Real estate investments in Germany – A Tax Perspective

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The German real estate market is still considered an attractive investment area in Europe - for Israeli investors – due to the size of the market and economic stability in the country.

German real estate can be acquired directly by purchasing the property or indirectly by purchasing the interests or shares of a real estate holding entity.

The property itself might be acquired by an individual directly or a legal entity with legal capacity, whether resident or non-resident. A legal entity includes a German stock corporation (AG), a limited liability company (GmbH) or a foreign corporation incorporated under foreign law. A further possibility is an investment through an unincorporated civil law association with unlimited liability of its partners (KG) or through a GmbH & Co KG, where the unlimited partner is a limited liability company (GmbH).

The sale and purchase agreement itself requires notarization by a German public notary. Only with the entry of the purchaser's name in the land register, does the transfer of title become complete. In order to protect the purchaser, the agreement will provide for the registration of a priority notice. An individual, legal entities and partial legal entities like KG, GmbH & Co KG or companies incorporated under foreign law are capable of being entered in the land register.

Real estate transfer tax – RETT - Grunderwerbsteuer

Real estate deals, whether outright property transfers or deals in shares of a real estate company, are subject to RETT triggered by the binding legal contract. The level of the taxation is decided by the respective Federal State where the real estate is situated and rates vary between 3.5% and 6.5 %.
RETT may also apply in a share deal, depending on the legal form of the real etate entity acquired (corporation or partnership) and the respective shareholding (at least 95 % transferred or total shareholding of the buyer). The tax base for share deals is the tax value of the real estate assessed according to the Tax Valuation Act.
Certain acquisition structures are used in order to not be liable to pay RETT in a share deal.

Value added Tax - VAT

VAT rate in Germany is generally 19 %.
The sale of real estate by way of an asset deal as well as the leasing of the real estate is usually exempt from VAT. However there is a possibility to opt for VAT in order to collect input VAT.

Taxation of rental income

The income of non-resident individuals who receive rental income are subject to individual income tax with a progressive tax rate, which can amount to 45% plus solidarity surcharge of 5.5%. The same applies if the foreign resident invests in German real estate through a KG or through a GmbH & Co KG.
Is the investment made through a German or foreign corporation then the profits are subject to corporate income tax of 15% plus solidarity surcharge of 5.5%. The distribution of dividends by a German corporation triggers withholding tax of 26.375 % incl. solidarity surcharge on the shareholder level, which in the case of an Israeli investor is not reduced according to the Double Tax Treaty between Israel and Germany. If the investment is made by a foreign corporation there is no further German tax upon the distribution to the foreign shareholder.
All commercial business operations are liable to pay trade tax irrespective of their legal form. Trade tax is set by the municipality where the business is located and rates differ from 7% to 17.5%. The tax is imposed when the investor engages in commercial activity or in commercial trade of real estate, in contrast to the mere administration, use and holding of the property. Unlike individuals or partnerships, German corporations are always deemed to carry on commercial enterprises with the result of trade tax except for various exemptions with strict conditions. In this case the trade tax is not deductible as business expense (resulting in an effective tax rate of approx. 30%-33%), in contrast to individuals where trade tax can be offset against the personal income tax. Foreign corporations are exempt from trade tax as long as they do not maintain a permanent establishment in Germany.

The tax treatment of financing

The deductibility of interest expenses for businesses is subject to the earnings stripping rules ("Zinsschranke"). This rule applies to all types of debt financing of unincorporated businesses and corporate entities including shareholder debt as well as any third party debt. The deduction of net interest expenses is limited to 30% EBITDA if the net interest expense exceeds €3 million. Disallowed interest expenses can be carried forward for five years. The "Zinsschranke" does not apply if there is an individual foreign investor with no commercial activity or if the investment is made through a "gewerblich entpraegte" KG.

Exit

Capital gain on the sale of real property by an individual or by a (KG) might be tax exempt if the property is held for more than 10 years. The same applies at the disposal of interests in the real estate holding partnership. Not depending on the holding period capital gains are always included in taxable income when a German or foreign corporation disposes of the property. In the case of disposition of shares in a German real estate holding corporation the Israeli-German tax treaty would assign the right to taxation to the residence state. There is no taxation upon the sale of shares in a foreign corporation, even though the transaction might be subject to RETT, which might be avoided through proper acquisition structures.

The taxation of real estate investments have a major impact on ultimate return on investment. Early and proper structuring is fundamental.