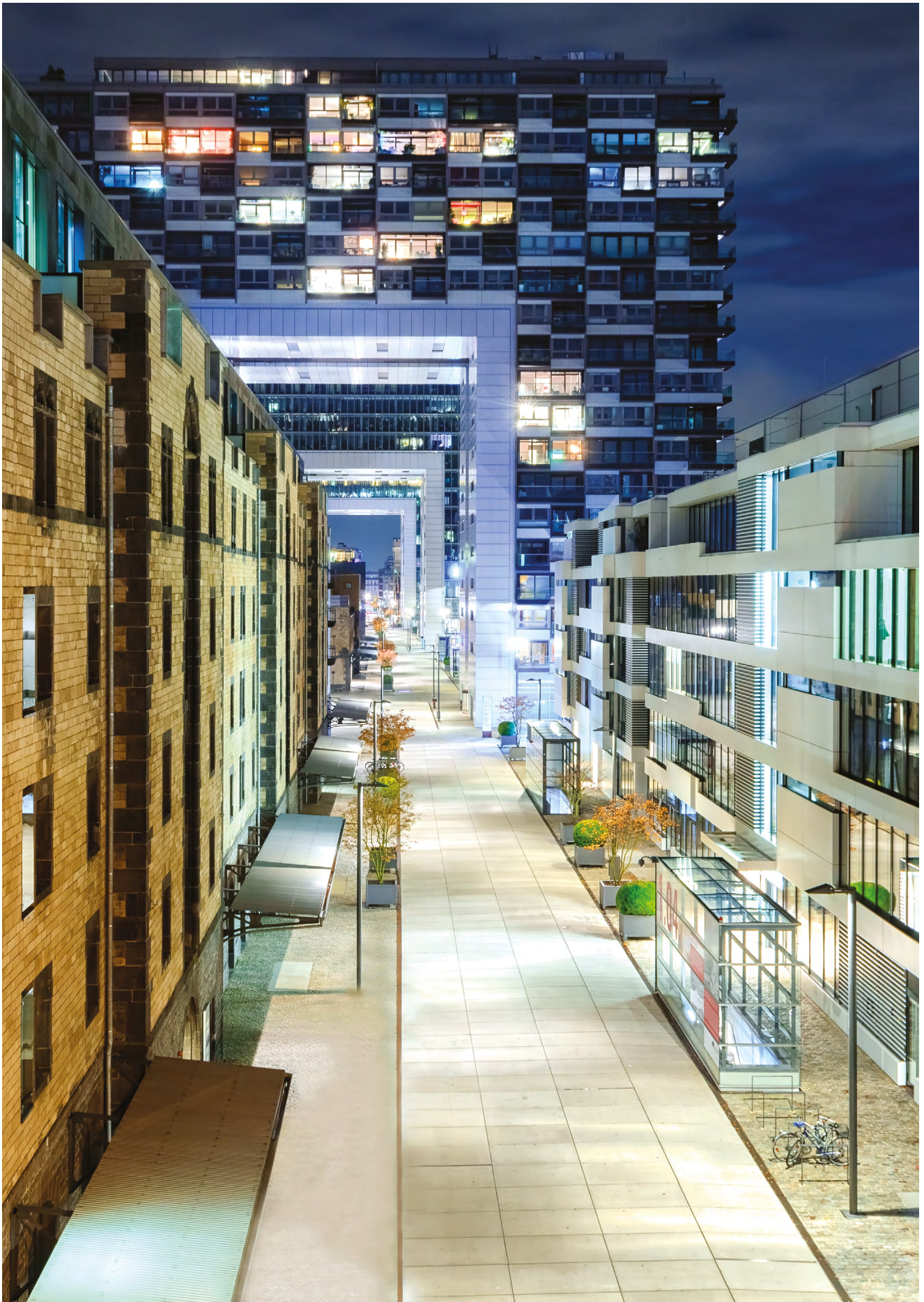




# Real Estate Investment in Germany

THE LEGAL PERSPECTIVE





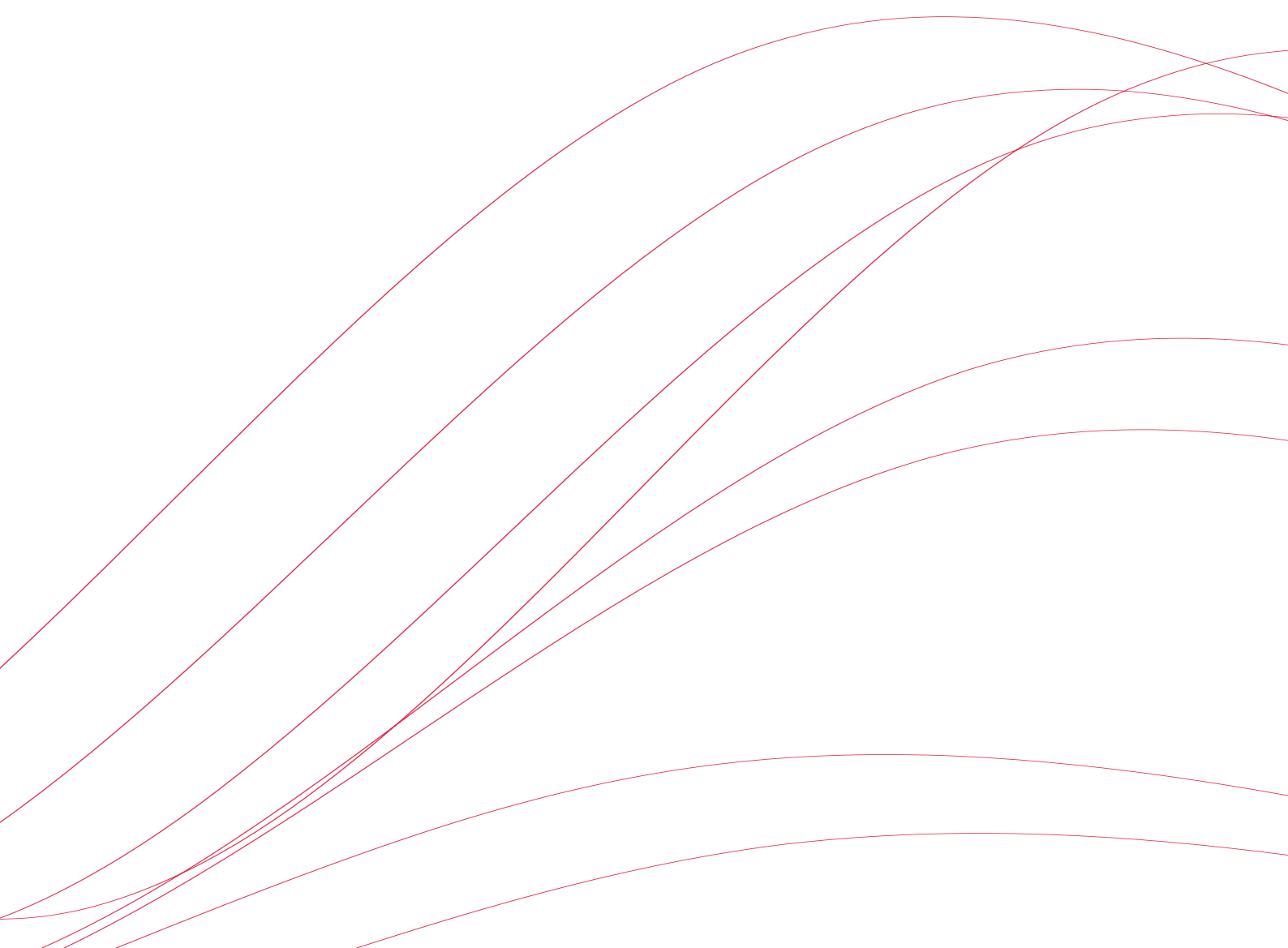
# Introduction

The German real estate market continues to be viewed as one of the most lucrative investment destinations in Europe. It offers great opportunities for investors who are seeking the security of a European economic powerhouse together with a real estate market that has both stable core assets and hidden gems for those who have a higher risk profile. Interest rates have remained low and cities such as Munich, Hamburg and Frankfurt have strong local micro-economic climates that have helped ensure stable and attractive yields for investors looking for safe-haven investments.

But it is more than that. Highly educated employees, comprehensive infrastructure, low inflation, economic and political stability and the lack of restriction on foreigners purchasing property, makes Germany an attractive destination for real estate investors from all over the world.

Real estate is an important part of DLA Piper.

We boast one of the largest real estate practices in the world. We believe that legal services relating to investments into real estate should consist of more than merely helping to acquire title. Any sound investment in real estate requires the knowledge of all available investment structures and their respective tax implications. This document is intended to serve as an overview guide to the most relevant civil and tax law aspects of investing in German real estate but of course cannot be viewed as a comprehensive summary of potential aspects. We aim to use our practical experience as a valuable source of information for our readers. The guide does not claim to be exhaustive so if you have any further questions relating to its content, feel free to reach out to our experienced German real estate team, which is eager to assist you.





