sec. 1 (3) no. 3 GrEStG for the buyer, the closing in this example on 1 April 2024 essentially triggers RETT a second time pursuant to Sec. 1 (2b) GrEStG for the GmbH.

The identical decrees of the state tax authorities of 10 May 2022 concerning the application of Sec. 1 (2b) GrEStG as of 1 July 2021 ("**Decree on Sec. 1 (2b) GrEStG**") do not eliminate the possibility of economic double taxation for real estate-owning **corporations** in terms of substantive law, but do provide some mitigation from a procedural law perspective. The same seems to also apply to real estate-owning partnerships (see the identical decrees of the state tax authorities of 10 May 2022 concerning the application of Sec. 1 (2a) GrEStG as of 1 July 2021 ("**Decree on Sec. 1 (2a) GrEStG**", both decrees together the "**Decrees**")), although the real estate transfer tax reform in 2021 did not change the law to this effect.

Thus, there is a risk that real estate transfer tax may be levied twice on the same transaction.

Precedence of taxation on closing

The Decrees do, however, clarify in each case in para. 8.1 that taxation at closing takes precedence over taxation at signing pursuant to Sec. 1 (3) no. 1 or no. 3 GrEStG. However, it is clear from the Decrees that this only applies if the real estate portfolio remains identical. If a property is only attributable to the corporation holding the property for RETT purposes at the time of signing, but no longer at the time of closing, this property is not to be considered for tax assessment at the time of closing under Sec. 1 (2a) or (2b) GrEStG and, in this respect, such taxation cannot

take precedence over taxation at the time of signing under Sec. 1 (3) no. 1 or no. 3 GrEStG.
The reverse is also true for properties that are not yet attributed to the company at the time of signing but are attributed to the company at the subsequent closing date. In any case, only Sec. 1 (2a) or (2b) GrEStG applies.

Signing and closing as separate transactions under real estate transfer tax law

However, the tax authorities do not draw the obvious conclusion from the precedence of Section 1 (2a) or (2b) GrEStG that taxation at signing would be blocked in such cases where the same property is considered attributable at both signing and closing. Instead, para. 8.1 of the Decrees emphasises that the signing and the closing are **two separate transactions under real estate transfer tax law**. This means that **economic double taxation of the signing and closing of the same transaction is essentially possible**.

Consequently, in line with the view taken by the tax authorities, RETT is to be assessed both at the signing with the buyer as taxpayer and at closing with the corporation as taxpayer. In practice, this means that RETT on the share deal is assessed in a real estate transfer tax notice issued to the buyer as the taxpayer and is generally due one month after the notice is issued in accordance with Sec. 15 GrEStG. The buyer should therefore plan to have sufficient liquidity. As a result of the closing taking place at a later date, the RETT on the share deal is assessed again, this time with the corporation as the taxpayer. The corporation must therefore also plan to have sufficient liquidity. The RETT notice issued to the buyer must then be cancelled or amended at the same time if possible or in a timely manner.

However, it is possible that the repayment of the RETT on the signing due to the cancellation or amendment of the notice will only be made after the RETT the corporation owes on the closing has fallen due. If the RETT already paid by the buyer on the signing is to be used to repay the RETT owed by the corporation on the closing in order to conserve liquidity, both parties need to make provisions for this in good time and, if possible, try to coordinate with the tax authorities. In addition, the question arises as to how the shareholder should make this liquidity available to the corporation (loan or contribution?).

Example 3:

The share purchase agreement for 100% of the shares in a real estate-owning GmbH is concluded on 15 September 2022 (signing), on which date the properties A, B and C are attributable to the GmbH. The shares are transferred on 1 April 2024 (closing), at which point only the properties A and B, as well as the additional properties D and E are attributable to the GmbH.

While based on the signing in this example on 15 September 2022 RETT pursuant to Sec. 1 (3) no. 3 GrEStG is assessed for the buyer for the properties A, B and C, the closing in this example on 1 April 2024 has the following effect:

- RETT is again assessed for properties A and B on 1 April 2024, but this time with the GmbH as taxpayer.
- However, RETT on the two properties A and B, which had been assessed at the signing with the buyer as taxpayer, should be cancelled and ultimately refunded.
- The RETT assessment with respect to property C at the signing with the buyer as taxpayer will not be cancelled as a result of the closing. However, RETT will be not be reassessed for property C on the closing with the GmbH as taxpayer.
- In the case of properties D and E, which were not covered by the RETT assessment at the signing with the buyer as taxpayer, however, RETT is assessed on the closing with the GmbH as taxpayer.

Subject to procedural hurdles, it should thus ultimately be possible to avoid the economic double taxation triggered with regard to the properties.

