



Greenwoods & Freehills

REIT (and similar bodies) Tax Conference

GERMAN PROPERTY STRUCTURES

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German Property Structures

- **Agenda**
 - ■ **Basics**
 - ■ **Structures**
 - ■ **G-REIT**
 - ■ **2008 business tax reform (proposed)**

Basics (1)

■ Income tax rates

- ■ 26.375 % corporate tax rate
- ■ 49.6 % top marginal income tax rate
- ■ 9 % - 20 % trade tax
- ■ 38 % - 40 % combined corporate and trade tax

■ Withholding tax

- ■ 21.1 % dividend wht
- ■ 15 % dividend wht (art. 10 (2) Australia-Germany tax treaty)
- ■ Zero dividend wht under EU P/S directive
- ■ No wht from rents
- ■ No wht from interest (other than on hybrid instruments)

Basics (2)

■ Taxable income

Rents

- ./ operating expenses
- ./ depreciation (2 % to 3 % of historic acq. cost)
- ./ Interest expense (subject to thin cap rules)

■ Thin capitalization

- ■ Shareholder/related party loans to foreign or domestic corporations or partnerships with a greater than 25 % corporate partner
- ■ Third party (recourse) loans
- ■ €250 K annual allowance
- ■ 1.5 to 1 debt to equity safe haven

Basics (3)

- **Capital gains**
 - ■ **Gain on shares in foreign corporation not taxable**
 - ■ **Gain on shares in domestic corporation ordinarily 95 % tax exempt**
 - ■ **Gain on interest in (domestic or foreign) partnership owning German property taxable at ordinary rates**
 - ■ **Gain on property taxable at ordinary rates (exception for individuals having owned property for more than 10 years as passive investment)**

Basics (4)

- **Real Estate Transfer Tax (RETT)**
 - ■ **3.5 % rate (Berlin 4.5 %)**
 - ■ **Based on property value (either purchase price or tax value)**
 - ■ **Acquisition of property**
 - ■ **Direct or indirect acquisition of a 95 % or greater interest in partnership**
 - ■ **Direct or indirect acquisition of 95 % or more of the shares in a corporation by a single purchaser or a group of purchasers belonging to the same RETT group**

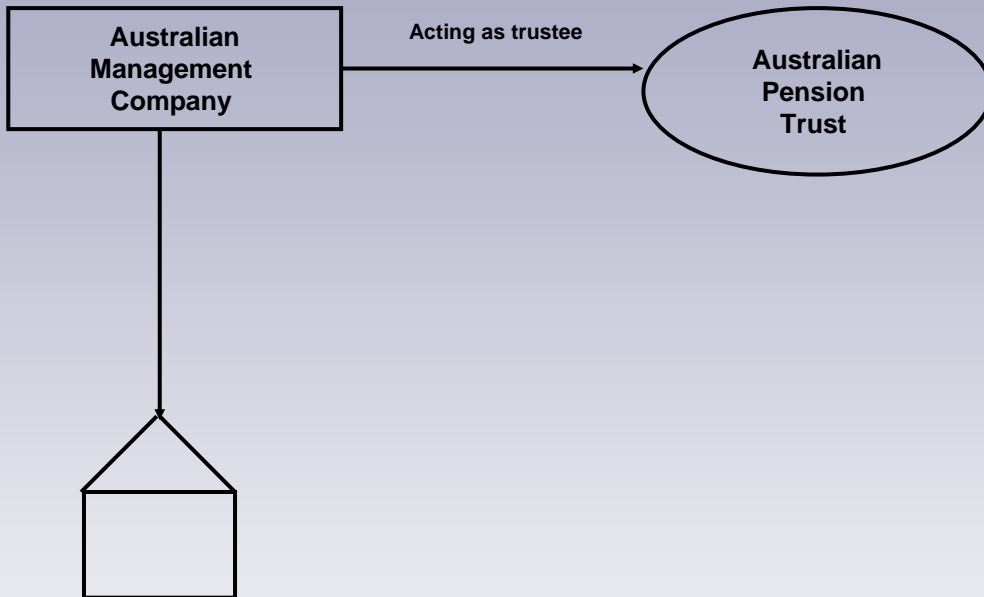
Basics (5)

- **Other taxes**
 - ■ **Property tax (recurring charge)**
 - ■ **VAT (important !)**
 - ■ **No wealth tax**
 - ■ **No capital duty**
 - ■ **Gift and inheritance tax**

Structures (1)

- **Structures used by domestic investors**
 - ■ **GmbH & Co. KG (limited partnership)**
 - ■ **AG/GmbH (corporation)**
 - ■ **Domestic investment fund**
- **Structures used by foreign investors**
 - ■ **BVI/Gibraltar/Malta/Madeira/Luxembourg companies**
 - ■ **Highly leveraged**

