

Tax and Business Law Consulting

Germany plans to extend taxation of non-resident capital gains resulting from the sale of shares in real estate-rich corporations



Background

Until recently, the disposal of shares in foreign corporations with domestic real estate assets by shareholders with limited tax liability could only be taxed if the corporation had its company seat or place of management in Germany and if the shareholder held at least 1 % of the company's share capital (pursuant to § 17 EStG - German Income Tax Act). A foreign corporation usually does not fulfill these company seat or place of management requirements. Although certain double taxation treaties (DTTs) already provide Germany with a right to taxation in this regard, at the moment there is no national taxation basis. The right of taxation remains theoretical, only. As a result, Germany's right to levy taxes, to which it is per se entitled based on several DTTs, has no impact.

The law "to prevent VAT losses relating to trade of goods in the internet and concerning the amendment of other tax regulations" - formerly: Annual Tax Act 2018 - is supposed to close this tax gap according to the wording of the government draft bill published early August 2018 (Bundesrat, Drucksache 372/18). § 49 EStG (income subject to limited tax liability) is to be amended in accordance with Article 13 (4) of the OECD Model Tax Convention, version 2017. Article 13 (4) of the OECD Model also forms the basis for negotiating new DTTs to be concluded or existing ones to be revised.

Tax Structures concerned

The vast majority of structures concerned is related to companies which own real estate located in Germany, while the real estate company itself (as the owner) as well as its shareholders are solely tax resident abroad.

Draft Legislation

With the addition of a double letter cc) in § 49 sec. 1 No. 2 letter e) EStG, respective revenue related to the disposal of shares in domestic and foreign real estate companies will be considered German taxable income. Prerequisite for the tax liability is that

- more than 50 % of the value of the corporation's shares is based, directly or indirectly, on real estate located in Germany at any point in time during the 365 days preceding the disposal and
- pursuant to § 39 AO (German Tax Code), the shares in the corporation were attributed to the seller at that time.

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Since the general prerequisites of § 17 EStG are also applicable, it is sufficient, if the seller held at least 1 % of the share capital of the corporation within the last five years preceding the disposal. Therefore, it is not necessary for the seller to hold at least 1 % of the shares in the corporation at the time of disposal.

Valuation of domestic company assets

The quota of 50 % of domestic immovable assets as part of the total assets is to be calculated based on the book values of the company assets. If the assets of an indirect shareholding are to be included, the quota of 50% is to be calculated based on a consolidated view of the assets of the companies, to which the domestic immovable assets can be directly or indirectly attributed - according to the explanatory note of the draft legislation.

Date of Application

The upcoming revision will be applicable to capital gains from the disposal of shares taking place after 31 December 2018. Furthermore, only gains based on a change in market value occurring after this date are to be considered. Past value increases of shares continue to be exempt from taxation.

Impact - practical implementation

The tax base gain in connection with the new legislation is likely to be rather small. Pursuant to § 8b KStG (German Corporation Tax Act), capital gains from the disposal of shares by foreign corporations remain fully tax-exempt (insofar, pursuant to BFH, judgment of 31 May 2017, case no. I R 37/15, the fiction of non-deductible operating expenses of 5 % is not applicable). In the absence of a domestic permanent establishment of the seller, trade tax is also not applicable. Therefore, especially investors who cannot claim § 8b KStG, namely natural persons - where the German partial income system pursuant to § 17 EStG applies - and certain finance and insurance companies would be materially affected.

Practical problems of application might arise concerning the method with which the existence of the required criteria can be determined or reviewed in the future. Non-resident shareholders of corporations - particularly those with micro shares - usually do not have the necessary information to derive and determine, whether the share value of the corporation in the year preceding the disposal was based on more than 50 % of real estate assets in Germany.

Moreover, the application of the 365-day-period could be difficult, if e.g. a complete disposal of the real estate by the foreign corporation is followed by a sale of shares by a shareholder and the 365-day-period has (formally) not expired yet. The capital gain arising from the sale of the real estate itself is already taxed on the level of the real estate owning corporation, see § 49 sec. 1, No. 2, letter f), double letter bb).

Further developments

The finalization of the legislative process is planned before the end of this year. Further developments and the specific version of the final legislation remain to be seen. Given that many related questions remain unanswered, changes cannot be ruled out.