

YPOG Briefing:

Real Estate Transfer Tax Implications of the Revised Partnership Law (MoPeG)

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As part of our series of briefings on the various amendments of tax laws (Global Minimum Tax Directive Implementation Act and Growth Opportunities Act) proposed by the German Federal Ministry of Finance this July, this briefing focuses on real estate transfer tax (RETT). Despite the German Real Estate Transfer Tax Act (RETT Act) being inadequately equipped for the reform of the partnership law coming into force in only a few months, RETT is notably not addressed in the draft of the Growth Opportunities Act.

Abolishment of the Principle of “Joint Ownership” for Partnerships

On January 1, 2024, the Act on the Modernization of Partnership Law (MoPeG – Gesetz zur Modernisierung des Personengesellschaftsrechts) will enter into force and, among other reforms, abolish the asset attribution principle of so-called “joint ownership” (Gesamthand) previously applicable to partnerships. This raises the question of whether partnerships will still benefit from the tax exemptions in sec. 5, 6 and 7 para. 2 of the German Real Estate Transfer Tax Act (RETT Act), given the fact that these provisions presuppose real estate assets which are jointly owned (Gesamthandsvermögen).

Partnerships and other communities of joint owners are deemed “independent legal entities” within the meaning of the RETT Act. If a partner transfers real estate to its partnership, such transfer is therefore subject to RETT. The same applies in the reverse case: If the partnership transfers real estate to its partner, RETT would generally apply as well. Additionally, transfers of real estate between partnerships are subject to RETT, even if the interests in these partnerships are (partly) held by the same persons (sister partnerships).

However, to avoid undue hardships, under certain conditions pursuant to sec. 5 (transfer to a joint ownership) and sec. 6 RETT Act (transfer from a joint ownership), RETT will not be levied. These provisions effectively provide for a RETT exemption for transactions involving joint ownerships to the extent the pro rata entitlement to the real estate asset is not affected by the transaction. The effective tax exemption is linked to ten-year holding periods. Within these periods, the former (indirect) owner of the real estate asset may not reduce its participation in the community of joint ownership to which the asset was transferred (sec. 5 para. 3 sentence 1, sec. 6 para. 3 sentence 2 RETT Act).

Example: A, as limited partner, holds a 100% participation in the assets of the A GmbH & Co. KG. The general partner GmbH does not participate in the assets of the partnership. In 2022, A transfers real estate to A GmbH & Co. KG. Such transfer is taxable, but fully tax-exempt pursuant to sec. 5 para. 2 sentence 1 RETT Act.

The fact that sec. 5 and 6 RETT Act do not refer to a specific legal form, but rather to the general principle of joint ownership, gives rise to serious doubts whether transactions involving partnerships will still be able to benefit from these tax benefits after the MoPeG enters into force. Without legislative adjustments, sec. 5 and 6 RETT Act may cease to apply to partnerships, since the abolition of the principle of joint ownership removes the legal basis under civil law for the application of these tax privileges.

Such loss of tax privileges would certainly have considerable disadvantages. But at least taxpayers would be able to adapt to this change in legislation. On the other hand, however, the possible side effects of the MoPeG on holding periods pursuant to sec. 5 para. 3 sentence 1, sec. 6 para. 3 sentence 2 RETT Act which are still ongoing would be far more problematic. These holding periods sanction any reduction in the co-entitlement to the assets of the joint ownership. Since the MoPeG abolishes the principle of joint ownership for partnerships all together, this could result in a vast amount of "passive" violations of holding periods at the turn of the year 2023/2024.

Continued example: When the MoPeG comes into force on January 1, 2024, A will technically cease to be a joint owner of the partnership's assets. This could be considered a breach of the ten-year holding period (sec. 5 para. 3 sentence 1 RETT Act). The transfer of real estate from A to A GmbH & Co. KG in 2022 may retroactively become subject to tax.

Growth Opportunities Act ("Wachstumschancengesetz") Omits to Address RETT

The first draft of the Growth Opportunities Act addresses certain tax frictions resulting from the MoPeG's abolishment of the principle of joint ownership for partnerships. The notable omission of RETT may surprise initially.

For income tax purposes, sec. 39 para. 2 no. 2 of the revised German Tax Code draft stipulates:

"Assets to which several persons are jointly entitled as well as the assets of a partnership with legal capacity shall be attributable proportionally to the participants or partners insofar as taxation requires separate attribution. Partnerships with legal capacity shall be deemed communities of joint ownership for purposes of taxation on income, and their assets shall be deemed to be jointly owned."