# Contents

<b>1. OWNERSHIP OF REAL ESTATE</b>	<b>05</b>	<b>7. TAXATION</b>	<b>15</b>
1.1 Full ownership	05	7.1 Real estate transfer taxes	15
1.2 Heritable building rights	05	7.2 Value added tax	15
1.3 Condominium	05	7.3 Land taxes	16
1.4 Restrictions on ownership by foreigners	05	7.4 Taxation of rental income from German real estate	16
<b>2. ACQUISITION OF OWNERSHIP</b>	<b>06</b>	7.5 Taxation of dividends from a German company owning real estate	17
2.1 Formal requirements	06	7.6 Taxation of capital gains on German real estate	17
2.2 Asset deals	06	7.7 Taxation of capital gains from the disposal of shares in a German company	18
2.3 Share deals	07	7.8 Taxation of gain on disposal of partnership interest in a German partnership	18
2.4 Public auctions	08	7.9 Real estate investment trusts	18
<b>3. OTHER RIGHTS TO PROPERTY</b>	<b>09</b>	7.10 German open-end real estate funds	18
3.1 Mortgages and charges	09	7.11 German closed-end real estate funds	19
3.2 Easements	09	<b>8. REAL ESTATE FINANCE</b>	<b>20</b>
3.3 Pre-emption rights	09	8.1 Interest rate risks	20
3.4 Register of public easements	10	8.2 Land collateral	20
3.5 Non-registrable rights	10	8.3 Further collateral agreements	20
<b>4. ZONING AND PLANNING PERMITS</b>	<b>11</b>	8.3.1 Security purpose agreement	20
<b>5. ENVIRONMENTAL LIABILITY</b>	<b>12</b>	8.3.2 Share/interest pledge agreement	20
<b>6. LEASES</b>	<b>13</b>	8.3.3 Global assignment agreement and assignment of lease receivables	20
6.1 Duration	13	8.3.4 Bank account pledge agreement	21
6.2 Rent	13	8.3.5 Duty of care agreement	21
6.3 Operating expenses	13	<b>CONTACTS</b>	<b>22</b>
6.4 Maintenance, repair and renovation at end of lease	13	<b>GLOSSARY</b>	<b>23</b>
6.5 Subleases and assignments	14	<b>ABOUT DLA PIPER</b>	<b>24</b>
6.6 Termination	14		
6.7 Sale of leased property	14		
6.8 Written form requirement	14		