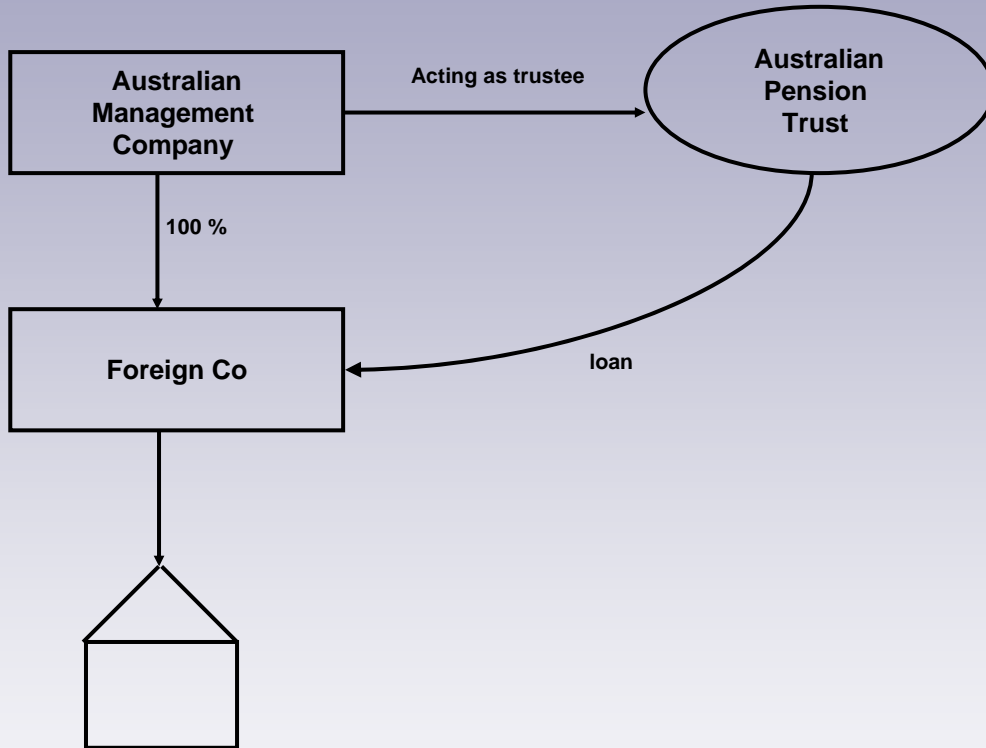
Structures – Acquisition of a property (1)



Issues:

1. **Who is the taxpayer?**
 - Management company
 - Pension Trust
 - Beneficiary
2. **Who must file a German income tax return?**
3. **Which tax rates apply?**
4. **Capital gain is subject to German tax**
5. **On-sale triggers RETT**

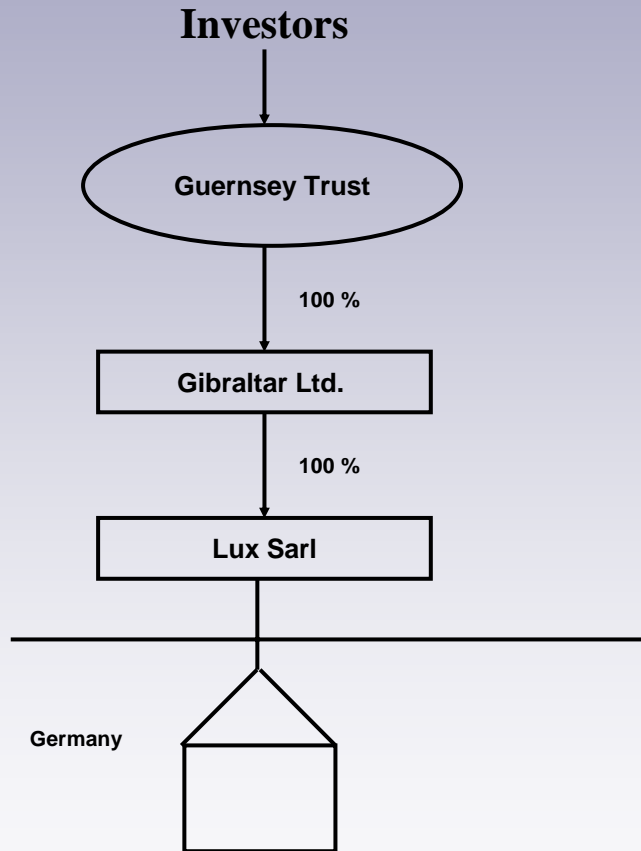
Structures – Acquisition of a property (2)



1. **26.375 % tax on net income (incl. capital gain)**
2. **Typically no trade tax.**
3. **Thin cap rules apply.**
4. **No German income tax on the sale of shares in FCo (no step-up in tax basis of the property)**

Structures – Acquisition of a Foreign PropCo (1)

