

Federal Tax Court rules on RETT implications of indirect changes of ownership in real estate-owning partnership

The Federal Tax Court has issued a decision in which it considerably restricts the scope of application of the Real Estate Transfer Tax Act in cases involving an indirect change in the ownership of a real estate-owning partnership. The tax authorities are expected to issue a non-application decree with respect to the decision.

Section 1 (2a) of the Real Estate Transfer Tax Act (RETT) provides that RETT will be triggered if 95 % or more of the interest in a real estate-owning partnership is transferred directly or indirectly to new partners within a five-year period. In such a case, the real estate-owning partnership will be deemed to have transferred the real estate to a fictitious new partnership.

According to a decree issued by the German tax authorities in 2010, the determination of whether there has been an “indirect change in ownership” is affected by whether the direct partner in the real estate-owning partnership is a corporation or another partnership:

- If a partnership is the (direct) partner, the partnership must be treated as being fully transparent when determining whether there has been an indirect change in ownership. As a result, it is necessary to look through the partnership to the ultimate corporation/individual that indirectly holds the interest in the real estate-owning partnership. The relevant ownership percentage is determined by multiplying the ownership percentages through the chain, i.e. by determining the economic percentage in the real estate-owning partnership held by the corporation/individual.
- If a corporation is the (direct) partner, the look-through approach is not applicable because a corporation is not transparent. The interest held by the corporation in a real estate-owning partnership will be deemed to be transferred to a new partner only if 95 % or more of the shares in the corporation are transferred directly or indirectly to a new shareholder. In the case of multi-tier structures of corporations, the 95 % threshold is to be applied separately at each tier.

In reaching its decision, the Federal Tax Court (BFH) did not follow the view of the tax authorities. The BFH held that an “economic” approach must be used to determine whether there has been an indirect change in ownership in a real estate-owning partnership, under which both partnerships and corporations are treated as transparent. The BFH even went a step further by holding that only a 100 % direct or indirect change in ownership of the direct partners in the real estate-owning partnership would qualify as an indirect change in ownership under the applicable provision in the RETT Act (section 1 (2a)). The court effectively introduced an “ultimate ownership test” for determining whether a 100 % direct or indirect change in ownership took place. Because the BFH approach requires corporations to be treated as transparent when applying section 1 (2a) of the RETT Act, it will be necessary to look up the corporate chain until an owner is found where no corporate participation or partnership interest can legally exist (which would be the case only if the owner is an individual or a body corporate, such as a public authority).

When looking at the level of the direct partners in a real estate-owning partnership, the BFH held that partnerships and corporations must be treated the same way for RETT purposes, although at the direct partner level, both are to be treated as nontransparent, i.e. the relevant interest in the real estate-owning partnership is to be treated in an “all or nothing” manner when applying section 1 (2a) of the RETT Act.

The BFH decision introduces an entirely new – and taxpayer favorable – approach to the interpretation of an indirect change in ownership in a real estate-owning partnership that potentially could allow a variety of alternatives in structures where the real estate is held by a partnership. Affected taxpayers should be aware of the new section 1 (3a) of the RETT Act (introduced in June 2013) that targets “RETT blocker structures” and effectively introduces

an economic analysis of the ownership chain that could limit the BFH's interpretation of the application of section 1 (2a).

Based on unofficial statements of the tax authorities, a non-application decree is likely to be issued in the near future, under which the authorities will limit the application of the BFH decision to the case at hand and apply their position in all other comparable cases.

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