# 1. Ownership of real estate

## 1.1 Full ownership

Full ownership is the most complete and comprehensive right over real estate. Ownership of the property includes ownership of all constituent parts of the property (*notwendige Bestandteile*), including all buildings located thereon and everything above and beneath the surface of the land (unless the rights thereto have been granted to a third party).

A number of persons, companies and other legal entities can be co-owners of the property. Such co-ownership may be subject to special agreements between the co-owners that restrain sale, transfer and/or use. Most commonly, however, co-ownership can be ended by any co-owner at any time on request (*Bruchteilsgemeinschaft*). In such an event, the property must be sold and the sale can be enforced by public auction on demand by any party.

Ownership of real estate is registered in the Land Register.

## 1.2 Heritable building rights

Similar to a long lease under English law, the owner of a heritable building right is entitled to long-term (often between 30 and 99 years) use and occupation of the property. The heritable building right is registered in the Register for

Heritable Building Rights. It can be transferred in the same way as any other form of property ownership; however, this will often require the consent of the legal owner of the property.

The holder of a heritable building right is entitled and often obliged to erect buildings on the land. Unless agreed otherwise, at the end of the agreed term of the heritable building right, the owner of the land must compensate the holder of the heritable building right for the value of buildings on the property at that time.

## 1.3 Condominium

A special kind of ownership for shared premises was established by the German Condominium Property Act (*Wohnungseigentumsgesetz, WEG*). It divides a building into units, such as apartments, which are owned by individuals, and common parts of the property, such as the structure of the building, staircases and entrances, which are owned jointly by the unit owners.

The existence of condominium property is registered in the Condominium Land Register.

The unit owners of condominiums form a legal association. They are bound by the association's regulations and have to make regular payments for maintenance,

care and administration of the jointly owned property. The association rules on all relevant issues and must meet at least once a year. A property manager (*Verwalter*) as well as an owner's counsellor (*Beirat*) has to be appointed for the association.

## 1.4 Restrictions on ownership by foreigners

In general, there are no limitations on the acquisition of property in Germany by foreign investors; however, there are certain restrictions that affect all purchasers.

Agricultural property may require a public permit authorising its transfer.

Properties located in publicly announced land reallocation areas or urban improvement areas may require a public permit for transfer.

A transfer of property within the territory of the former German Democratic Republic may be subject to a public permit in order to avoid restitution claims. The said restrictions are, however, of very little practical importance today.

In the case of a property transfer, the local authority or municipality may also have a legal pre-emptive right for acquisition, but this is usually waived.

## 2. Acquisition of ownership

### 2.1 Formal requirements

In order to be valid, any agreement for the transfer of property must be in the form of a notarial deed. The deed must cover all relevant aspects of the acquisition. Any kind of side letter or agreement that amends the contents of the notarial deed either orally or in writing may result in the purchase agreement being invalid.

Every property in Germany is recorded in the Land Register. To complete the transfer of ownership, the new owner must be registered in the relevant Land Register. The change of ownership is effective from the date of registration.

Any buyer of property may rely on the contents of the Land Register and can rely upon, and is protected by, its accuracy and, as long as the buyer does not have knowledge to the contrary, ownership can be acquired in good faith (*bona fide*; *Gutgläubenserwerb*).

The restrictions mentioned in paragraph 1.4 above may raise the necessity of obtaining a public permit prior to a transfer of property. The permit is usually requested by the notary. The notary also applies for the waiver of the local authority's legal pre-emptive right also referred to above and the tax clearance certificate. The latter is issued by the tax authorities after the payment of any real estate transfer tax (RETT) which may be payable on the transfer.

### 2.2 Asset deals

The property can be acquired directly (asset deal) by the buyer from the owner. All formal requirements referred to above must be observed meaning that asset deals also need to be notarized in order to be effective. In principle, a later modification or addition must be notarized as must a conditional purchase agreement binding offer.

In most cases the parties are assisted by specialist lawyers when drafting the relevant documents, negotiating the parties' agreement, financing the transaction and completing the transfer.

It is highly advisable for the buyer to carry out due diligence on all aspects of the property prior to notarization of a property transfer agreement. Such due diligence should be carried out by appropriate professionals and should cover:

- all legal aspects such as title to property, easements, agreements with neighboring owners, environmental aspects, zoning law aspects, building law, previous contracts, lease agreements, etc.;
- particular environmental aspects; and
- the state of existing buildings and any permissible future development.