Seller's structure

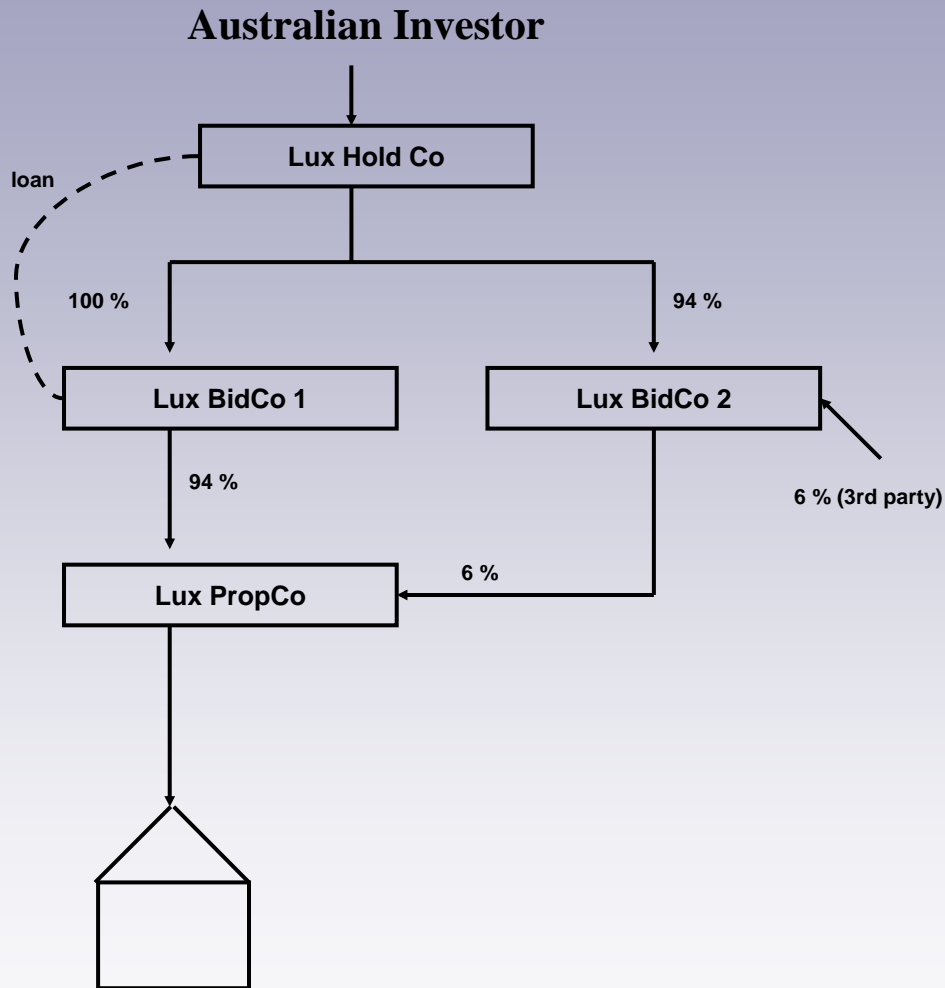


1. **Sellers offers all shares in Lux Sarl.**
2. **Seller suffers no German capital gains tax.**
3. **Purchaser shall bear RETT (if any).**

Structures – Acquisition of a Foreign PropCo (2)

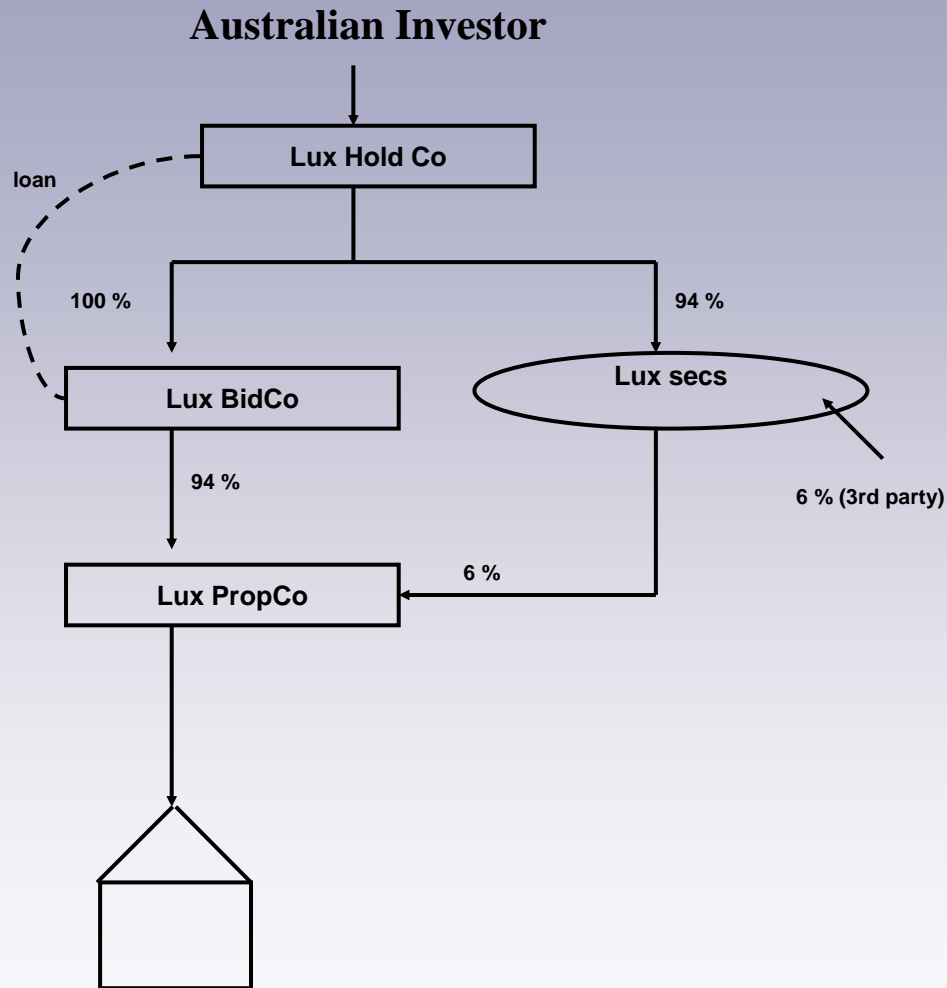
- **Issues for the Purchaser**
 - ■ **Avoiding RETT**
 - ■ **Debt push down**
 - ■ **Tax free exit**

