

German Tax Issues Involved in the Purchase, Ownership and Sale of Real Property in Germany

Rechtsanwalt Volker Krümpel

Friedrichstrasse 153a
D-10117 Berlin

Fon: +49 30 4000 4696
Fax: +49 30 4000 4697

kruempel@wkberlin.com

This memorandum has been composed for the clients of Solid Rock Consultancy

Solid Rock Consultancy
Checkpoint Charlie
Friedrichstrasse 50
10117 Berlin
T.+49 (0)30 501 85 959
F.+49 (0)30 501 85 960

Head Office
Spaarndammerstraat 53
1013 TA Amsterdam
info@soidrockconsultancy.com
www.solidrockconsultancy.com

Table of Contents

- 1. Introduction.....2
- 2. Form of ownership.....2
 - a) Direct ownership.....2
 - b) Ownership through a non-German legal entity.....2
 - c) Ownership through a GbR.....2
 - d) Ownership through another German legal entity.....3
- 3. Taxes or fees payable upon the purchase of real property3
 - a) Land transfer tax.....3
 - b) Notary fees3
 - c) Real estate agent's fees3
 - d) Land registry fee.....4
- 4. Taxes payable in connection with the ownership and sale of real property4
 - a) Double taxation convention4
 - b) Real property tax4
 - c) Income tax4
 - d) Capital gains tax.....4
 - e) How taxes are payable if a GbR is used5
 - f) Taxes payable by real estate dealers.....5
 - g) Taxes payable if a GmbH or other corporate entity is used5

1. Introduction

The following is a very brief summary of the taxes and certain other fees one must pay in connection with the purchase, ownership and sale of real property in Germany. There is also a short description of a Gesellschaft bürgerlichen Rechts (GbR), the type of partnership often used in Germany to buy and hold real property.

2. Form of ownership

The first decision a purchaser of real property in Germany must make is how it wants to hold the property. There are basically four alternatives: direct ownership, ownership through a non-German legal entity or ownership through a German GbR or other German legal entity.

a) Direct ownership

If a single person is purchasing the real property, it is probably simplest for that person to take legal title in his or her name.

If two or more persons purchase a property and wish to take title to the property directly, that kind of co-ownership is called Miteigentum in Germany. Each purchaser owns an undivided interest in the property equal to its percentage share. A disadvantage of Miteigentum is that there may be legal uncertainty concerning the management, operation and eventual sale of the property. These issues could, of course, be addressed in a separate agreement between parties.

b) Ownership through a non-German legal entity

There may be tax or other reasons under the law of the purchaser's home jurisdiction that make it advantageous for the purchaser to use a separate non-German legal entity to hold real property purchased in Germany. A purchaser should discuss these issues with its accountant or legal adviser.

c) Ownership through a GbR

Individuals buying real property in Germany often establish a GbR, which buys and takes title to the property. Establishing a GbR is simple and inexpensive. A GbR is useful because in the GbR agreement the owners can set forth how the property will be run and managed, how decisions will be made and how profits and expenses will be apportioned.

Under German law, a GbR is a simple form of partnership, which is established by an agreement between at least two natural persons to promote an economic purpose by combining their efforts and contributing capital to the venture. Although it is not legally required, a written GbR agreement is usually entered into. Notarization of the agreement is only required if real estate is contributed to the GbR by one or more of the partners for further sale by the GbR (as opposed to use by the GbR).

The GbR itself does not possess the status of a legal entity separate from its owners. It is not registered as an entity in the German Commercial Register (Handelsregister), and any action by a GbR must be taken by all of its partners, unless the GbR agreement delegates the authority to act to a particular partner or partners. However, the German Supreme Court has held that a GbR can be sued without naming the owners as well.

The assets of a GbR are held by all its partners jointly (Gesamthandsvermögen) and the liability for obligations of the GbR is borne by all the partners jointly and severally. Creditors with unsatisfied claims against the GbR are entitled to sue the partners both

as members of the GbR and as private individuals, unless a contract with a particular creditor provides otherwise.

d) Ownership through another German legal entity

Real property may also be held through other German legal entities, such as a Gesellschaft mit beschränkter Haftung (GmbH). The primary advantage is that the owners would be shielded from most liabilities arising from the property. However, a more complex legal structure is required. For instance, a GmbH must have a manager (Geschäftsführer) who is responsible for the GmbH's activities. In addition, a GmbH and other German corporate entities are subject to a different tax regime, which can result in adverse tax consequences to the investors. These are described briefly below.

If limitation of liability is a primary concern, we are happy to describe in greater detail the alternative structures that are available, as well as their advantages and disadvantages.

In the normal situation, however, it is customary in Germany either to hold real property directly or through a GbR.

3. Taxes or fees payable upon the purchase of real property

a) Land transfer tax

When property is purchased in Germany, the buyer must pay a land transfer tax (Grunderwerbssteuer) in the amount of 3.5 % of the purchase price.

The land transfer tax is also payable if one purchases a GbR whose only or principal asset is real property. There is one exception to this rule and where the land transfer tax may be avoided. That is the case where the seller retains at least 5% ownership of the GbR for at least 5 years. The contract may provide that this 5% is automatically transferred to the purchaser at the end of the five-year period. Obviously, there are risks in buying a GbR, inasmuch as the GbR may have liabilities and obligations that are not disclosed to the purchasers. Furthermore, it may be undesirable to have an unrelated party owning a minority interest in the GbR.

b) Notary fees

A purchase agreement transferring ownership of real property must be notarized and later entered into the land registry (Grundbuch) of the district where the property is located. The notarial fees are fixed by law and depend on the value of the property as well as on the way the transaction is structured. Notarial fees are approximately between 0.5% and 1.5 % of the purchase price.