Memorandums of understanding, letters of intent, heads of terms or the like will not have a binding effect under German law unless

they are agreed to in a notarial deed. Exclusivity and confidentiality agreements, with provisions for liquidated damages in case of breach, are however valid and enforceable and are widely used.

Typically, in a property transaction, the ability to complete the transfer of the property by registration will be secured by a priority notice of conveyance which is registered in the Land Register. The priority notice secures proper transfer of ownership following the payment of the purchase price.

In order to enable the buyer to finance payment of the purchase price, the owner of the property generally authorizes the buyer to create a Land Charge in favor of the financing bank, provided it is specified that the Land Charge will only be used for the purpose of financing the purchase price (*Belastungsvollmacht*). This typical mechanism under German law ensures fully secured financing and is standard procedure with financing banks.

It is standard procedure that the buyer submits itself to immediate enforcement in respect of all its assets for the payment of the agreed purchase price (*Zwangsvollstreckungsunterwerfung*).

Finally, it is common practice to authorize the notary to make all necessary applications and declarations in order to effect the transfer of the property.

Although every buyer of a property should undertake its own survey and due diligence, the seller may not withhold important information relating to the property. Under German law the seller of a property is obliged to disclose information to the prospective buyer on any important matter which would have a negative impact on the value of the property. It is reasonable to conclude that the buyer would not have agreed on the purchase price if they had known about such matters. Such information may, for example, include construction work without the appropriate permit, public orders, issues with the tenant, technical defects, etc. Any failure by the seller to disclose this information overrides any waiver of liability that the purchase agreement may contain and may result in claims for compensation or even rescission of the purchase contract.

Notaries are entitled to be paid pursuant to a legally binding fee order. The law prohibits any agreement on lower notarial fees, however, fees are capped at a transaction value of EUR60 million. Notaries are regularly investigated to ensure that the fee order is observed. The declaration of transfer of ownership itself must be contained in a notarial deed issued by a public German notary.

Transaction costs for the transfer of property to cover registration fees, notarization etc. can be estimated at 1.5% of the purchase price. Real estate transfer tax (see paragraph 6 below) currently varies between 3.5% to 6.5%, depending on the German federal state. This excludes costs for due diligence and the involvement of attorneys and technical experts.

## 2.3 Share deals

Another way to acquire real estate is to purchase the legal entity which owns the property. In Germany, such legal entities are often organized as limited partnerships (*Kommanditgesellschaft (KG)*) with a limited liability company (*Gesellschaft mit beschränkter Haftung (GmbH)*) as sole general partner (GmbH & Co. KG).

The name of the GmbH emphasizes the fact that the owners (*Gesellschafter*, also known as shareholders) of the GmbH are not personally liable for the company's debts. The GmbH & Co. KG, therefore, combines the advantages of a partnership with those of a limited liability company. Instead of a GmbH, the general partner is often a foreign limited company such as a UK Limited Company or a Luxembourg S.à r.l. The establishment of such entities is generally tax driven.

In order to transfer the shares of the property-owning company from the seller to the buyer, the parties have to execute a share purchase and transfer agreement. In cases where the shares in a GmbH are to be transferred (e.g. in case the property is owned by a GmbH or in case a KG owns the property and both the limited partners' interests and the shares in the general partner are to be transferred), statutory law requires a share purchase agreement for shares in a GmbH to be notarized. The fees payable to the notary depend on the value of the transaction and are capped as stated above. In principle, the transfer of interest in a partnership does not need to be notarized.

It is currently common for only 94.9% of the shares to be transferred because a transfer of 95% or more to the same investor/group of investors would trigger German real estate transfer tax. The remaining shares may be acquired after five years.

However, as of the date of this brochure, amendments to the real estate transfer tax rules for share deals are in the making. For more details see below at 7.

The due diligence prior to a share deal should, in addition to the points mentioned in paragraph 2.2 concerning the property itself, cover the following aspects:

- all legal aspects of the shares in the company owning the property such as pre-emption rights, encumbrances etc.;
- whether the authorized share capital has been contributed completely and accurately and whether it still exists;
- annual accounts of the company;
- debt and risks; and
- whether the property company has employees and the liabilities in relation thereto.

Unlike in many other jurisdictions, reliable shareholder registers do not exist in Germany. Consequently, if the shares have been transferred several times, it is important to ascertain that there is an unbroken chain of notarial transfer agreements from the original shareholder to the current shareholder in order to ensure that the seller actually owns the shares. If the seller does not have a good title to the shares, there is no protection in place in favor of

the buyer even though it may be purchasing in good faith. This is a clear distinction from an asset deal where, as previously mentioned, the seller will be assumed to be the owner of the real estate if it is registered and therefore an acquisition in good faith is possible. This demonstrates the paramount importance of a thorough and properly conducted due diligence exercise in the case of a share deal and the need to investigate potential third-party rights.

Furthermore, it is not uncommon for the company's articles of association to contain certain restrictions regarding the transfer of shares. It is common for any transfer of shares to require the prior approval of a certain majority of the existing shareholders or the existing shareholders may have rights of pre-emption.