Structures – Acquisition of a Foreign PropCo (3)



1. Acquisition of 95 % or more of the shares in Lux PropCo triggers RETT.
2. 3rd party's 6 % ownership in BidCo 2 avoids attribution of 6 % shares in Lux PropCo to Lux HoldCo.
3. But: RETT is triggered if both BidCos are integrated into Lux HoldCo. (RETT group).

Structures – Acquisition of a Foreign PropCo (4)



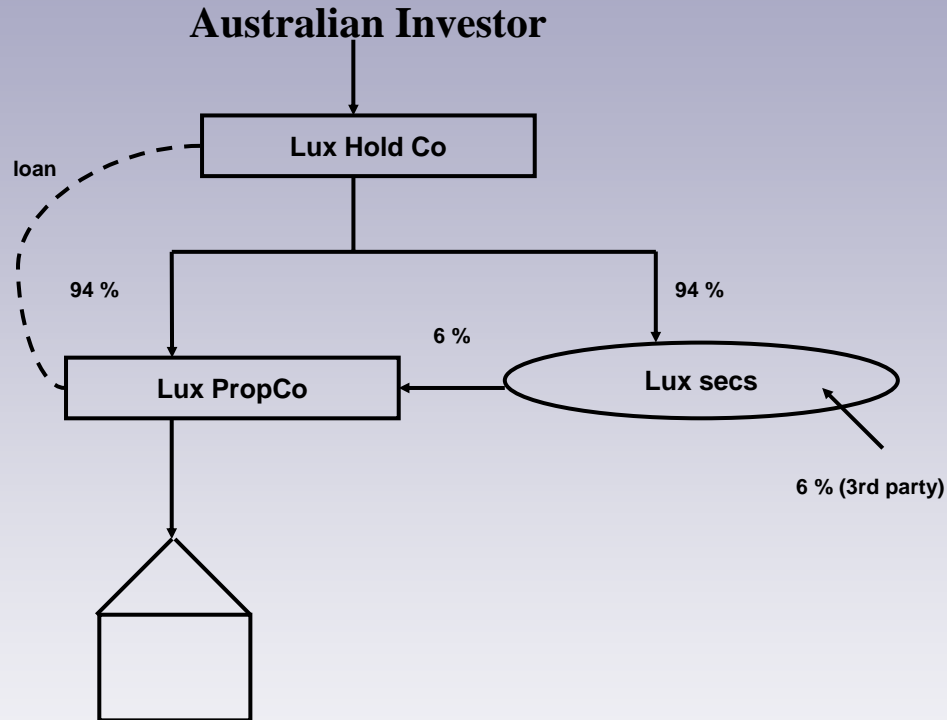
1. Lux secs is a Lux limited partnership.
2. Partnership cannot be integrated and is thus outside RETT group.

Structures – Acquisition of a Foreign PropCo (5)