If, instead, the shares of a GbR owning that real property are purchased, there is no legal requirement that this share purchase contract be notarized. However, it is currently universal practice to have the contract notarized in order to avoid any future legal dispute concerning the parties' intentions or the legal effect of the transaction. The notary fees would be approximately equal to those involved in a direct purchase of the real property.

c) Real estate agent's fees

If a real estate agent (Makler) is involved in the sale, the agent will be paid a fee. Normally, this fee is paid by the purchaser, though under certain circumstances this is negotiable and the seller may be willing to pay it. The agent's fee is typically 6% of the purchase price plus VAT (6.96% under the current 16% VAT regime). The fee is,

however, often negotiated, and certain agents, especially smaller companies, will accept a fee of 3% (3.48% with VAT).

d) Land registry fee

A purchaser of real estate must pay a fee to have its name entered in the local land registry (Grundbuch) as the legal owner. This fee is fixed by law and depends on the value of the property as well as on the way the transaction is structured. It is approximately 0.2% to 0.5 % of the purchase price.

4. Taxes payable in connection with the ownership and sale of real property

a) Double taxation convention

The German-U.S. Double Taxation Convention provides that income derived in Germany by a U.S. resident may be taxed in Germany (beschränkte Steuerpflicht). The Convention also provides that any tax paid in Germany will be allowed as a credit against taxes payable on that income in the U.S. (subject to U.S. tax law on such allowances).

b) Real property tax

Annually a real property tax (Grundsteuer) is assessed against any real property owned in Germany. This tax is calculated by the local tax office in a rather complicated fashion, based on assessed values and rates. It is usually 0.25% to 0.35% of the purchase price. It is common practice in Germany for a landlord to shift the Grundsteuer to its tenants under the rental agreements.

c) Income tax

Natural persons without permanent or habitual residence in Germany are normally subject to German income tax (Einkommensteuer) only on income earned in Germany.

Thus rental income from any property owned by a non-resident of Germany or the capital gain from selling the property is subject to income tax.

The income tax rate is between 15% and 42%, depending primarily on the amount of income that individual receives in Germany. In addition to the income tax a supplement of 5.5 % of the assessed income tax is charged as a "solidarity surcharge" (Solidaritätszuschlag). Thus, for example, on the basis of an income tax rate of 15 % the supplement would result in a rate of approximately 15.8 %. The solidarity surcharge was established in order to finance German reunification.

d) Capital gains tax

As noted, any gain upon the sale of a property is subject to income tax. However, if a property is held for at least 10 years and if the owner is not someone who "deals" in real property (real estate "dealership" is discussed below), no German income tax is payable on any capital gain arising from the sale of the property. This is a significant benefit. It should be noted, however, that there are currently moves in the German parliament to change or remove this tax benefit. It is not yet known whether a purchase made prior to any change will be "grandfathered" and retain the benefit of this tax-free status.

If the property is held for less than 10 years or if the seller is a real estate "dealer", a capital gains tax equal to the income tax described above is payable on any gain.

e) How taxes are payable if a GbR is used

A GbR is in essence a type of partnership, and is not itself subject to income tax under German law. However, the economic results of the GbR determine the taxable income from the GbR for each person having an ownership interest in it.

Thus, each person having an interest in the GbR pays, on an individual basis, his or her own income tax. The reason for this is that each person with an interest in a GbR will have his or her own particular German tax situation. For instance, one person, but not all others, may have other German income, placing that person in a higher tax bracket.

f) Taxes payable by real estate dealers

Note that there is no clear definition of a person who “deals” in real estate. It is thought that this term includes only persons or entities that own multiple properties and who buy and sell properties on a regular basis and would not include most normal foreign investors.

There is a rule of thumb that a person, or GbR, is not a real estate dealer if it sells no more than three properties within a five year period. This period may be increased to ten years under certain circumstances.

If someone is a real property dealer, he must pay a trade tax as a special type of income tax called Gewerbesteuer. The Gewerbesteuer is assessed on the basis of the trade income in a rather complicated way and determined by local regulations. The trade tax in Berlin is approximately between 4% and 20 % and reduced by certain amounts to avoid double tax burdens for example in relation to real estate tax (Grundsteuer) or income tax.

In addition to that the dealer must also charge 16% VAT on each sale. The current government in Germany intends to increase VAT to 19%.

However, VAT and the other effects of being a real estate “dealer” do not affect the normal non-resident purchaser of German real estate, who buys one or more properties and holds them for investment.

Note also that a developer who develops and sells real property it owns is not a real property dealer and is not obligated to charge VAT.

g) Taxes payable if a GmbH or other corporate entity is used

Unlike GbRs, legal entities are subject to corporate income tax (Körperschaftsteuer) as a special form of income tax (Einkommensteuer). The corporate income tax rate is 25% plus the 5.5 % solidarity surcharge, thus approximately 26.4 %. In addition, any profits or dividends paid to shareholders are taxed at the rate of 20% (Kapitalertragssteuer) as part of the income tax the shareholder has to pay. This results in double taxation of the same income. Note, however, that only half of any dividend (Halbeinkünfteverfahren) paid by a German legal entity to its shareholders is subject to the income tax payable by that shareholder, which in case of a natural person is his Einkommensteuer and in case of a legal entity is its Körperschaftsteuer.

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Volker Krümpel, Friedrichstrasse 153a, 10117 Berlin, Germany
Fon: +49 30 4000 4696; Fax: +49 30 4000 4697; Email: office@wkberlin.com

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