The share purchase agreement to be entered into by the seller and the buyer must include certain mandatory aspects such as the parties, the denomination of the shares which are being transferred and the purchase price.

Beyond these mandatory aspects, the parties frequently agree on various other matters such as calculation methods for the purchase price, subsequent conditions, warranties and remedies in case of breach of warranty.

The transfer of shares becomes (unless otherwise agreed in the agreement) immediately effective upon signature. Although the managing director of a company is obliged to submit updated shareholders' lists to the competent commercial register, such lists have no official status and any potential buyer should not rely on their accuracy.

## 2.4 Public auctions

For specialist investors, purchasing at a public auction can be an option. Properties for sale by auction are usually the subject of an enforced sale, such as a sale pursuant to a court order or a sale where there has been default under a Land Charge.

The complexity of the auction procedure makes it advisable for a prospective buyer to be

accompanied by legal advisors. In brief, the public auction is led by the competent local court which will appoint an expert to value the property. At the first date of the auction, the property can be withdrawn from sale if the bid is less than 70% of the estimated value of the property. In such a case a second date for the auction must be set. At this second date the property can be sold as long as the bid is high enough to pay for the costs of the auction. With thorough preparation and investigation, a portfolio of properties can be acquired at a low cost at public auction, but this option usually only appeals to specialist investors.

In this context, it should be added that the number of public auctions has continuously decreased in recent years as other work-out strategies are preferred by both property owners and banks.



## 3. Other rights to property

### 3.1 Mortgages and charges

There are three types of charges.

The ordinary mortgage (*Hypothek*) depends on the existence of an underlying claim, whereby the *Hypothek* can only be enforced as long as, for example, a repayment claim for a loan exists. The *Hypothek* can only be assigned to a third party together with the underlying claim.

Nowadays, mortgages do not play a significant role in practice as land charges are generally favored by banks as security for loans financing the acquisition of property. These land charges (*Grundschulden*) do not depend on the existence of an underlying claim and can be assigned independently. In almost all cases these land charges will be linked to the underlying claim with a security purpose declaration.

Both the *Hypothek* and the *Grundschuld* can be created as a certified mortgage or land charge, i.e. with a document certifying and evidencing the existence of the mortgage or land charge in addition to being registered in the Land Register. Any assignment or variation of a registered certified mortgage or land charge requires the presentation of the original certificate. Certified land charges are sometimes required by financing banks but their use is not widespread due to the formalities required in the event of assignment or variation. From an investor's point of view, the acceptance of land charges as opposed to mortgages is

unavoidable; certified land charges should be and usually are avoided for the reasons mentioned.

In order to be valid, mortgages and land charges must be registered in the Land Register. Creating a mortgage or land charge does not of itself require a notarial deed, however, to enable registration to be effected in the Land Register, notarization is necessary.

The third type of mortgage, which is not commonly used, is an annuity charge (*Rentenschuld*). This is a form of land charge where the principal amount of the loan is not to be paid out of the land but instalments are to be paid at fixed intervals. Like land charges in general, annuity charges must be registered in the Land Register.

### 3.2 Easements

Properties under German law can be encumbered in favor of the owner of a neighboring property by establishing rights of way, certain rights of use or prevention of use, prevention of construction, allowance of construction etc. (*Grunddienstbarkeit*). Such rights or easements are widely used to create rights of way, rights to erect and maintain electrical or other supply lines, and to prevent or control development on certain land in the circumstances mentioned in paragraph 3.4 below.

The property may also be encumbered by Limited Personal Easements under which a particular person or entity is entitled to certain rights (Limited Personal Easement – *beschränkt persönliche*

*Dienstbarkeit*). This type of easement is used, for example, to ensure that long-term leases are protected from extraordinary termination in the case of an insolvency of the landlord. The construction and maintenance of supply lines are often secured by a Limited Personal Easement as opposed to unlimited easements granted in favor of neighboring property owners.

Finally, properties may be encumbered in a way that gives a particular person certain rights of use, especially to harvest crops or have the right to lifetime use as their own residence. Such rights are most commonly used in order to ensure the right to continue living in a certain property, i.e. when parents give the property to their children during their lifetime for tax reasons.

All easements must be entered in the Land Register. The contract itself does not need to be set up as a notarial deed; however, the contract must be notarized to enable a valid application to be made to the Land Register for registration.

### 3.3 Pre-emption rights

A landowner can grant a pre-emption right over its property to any third party. Such a right must be set up as a notarial deed and registered with the Land Register in order to be valid and binding. Nevertheless, it is quite common in practice for pre-emption rights to be entered into without observing these formalities, but no claims for any remedies would succeed if the formalities are not observed.

### 3.4 Register of public easements

The Land Registers are maintained by the local courts. Beside them, the local authorities maintain public registers for particular easements designed to protect or prevent construction. For example, if a property is built upon in a manner exceeding local building and zoning laws, this can be regularized by the owner of a neighboring property waiving their right to future development. By registration in this Register for Public Easements (*Baulastenverzeichnis*), these two properties will be regarded as one and future development of the burdened property will be prevented (*Vereinigungsbaulast*). Other limitations on construction can be registered in the Register for Public Easements.

### 3.5 Non-registrable rights

Apart from the registrable rights mentioned above, under German law, anybody is free to enter into any contract with anybody else covering a variety of obligations and rights which relate to a particular property, but which are personal in nature and not intended to be assigned or passed on to other people.