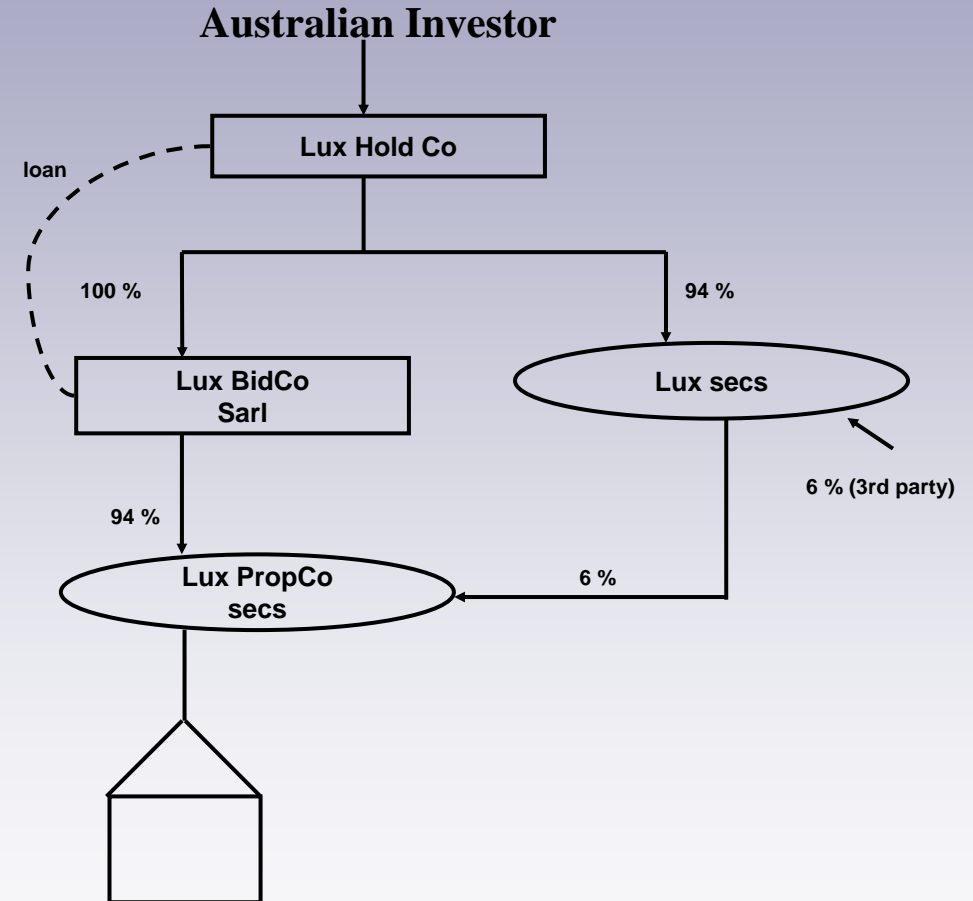
- **Debt push down**
 - ■ **Downstream merger of Lux BidCo into Lux PropCo**
 - ■ **Conversion of Lux PropCo into secs**
 - ■ **No RETT**
 - ■ **No gain recognition**

Structures – Acquisition of a Foreign PropCo (6)

Downstream merger

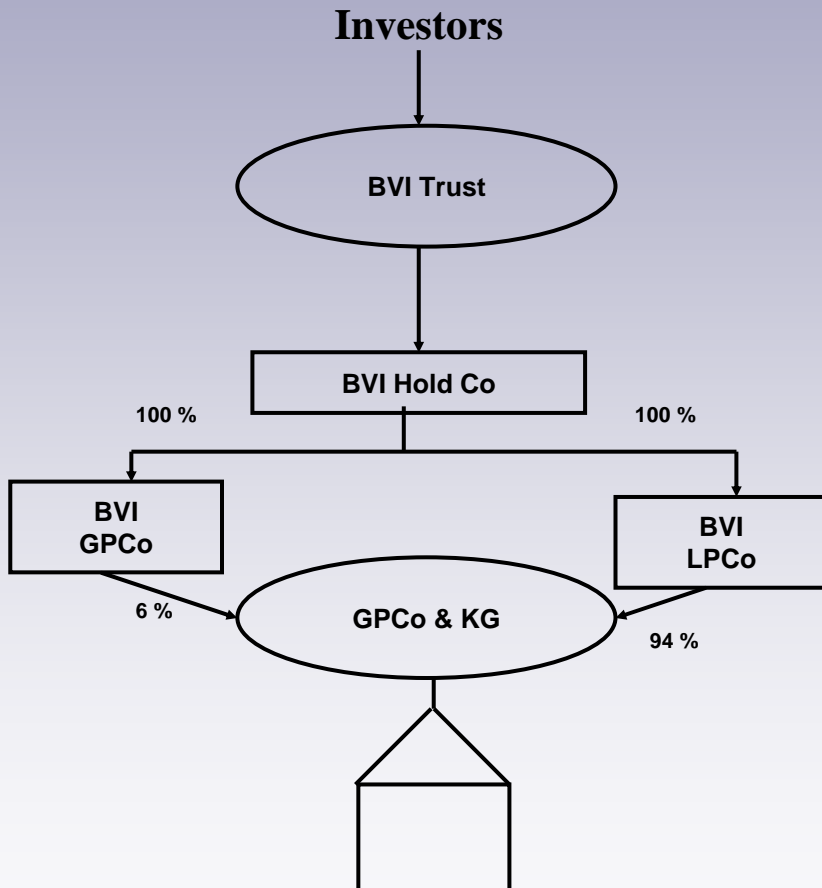


Conversion into secs



Structures – Acquisition of a German Partnership (1)