No specific cancellation or amendment provisions

It is unsatisfactory in practice that, while the Decrees provide for the cancellation or amendment of the RETT assessment on the signing in the event of closing at a later

date in para. 8.2, they do not specify in detail any provision under which this is to be done. According to reports, the tax authorities were unable to reach an internal consensus regarding a specific applicable regulation. However, the question has practical consequences, because the regulations discussed so far differ in terms of the requirements that have to be met. The buyer will therefore have to check the RETT assessment notice on the signing closely to see whether the tax office has issued the assessment notice subject to review ("Vorbehalt der Nachprüfung"; however, the notice becomes final after expiry of the limitation period for assessment) or provided a **provisional tax assessment** ("vorläufige Steuerfestsetzung"). In our opinion, the buyer should see if the tax office can be persuaded to issue a provisional assessment as a precautionary measure. Otherwise, a **precautionary appeal** should be considered to keep the assessment notice "open". This is likely a safer option than accepting the formal validity of the expiration of the objection period and only objecting to it thereafter by mean of a correction provision according to Section 172 et seq. of the German General Tax Code.

Time limit on exemption from tax assessment as of signing

The Decrees provide an exemption from tax assessment as of the signing in para. 8.2 only if taxation on the closing is to be expected in accordance with Sec. 1 (2a) or Sec. 1 (2b) GrEStG within one year after the tax authorities become aware of the taxable transaction. This is not based on the competent tax office being notified, but rather on **the tax authorities as a whole**. Consequently, reporting the transaction to a non-competent tax office or another tax office gaining knowledge of the transaction by some other means could also trigger the start of the time limit.

Example 4:

The share purchase agreement for 100% of the shares in a real estate-owning GmbH is concluded on 15 September 2022 (signing). The tax authorities become aware of the transaction on 1 October 2022. The shares are transferred on 1 January 2023 (closing).

In this example, the signing on 15 September 2022 triggers RETT pursuant to Sec. 1 (3) no. 3 GrEStG for the buyer. However, it should be possible to demonstrate to the tax office that the closing is expected to take place within one year of the tax authorities becoming aware of the transaction on 1 October 2022. This should save the buyer an assessment of real estate transfer tax on the signing. At the time of closing, however, real estate transfer tax will be assessed with the GmbH as taxpayer. This should therefore prevent double taxation of the transaction.

An obvious scenario in practice could be that the competent tax office will wait for the closing to take place within one year and, if this does not occur by then, issue the RETT assessment notice on the signing shortly after the end of this one-year period.

Modification or continuation of example 4:

If the closing in the above example does not ultimately take place by 31 September 2023, it is likely that the tax authorities will now assess the real estate transfer tax to be paid by the buyer on the signing. At the time of the closing, real estate transfer tax will also be assessed with the GmbH as taxpayer, but the RETT assessment on the signing issued to the buyer should then be cancelled and any real estate transfer tax paid should be refunded. Subject to procedural hurdles, it should therefore be possible to avoid double taxation of the transaction.

Notification obligations must be observed

Even if the closing is expected to take place within one year, a complete **notification of the acquisition transaction** as of the signing must be submitted to the competent tax office in due time (generally within two weeks).
Furthermore, a complete (new) notification of the acquisition transaction as of the closing must be submitted in due time (generally within two weeks).
Submitting the notifications in due time in each case is also relevant, in particular, for any future rescission or reacquisition pursuant to Sec. 16 GrEStG. In addition, failure to notify the tax authorities may have consequences under criminal or administrative offence law.

Conclusion

Regardless of the wording of the law, taxpayers show no support for a double taxation of a single share deal. It is therefore good to see that the tax authorities are endeavouring to find a procedural remedy by issuing the Decrees. It remains to be seen whether there are still a few individual cases that cannot be remedied procedurally. Furthermore, the tax courts are not bound by the tax authorities' decrees and can deviate from them – including to the detriment of the taxpayer.

Taxpayers will (have to) make active efforts to meet the conditions for a procedural remedy, in particular in cases where closing takes place more than one year after notification of the signing.

It is unfortunate, however, that this discussion probably also applies to open cases involving partnerships from the time before 1 July 2021. This applies in particular to complete signing and closing notifications that were submitted in due time, as otherwise a rescission or a repurchase pursuant to Sec. 16 GrEStG could fail.

One solution could be to place the respective share purchase agreement under a condition precedent within the meaning of Sec. 14 GrEStG in order to prevent the real estate transfer tax being incurred on the signing until the condition precedent occurs. If the occurrence of the condition can be scheduled concurrently with the closing, Sec. 1 (2b) GrEStG, which provides for the taxation of the real estate-owning company, should prevent the buyer from being taxed simultaneously for the signing under Sec. 1 (3) GrEStG. However, this must be verified in each individual case and, if necessary, effectively hedged.

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