In an asset deal, the rights and obligations created by such contracts, because of their personal nature, will not pass to the buyer. Only rights registered in the Register for Public Easements or in the Land Register are an integral part of the property and will pass to the buyer when ownership is transferred.

In share deals, however, such personal contractual rights and obligations can be inherited as the company or other entity which entered into the contract is itself being acquired by the buyer. Under such circumstances, it is necessary to undertake due diligence with regard to the possible existence of any such contracts or other arrangements with third parties. Appropriate representations and warranties should be included in any purchase agreement in a share deal.





## 4. Zoning and planning law permits

In Germany, land-use planning is one of the major functions of local government. It gives the local municipality the opportunity and obligation to control urban development. The municipality may set up a land use plan (*Flächennutzungsplan*) that relates to the land usage in the area of the municipality and outlines the main features of land usage identifying areas designated for development, public and private infrastructure, certain types of transport, green areas, areas with restriction on use, etc.

On a smaller scale the municipality may also issue a development plan (*Bebauungsplan*) as a by-law. There are various types of development plans which differ in their content and in their dependence on a land use plan, such as qualified, non-qualified and project-related development plan. Contents of a development plan will include:

- stipulations on the extent and use of a building, the land areas which can be built on, the building method;
- designation of areas subject to special structural precautions or for areas severely contaminated with substances detrimental to the environment; and
- subsequent provisions taken from other statutory regulations such as the law on the preservation of historical sites and state laws.

If there is no land use or building plan in place which regulates the planned development, permissibility of a project will have to be in accordance with the immediate surroundings, the security of public infrastructure, the requirements of healthy living and working conditions and the overall appearance of the locality.

In Germany, a building permit is required to develop a project or significantly alter an existing property after purchase.

The requirements for obtaining such a building permit are set out in the building regulations. Although each German federal state has its own regulations, they are all similar in content. A building permit contains a declaration by the building control authority that the building project does not conflict with the provisions of public law.





## 5. Environmental liability

Under the German Federal Soil Protection Act (*Bundesbodenschutzgesetz*), the polluter, the current owner, the current user and all former owners and users of a property may be subject to mandatory measures for decontamination by order of the competent authorities. Should any contamination of a property render it necessary to undertake decontamination measures, the relevant authorities will not necessarily charge the polluter, but look for the most financially sound party that is or has been the owner or has been in any other way in possession of the property. The law grants specific rights to any party which may be

charged to recover payment from any other party whose liability for the particular contamination can be proven.

The law is such that there is no way of avoiding the possibility of being charged by public authorities under these circumstances.

This sometimes has the effect of complicating the sale of properties with known contamination due to the difficulty of sufficiently securing recourse for the buyer against the seller.

The local authorities maintain a cadastre in which all available information on possible contamination of soil or ground

water by existing or former use of the property or as a result of warfare etc. is registered (the Cadastre for Contaminated Sites – *Altlastenkataster*). These cadastres are an important source of information on any investigation prior to acquisition of a property. However, if the property is not registered or no issues are referred to in the cadastre, this does not necessarily mean that the property is free from contamination.

It is highly advisable to undertake an environmental investigation prior to any acquisition of property.



## 6. Leases

German law differentiates between leases for commercial and/or residential premises (*Mietvertrag*) and leasehold agreements (*Pachtvertrag*). Leases of commercial or residential premises are more common than leasehold agreements. While a lease of commercial and/or residential premises entitles the tenant to use the leased property, the beneficiary of a leasehold agreement is entitled both to use the leased property and to benefit from it. For example, in the case of a lease of a farm that includes all farm machinery and the right to harvest crops etc. The legal differences are usually covered by regulations within the leases themselves so that regular leases and leasehold agreements can for the most part be regarded as synonymous. All issues mentioned below refer to both types of lease.

### 6.1 Duration

Residential leases in Germany are normally entered into for an indefinite period of time while commercial leases mostly have fixed terms of five to ten years, although it is possible to have a longer term. However, it is rare to see lease terms of longer than 15 years. The tenants under commercial leases often have rights of renewal.

A lease may not be entered into for a period of more than 30 years. If a lease continues for longer, either party can terminate it at any time after the end of the 30<sup>th</sup> year.

In residential leases, the rules protecting tenants are strong. It is seldom possible for a landlord to recover possession from a residential tenant except in limited circumstances (proven necessity for the landlord itself or a family member to use the premises, essential works of renovation, etc.).

### 6.2 Rent

Rent is usually calculated on the basis of a figure per m<sup>2</sup> of usable space. Usually, rent payments are due on a monthly basis and are paid in advance.

Value added tax (VAT) must be treated separately. Rental payments are normally exempt from VAT. A landlord can however waive this exemption in certain circumstances, as detailed in paragraph 7.2 below.

Generally, commercial rents are adjusted according to changes in the Consumer Price Index (*Verbraucherpreisindex*), although it should be noted that the Consumer Price Index does not necessarily move in line with market rents. The increase in rent will vary between 60% and 100% of the index change, and often will only be triggered if the corresponding index changes for example by 10%.