Seller's structure

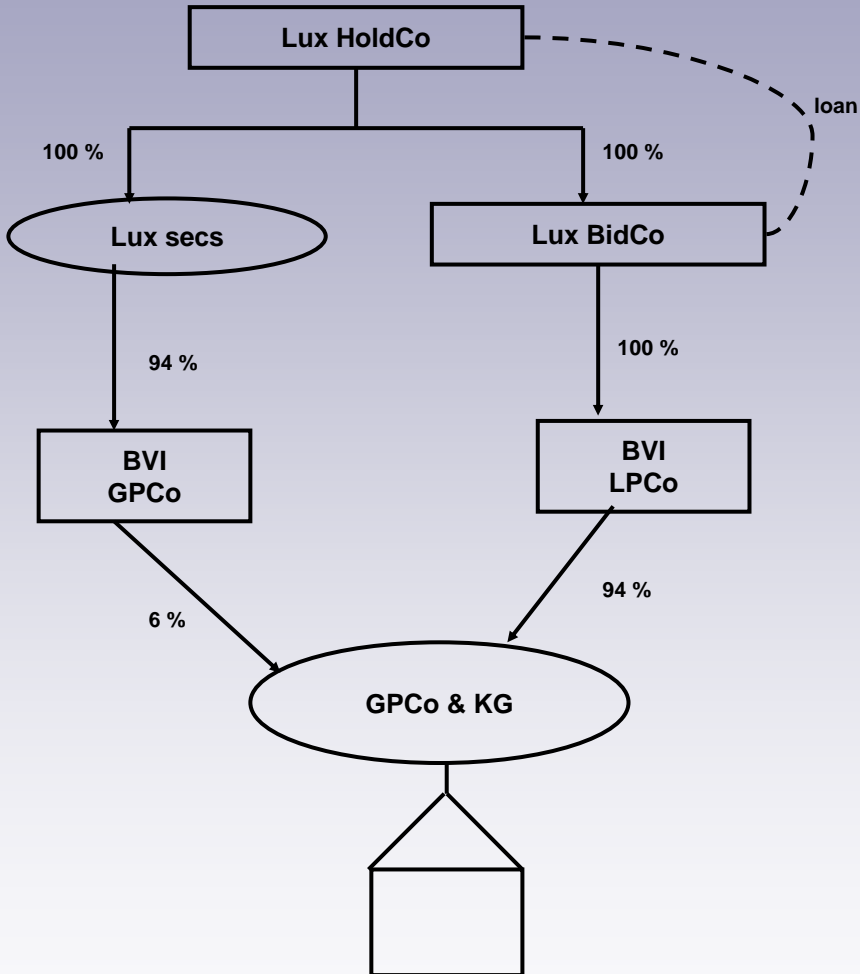


1. Seller offers all shares in BVI GPCo and BVI LPCo
2. Seller suffers no German capital gains tax
3. Purchaser shall bear RETT (if any)

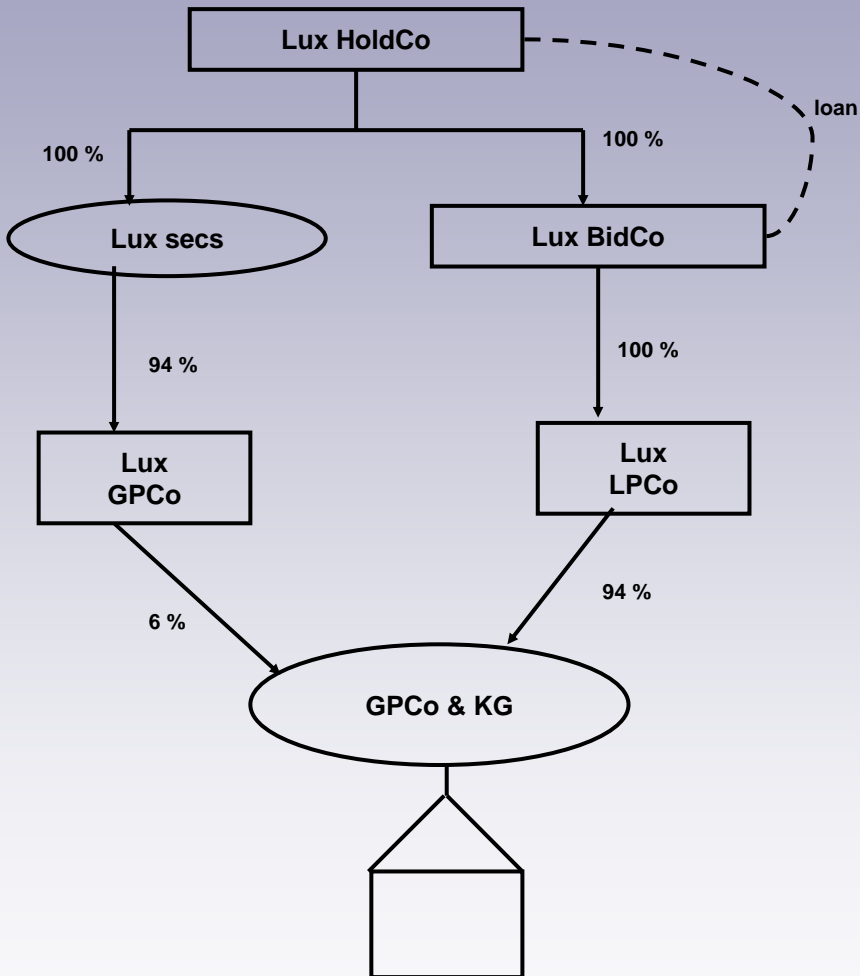
Structures – Acquisition of a German Partnership (2)