For inheritance tax purposes, the draft legislation would introduce a new sec. 2a to the German Inheritance and Gift Tax Act:

"Partnerships with legal capacity (sec. 14a para. 2 no. 2 of the German Tax Code) shall be deemed a community of joint ownership for the purposes of inheritance and gift tax, and their assets shall be deemed to be jointly owned. In the case of a reception pursuant to sec. 1 para. 1 no. 1 to 3 by a partnership with legal capacity, its partners shall be deemed to be the recipients. In the case of gifts by a partnership with legal capacity, its partners shall be deemed to be donors."

The first draft of the Growth Opportunities Act does not contain any RETT provisions.

However: Discussion Draft to Reform the RETT Act

From the Federal Ministry of Finance's (BMF) point of view, this "omission" seems understandable. After all, the BMF has almost simultaneously launched a "discussion draft" for a comprehensive reform of the RETT Act. This reform is also drafted to come into force on January 1, 2024. The BMF primarily intends to replace the unsystematic and complex provisions on the taxation of share deals by an entirely new system. En passant, the discussion draft also addresses the abolishment of the principle of joint ownerships by the MoPeG.

The discussion draft proposes a revised sec. 5 RETT Act:

„(1) [...].

(2) If real estate is transferred from multiple co-owners to an entity, the tax shall not be levied to the extent that the share of the individual co-owner in the assets of the entity corresponds to his fractional share in the real estate and provided that the real estate was continuously attributable to the co-owner within the meaning of sec. 1a para. 3 sentences 2 to 4 in the five years preceding the transfer. If real estate is transferred from a sole owner to an entity, the tax shall not be levied to the extent the transferor holds a share in the assets of the entity, provided that the real estate was continuously attributable to him in the five years preceding the transfer within the meaning of sec. 1a para. 3 sentences 2 to 4.

(3) If real estate is transferred from an entity to the co-ownership of several participants in the entity, the tax shall not be levied to the extent the fraction of co-ownership received by the individual transferee corresponds to his share in the entity and provided that the real estate is continuously attributable to the transferee within the meaning of sec. 1a para. 3 sentences 2 to 4 in the five years following the transfer. If real estate is transferred from an entity to the sole ownership of a participant in the entity, the tax shall not be levied to the extent the transferee holds a share in the assets of the entity, provided that the real estate is continuously attributable to the transferee within the meaning of sec. 1a para. 3 sentences 2 to 4 in the five years following the transfer."

The discussion draft thus now longer refers to the principle of the joint ownership. Instead, it focuses on the participation quota of the participants in an entity, including partners in a partnership and shareholders in a limited liability company or stock corporation. This would ensure the continuation of the tax privileges for transactions involving partnerships realized after December 31, 2023.

The risk of unintentional violations of holding periods pursuant to sec. 5 para. 3 sentence 1 and sec. 6 para. 3 sentence 2 RETT Act which have not yet expired at year end 2023 would be addressed in the transitional provisions. Namely, sec. 23 para. 27 RETT Act is intended to regulate the following:

"Sec. 5 para. 3 sentence 1, sec. 6 para. 3 sentence 2 and sec. 7 para. 3 sentence 1 in the version applicable until December 31, 2023, shall continue to apply until the expiration of the periods specified therein to transfers realized under sec. 5 paras. 1 and 2 and sec. 6 para. 3 sentence 1 and conversions of joint property into area property under sec. 7 para. 2 in the version applicable until December 31, 2023, with the stipulation that the assets of the community of joint ownership shall be replaced by the assets of the partnership within the meaning of the Act on the Modernization of Partnership Law of August 10, 2021, (Federal Law Gazette I, p. 3436)."

This provision would prevent automatic breaches of holding periods merely due to the abolishment of the principle of joint ownership.

Outlook

The MoPeG may lead to tax frictions for real estate transactions involving partnerships. So far, the BMF has only addressed these issues in a discussion draft for a comprehensive reform of the RETT Act. Whether the discussion draft will be implemented by the legislator by the time the new partnership law comes into force is highly questionable. In particular the federal states could veto such a far-reaching reform of the RETT Act. The legislator should therefore keep a close eye on the prospects of success of the project and should not miss the opportunity to implement at least minimally invasive adjustments of the RETT Act to the MoPeG by the end of 2023.

Taxpayers should consult their tax advisors regarding any necessary measures in case the RETT Act will not be amended in time.

Experts



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