Care should be taken when drafting indexation clauses as they may be deemed to be invalid by German courts in certain circumstances, e.g. if the lease agreement does not bind the landlord for at least ten years or in cases where no decrease in rent will be allowed in the case of a declining index.

Residential leases may be adjusted in line with market rent; however, only within certain limitations, e.g. the rent shall not be increased by more than 20% within three years etc.

### 6.3 Operating expenses

In commercial leases, the tenant is generally obliged to pay all operating expenses relating to the property, including costs of maintaining common facilities, ground tax and insurance. Lease agreements often refer to the operating expenses stated in the Ordinance on Operating Costs (*Betriebskostenverordnung*). The validity and interpretation of clauses on operating expenses is often subject to dispute between landlord and tenant. German courts have for instance ruled that the tenant's contribution to the cost of repairs of common parts of the building must be capped or that the scope of center management costs must be clearly defined in the case of commercial leases.

In residential leases, the landlord may not charge management or administration costs to the tenant nor the costs of repairs of common parts.

### 6.4 Maintenance, repair and renovation at end of lease

Under German law the landlord has to bear all costs for repair and interior decoration works since they are obliged to maintain the premises in such condition as agreed in the lease. In most cases the landlord generally remains responsible for structural and major repairs. The tenant usually carries out internal repairs and maintenance as well as repairs for interior decoration.

Germany has strong consumer protection laws and they apply to standard forms and general conditions. Under case law almost every lease is regarded, wholly or partially, as comprising of general conditions and are thus subject to the consumer protection laws which results in a lease not containing any unfair clauses. These consumer protection laws apply similarly to residential and commercial tenants.

Case law has regarded clauses as unfair if they oblige the tenant to repair the roof and structure of the lease object, to decorate at fixed intervals, to comply with unlimited renovation obligations at the end of the term or to pay for renovation at the end of the term.

Therefore, any investor in German property should carefully review all maintenance and repair clauses, as many of these clauses could be deemed invalid. The investor might make allowance for this in the financial calculation.

### 6.5 Subleases and assignment

According to German law, a tenant is not entitled to sublease the rental spaces without the consent of the landlord. Should the landlord not give consent, the tenant has the right (in the absence of any provision to the contrary) to terminate the lease. However, most commercial leases contain clauses which prevent such a termination right being exercised. Many lease agreements entitle the tenant to sublease the rental spaces within the tenant's group or

to any third party using the spaces as provided for under the lease agreement.

Any assignment of a lease agreement also requires the landlord's consent. However, some commercial lease agreements grant an assignment to the tenant's group companies or allow for an assignment if the previous tenant remains liable.

### 6.6 Termination

Commercial leases ordinarily cannot be terminated during a fixed term. Walk-away clauses and premature termination clauses are possible and sometimes provided for in connection with the payment of contractual compensation.

Residential leases can usually only be terminated by the landlord under the circumstances mentioned in paragraph 6.1. Notice periods in this case and when the tenant terminates the residential lease vary between three and nine months depending on the duration of the lease. In exceptional circumstances, both residential and commercial leases can be terminated immediately if either party repeatedly breaches its obligations under the lease, in particular (in the case of the tenant) the obligation to pay rent.

### 6.7 Sale of leased property

A sale of the property that is leased does not affect the lease in any way. The benefits and liabilities of the lease are inherited by the new owner as the legal successor of the former owner.

### 6.8 Written form requirement

A lease with a duration of more than one year must be in writing.

This written form requirement is generally only of relevance in commercial lease agreements and is complied with by the creation of a deed. Any future amendment to the lease must also be effected in the form of a deed. If the formal requirements are not met, the lease remains valid but it is regarded as a lease for an unlimited term and can be terminated at any time.

In the case of commercial leases, termination takes effect after a period which varies between six and nine months.

Absence of compliance with formal requirements is often used by landlords to dispose of unwanted leases. Formal requirements must be carefully complied with when entering into a lease and when making any amendment to it during its existence.



## 7. Taxation

In this section we will summarize the main tax-related aspects of real estate investment in Germany. An understanding of the German tax regime is crucial in determining the likely profitability of an investment and in structuring the investment in the most tax efficient way.

As previously mentioned, the investor can either structure its acquisition as a direct purchase of German real estate or via a company. These alternatives differ significantly from a tax perspective and this distinction is relevant throughout this section.

This overview follows the stages of an investment beginning with the acquisition of real estate and ending with taxes in relation to its disposal.

### 7.1 Real estate transfer taxes

Generally, real estate transfer tax (RETT) is levied upon the acquisition of real estate located in Germany (asset deal). In cases of a share deal, a threshold of 95% has applied for years in Germany. So if at least 95% of the shares or interests in a real estate company/partnership have been acquired by one purchaser or one group of related purchasers, then RETT is due. Furthermore, if within five years the interests in a partnership were directly or indirectly transferred to new partners, then RETT is also triggered.

On the date of this brochure, amendments to the German RETT rules on share acquisitions (applying to both corporations and partnerships) are in the making. Investors should carefully consider

these likely amendments even though the legislative outcome is not fully clear yet.