Acquisition structure

1. No RETT
2. Secs avoids RETT grouping rules



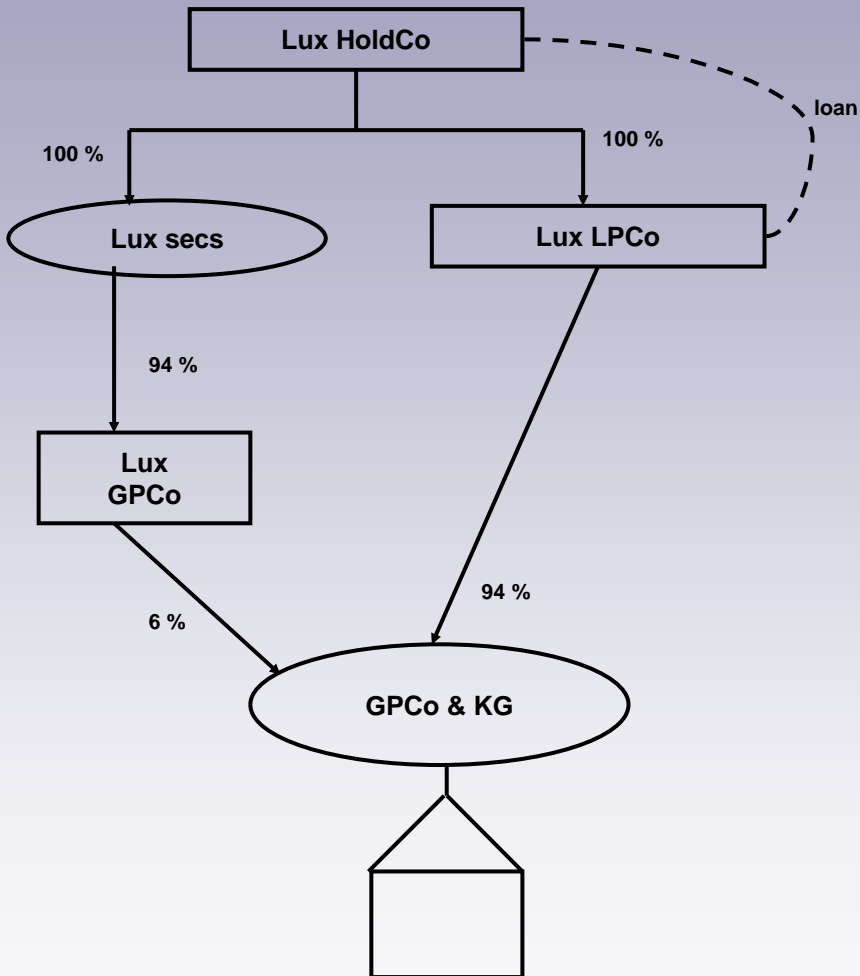
Structures – Acquisition of a German Partnership (3)



Corporate continuance

1. **BVICos move to Lux under continuance of their corporate identity (no asset transfer)**
2. **Should neither trigger RETT nor gain recognition (ruling recommended)**

Structures – Acquisition of a German Partnership (4)



Downstream merger

1. **LuxBidCo is merged downstream (into Lux LPCo (former BVI LPCo))**
2. **Interest of Lux LPCo should be deductible against taxable profit shares in GPCo & KG (subject to thin cap rules)**

G-REIT: Overview

- **Legislative proceedings**
- **Requirements to qualify as G-REIT**
- **Tax treatment of a G-REIT**
- **Tax treatment of the shareholders of a G-REIT**
- **Tax treatment of a foreign REIT**

G-REIT: Legislative Proceedings

- **First draft law of 25 September 2006**
- **Second draft law of 2 November 2006**
 - ■ **No major changes except that a G-REIT may not hold existing residential properties**
 - ■ **To be submitted to parliament**
 - ■ **Enactment expected for March 2007 with retrospective application as of 1 January 2007**

Requirements to qualify as a G-REIT

- **Shareholders**
- **Assets and Activities**
- **Listing**
- **Leverage**
- **Distribution**
- **Entity**
- **Non-trading**

