10 common mistakes and misconceptions when investing in German real estate from abroad

As of 11/2021

1 Underestimating the German bureaucracy.

Yes, it can be even worse than expected. The German system is very bureaucratic and there is no real viable way around it: Paper forms have to be filled out and it does take some time to finalize the official processes. But no need to worry. We are happy to guide you through the entire process of acquiring, maintaining and selling real estate in Germany or helping you with any ongoing issues.

2 Assuming that the English language can be used when communicating with German authorities

While the level of English proficiency is rather high in Germany – it´s typically the first foreign language in the school systems - the bureaucracy is still very much exclusively based on German. Forms and applications must be filled in German language and are rarely available in English. This is not only limited to public bureaucracy but also applies to the bank system, trade offices and public notaries. As learning German typically is not an option and if so, is all too often a lifetime project, there is no need to be concerned. We are happy to assist you and guide you through the formalities and helping you overcome the language and cultural barriers.

3 Closing costs in Germany can be rather high

When investing in German real estate, the closing costs are often underestimated. In fact, they are rather high. Germany requires a public notarization of all real estate related transaction be it in the form of an asset or share deal. In addition, any real estate transaction is subject to a real estate transfer tax. The real estate transfer tax varies between the 16 states in Germany with a tax rate range of 3.5% – 6.5% of the purchase price. Commonly estate agents / real estate brokers are involved and their fees vary between 2% and 6% of the purchase price.

Minor administrative costs (e.g. amendments of the public land register) are also levied in the course of the acquisition of real estate.

All the above costs are generally paid by the buyer.

4 Due to recent reforms, share deals involving the acquisition of German real estate are subject to real estate transfer tax

The acquisition of German real estate portfolios can result in considerable tax burdens for an acquirer due to high real estate transfer tax rates (between 3.5% - 6.5% depending on the federal state in which the real estate which is being transferred is located). In the past, in order to avoid such real estate transfer tax (“RETT”), many transactions were structured as share deals.

The recent reforms amending the RETT provisions came into effect 1 July 2021. Under these new rules, the circumstances that trigger RETT include the direct transfers of real estate, as well as where 90% or more of the shares in a German real estate-owning corporation are directly or indirectly transferred to either one new owner or multiple new owners within a 10-year monitoring period, or where 90% or more of such shares are directly or indirectly combined for the first time in the hands of a new shareholder (or where there is a 90% or greater change, directly or indirectly, of the partners in a German real estate-owning partnership within a 10-year monitoring period).

The amended RETT rules applicable as from July 2021 onwards are significantly more complex than the former rules. The transfer of shares of entities holding real estate in Germany can result in unexpected tax consequences. In particular share deals or merger and acquisition (M&A) transactions should be subject to a detailed due diligence to identify any potential RETT implications prior to closing.

5 Foreign corporations earning income from German real estate are not subject to German trade tax

Based on the German tax law, corporations are generally subject to Corporate Tax (flat line tax rate of 15 %) and Trade Tax (the trade tax rate varies between municipalities, but averages approximately between 14% and 17% of income) irrespective of their activity.

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Foreign corporations without a German permanent establishment ("PE") are not subject to German trade tax. Thus, income derived from German real estate is subject only to German CIT and not trade tax.

However, the risk of constituting a German PE of a foreign based corporation holding real estate shouldn't be underestimated and is particularly high, if the domestic property manager has extensive rights e.g., based on a power of attorney to act on behalf of the foreign based entity.

6 German corporations generating income from German real estate can avoid the trade tax burden under certain restrictive conditions

Based on the German tax law, corporations are generally subject to Corporate Tax (flat line tax rate of 15 %) and Trade Tax (the trade tax rate varies between municipalities, but averages approximately between 14% and 17% of income) irrespective of their activity.

If the entity however meets certain criteria, a specific trade tax exclusion may apply. If a corporation is exclusively (or almost exclusively) engaged in the administration of its own real estate, the entity is allowed to benefit from an "extended trade tax deduction," i.e., income derived from the management of a company's own real estate (such as rental income) is exempt from trade tax.

The application for this trade tax exclusion is very restrictive and should be verified and actively managed to avoid unwanted tax consequences. Note that this trade tax exclusion is typically subject to tax audits.

7 Germany levies a property tax ("Grundsteuer")

Owning real estate located in Germany is subject to an annual property tax. The tax liability of the property tax is based on the assessed value of the real estate property, the applicable valuation factor (which depends on the type of real estate, e.g., farmland, residential properties or business properties) as well as a multiplier which is determined by the respective municipality.

The German property tax was subject to a recent reform. The revised provisions provide for a valuation of real property based on a fair market value, which is multiplied by a uniform factor (known as the basic federal rate) as well as a multiplier determined by the municipalities. Further, the federal states will be entitled to, and several federal states have announced to, opt out of the federal system and to adopt their own land tax systems instead.

8 Depreciation of real estate in Germany

The purchase price for buildings acquired through an asset deal or a share deal with a partnership as the real estate-owning entity can be depreciated over the useful life of the asset in form of a straight-line depreciation. Subject to certain factors, the tax acceptable useful life for buildings is generally 33.3, 40 or 50 years.

In case of a share deal with a corporation as the owner of the building, the depreciation of the current book value remains unchanged (in contrast to the asset deal scenario) and no step up of the book value is possible.

However, the purchase price of land is excluded from annual depreciation.

In light of the above, the total purchase price of the real estate property is to be attributed to the building and land. This attribution is subject to strict rules of the German fiscal authorities.

9 VAT treatment of rental income

Based on the rather complex German VAT code, the leasing of real estate qualifies as a supply of services and is subject to VAT (VAT-able) but VAT-exempt.

Where the lessee uses the real estate for services or supplies subject to VAT (VAT-able), the lessor might opt/elect to treat its supply as a service subject to VAT (VAT-able) in order to claim the input VAT.

This VAT option/election is common market practice for business premises. It allows the investor to claim credit for the input VAT on construction works.

If the supply or service of the property owner and lessor of business premises is not subject to VAT and the lessor can, therefore, not opt for a VAT liable lease.

10 VAT treatment of the acquisition of real asset

In general, the supply of immovable property is exempt from VAT.

However, if the sale is made to an entrepreneur for business purposes, the exemption from the VAT liability can be waived.

The buyer is liable to pay VAT under the reverse charge procedure where transactions are subject to RETT and the buyer operates a business. 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.

The acquisition of a whole business or an independent part of a business ("Geschäftsveräußerung im Ganzen") to an entrepreneur is, in general, also not subject to VAT. Even the disposal of one piece of real estate can fall into this category, if it represents the main business asset. For purposes of input VAT adjustment, the purchaser replaces and 'succeeds' the seller.

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