G-REIT: Shareholder Requirements

- **At least 25% free float at listing, thereafter at least 15% free float**
 - **Only shares held by shareholders owning less than 3% count as free float for the 15 % test**
- **Maximum participation of less than 10% per shareholder**
 - **10% limit relates to direct shareholdings only**
 - **Shareholder may own in addition to a direct shareholding of less than 10% indirectly further shares up to an aggregate participation of 85%**

G-REIT: Assets and Activities (1)

- **Business purpose of G-REIT must be restricted to**
 - ■ **Acquiring, holding, managing and disposing of property or rights in rem in real estate in Germany and abroad**
 - ■ **Other than existing rented residential property**
 - ■ **Acquiring, holding, managing and disposing of interests in real estate partnerships**
- **G-REIT may invest in foreign real estate**
 - ■ **Either directly or through (domestic or foreign) wholly-owned corporations which own exclusively foreign properties (other than existing rented residential properties)**
- **G-REIT may own shares in (taxable) REIT Service Corporations provided that the G-REIT owns all shares in the service company**
- **G-REIT may engage in real estate-related ancillary services pertaining to its own properties**

Assets and Activities (2)

- Real estate related ancillary services serving third party properties may not be carried out by the G-REIT but only by a wholly-owned REIT Services Company
- Total assets (after deducting the distribution liability and a capital gains reserve) must be comprised of not less than 75% of real estate
- A G-REIT must derive not less than 75% of its gross earnings from renting, leasing, letting and disposing of real estate
- G-REIT must not engage in trading in real estate

G-REIT: Listing Requirements/Leverage

- Shares of the G-REIT must be admitted to trading in an organised market (as defined in § 2 para. 5 of the Securities Trading Law) in a member state of the EU or the EEA

- Leverage limited to 60% of total assets
 - Total assets for this purpose to be valued at fair market value

G-REIT: Distribution and Entity Requirements

■ Distribution

- ■ At least 90% of the distributable profits shown on the stand-alone balance sheet by the end of the following financial year
- ■ Up to 50% of capital gains may be transferred either to a reserve to be dissolved by the end of the second financial year or to be deducted from the acquisition cost of real estate acquired

■ Entity

- ■ German stock corporation with seat and place of management in Germany
- ■ Minimum share capital of EUR 15 mil.
- ■ Single class of shares

Tax Treatment of the G-REIT

- **G-REIT is exempt with its total income from corporate tax (Körperschaftsteuer) and trade tax (Gewerbesteuer)**
 - ■ **No ring-fencing concept**
- **G-REIT is not exempt from other taxes such as RETT and VAT**
- **Corporate subsidiaries of a G-REIT are not tax-exempt**
- **Profit share in a real estate partnership is exempt from corporate and trade tax at the level of a G-REIT (but profit may be subject to trade tax at the level of the partnership)**
- **G-REIT does not qualify for the benefits of the EU Parent/Subsidiary Directive nor for the benefits of the EU Merger Directive (neither as parent company nor as subsidiary)**
- **G-REIT does not qualify as controlling company for purposes of a corporate and trade tax Organschaft**

Tax Treatment of the Shareholders of a G-REIT

- Resident shareholders
- Non-resident shareholders
- Dividends received
- Capital gains/losses

Resident Shareholders

- 26.375% dividend wht from distributions
- Dividends received from a G-REIT are fully taxable in the hands of the resident shareholder
 - Neither the 95% exemption for corporate shareholders nor the 50% exemption for individual shareholders is applicable
- No relief for underlying taxes incurred by the G-REIT
 - Foreign income taxes suffered by the G-REIT (or by a corporate subsidiary) on income derived from foreign properties
 - German income taxes suffered by a G-REIT services company on its taxable income
 - Trade tax suffered by a subsidiary real estate partnership
- Participation exemption (50%/95%) not applicable on capital gains

Non-Resident Shareholders

- **Dividends**
 - ■ 26.375% wht subject to lower treaty rates
 - ■ Treaty rates for substantial shareholdings (more than 10%, 20% or 25% depending on the treaty) explicitly excluded
 - ■ Typically, reduction to 15% (rarely 10%, e.g. Ireland)

- **Capital gains**
 - ■ Participation exemption non-applicable
 - ■ Ordinarily, treaty protection is available
 - ■ Important exceptions (Australia, Canada, US treaty)

Tax Treatment of a foreign REIT

- A foreign REIT does not qualify for the tax exemption
 - is regarded by the German government as justified discrimination irrespective of the ECJ decision in the Stauffer case
- Foreign REIT earning German-source income is subject to German income tax as any other foreign corporation
- Foreign REIT should qualify as “resident person” and be entitled to treaty benefits irrespective of tax exemption in its country of residence

2008 Business Tax Reform (proposed)

- Presented in November 2006 in very broad terms
- Corporate tax rate down to 15.825%
- Combined corporate and trade tax rate down to about 30%
- Abolishment of thin cap rules
- Introduction of an earnings' stripping provision
 - Applies to any interest incl. on bank loans
 - Unlimited deduction for the first €1 mil. p.a.
 - Current deduction for additional interest expense limited to 30% of EBIT