These likely amendments to the RETT rules for share deals can be summarized as follows:

- The threshold for triggering RETT will be lowered from 95 % to 90%, which means that RETT can only be avoided if less than 90 % of the shares or interests in corporations or partnerships are transferred.
- The rules applicable to corporations will be aligned to the rules that currently apply to partnerships. This means it will no longer be possible to transfer 100% of the shares of a real estate holding corporation (e.g. a German GmbH) to two unrelated investors without triggering RETT.
- The holding periods for the seller for their minority stake or interest of more than 10% (currently 5%) will be extended from five to ten years.

As of the date of this brochure, no draft wording of the legislation implementing the new RETT rules has been in circulation. Therefore, it is not yet known when these rules will apply for the first time and to what extent they may apply with retrospective effect.

If the transfer takes the form of a conventional sale and purchase of the property, both parties to the agreement are liable to the tax authorities for the RETT. If the relevant partnership threshold is exceeded (see above), RETT can either be payable by the partnership itself or by the purchaser(s) holding 95% or more of the interests/

shares in the company. However, from a civil law perspective, the tax burden is often subject to specific contractual agreements between the parties and it is market practice for the buyer to bear the RETT burden. The current RETT rate varies between 3.5% and 6.5% and depend on the relevant German federal state. Tax basis is generally the amount of the consideration. If no specific consideration for the deal-included real estate exists, the value of the real estate needs to be assessed.

RETT-Blocker avoidance rules have been introduced designed to tackle certain RETT optimization strategies with acquiring 94.9% of shares in a company while also establishing an indirect influence on a 5.1% minority shareholder (the RETT-Blocker). Now – roughly put – the 95% rule which is referred to above must be reviewed on the basis of substance-over-form rules, which forces taxpayers to apply a more commercial approach to the structure.

### 7.2 Value added tax

The transfer of real estate generally is exempt from value added tax (VAT). When the sale does not qualify as a transfer of a going concern, the seller can however waive the VAT exemption where the buyer is a taxable person (entrepreneur) entitled to deduct input VAT from its own VAT liability. Although the buyer legally bears the VAT liability, it does not pay the amount of the VAT to the seller under the German reverse charge mechanism. Instead, the buyer declares the VAT to the tax authorities and, at the same time, reclaims the corresponding amount as input VAT. Thus, the transaction will generally not result in the buyer actually

having to pay VAT, provided that the buyer itself carries out VAT-able transactions with the real estate. For fixtures, neither the tax exemption nor the reverse charge mechanism applies. VAT on fixtures has to be paid by the buyer to the seller. The amount can however be claimed back as input VAT by the buyer in its VAT return for the period during which the transaction was completed. The buyer itself needs to carry out VAT-able supplies though.

The sale of a business or business unit as a whole (total assets) (so-called transfer of a going concern – *Geschäftsveräußerung im Ganzen*) is not subject to VAT. The requirements of a transfer of a going concern as a whole are usually met if:

- the sold property qualifies as a fixed asset;
- the sold property was leased out prior to the sale; and
- the buyer intends to continue this letting activity.

As a consequence, the buyer is deemed to be the successor in rights and obligations of the seller for VAT purposes.

Rental income from leasing real estate is generally exempt from VAT. The landlord can waive this exemption if, and to the extent that, the real estate is leased to a taxable person who uses the real estate for a business purpose which entitles it to claim input VAT.

### 7.3 Land tax

The land/real estate tax is assessed and levied by the German municipalities based on the general administrative value (*Einheitswert*), which is assessed by the fiscal authorities. The general administrative value is mostly below the market value. The tax is due on an annual basis and has to be paid by the beneficial owner. Recently, the German Constitutional Court has ruled the use of the general administrative value as unconstitutional (inequitable and discriminatory). Hence, amendments to the German land tax are due. Investors should consider these likely amendments even though the legislative outcome is not yet fully clear.

The municipalities can autonomously determine the multiplier for the purpose of the land tax so there is no generally applicable tax rate. The average tax rate in Germany varies between 1.3% and 1.5%.

### 7.4 Taxation of rental income from German real estate

In order to avoid international double taxation, Germany has entered into double taxation treaties with a large number of other countries. Most treaties are in accordance with the OECD Model Convention. Under these treaties, rental income from real estate is taxable in the country in which the real estate is located. Double taxation is avoided either by the income being exempted from taxation in the country where the investor is resident, or by a tax credit

for taxes paid in Germany being applied against the taxes of the country where the investor resides.

If a non-resident investor owns German real estate directly, rental income received from it is subject to German-source income or corporate income tax.

Additionally, it is subject to trade tax if the investor establishes a permanent establishment. This requires a fixed place of business in Germany through which a trade or business is carried on. If, however, certain requirements are met, the trade tax can be avoided for mere real estate letting activities. Trade tax is levied by municipalities and effective tax rates vary between 7% and 17.15%, the average rate being approximately 14%.

The taxable basis is the net rental income from the letting of German real estate. The individual income tax rate is progressive and with a 45% tax bracket applying to any taxable income exceeding EUR260,533. Additionally, a solidarity surcharge is levied resulting in an effective maximum tax rate of 47.45%.

Alternatively, the investor can hold the real estate via a German partnership or company. The income of a German partnership is taxed at the level of its partners. Nonetheless, the partnership itself can be subject to trade tax if it is engaged in a trade or business or is deemed to be engaged in a trade or business. If it is exclusively engaged in administering and leasing real estate on a long-term basis, its activity should generally not be treated as a trade or business.

Rental income generated by a corporation is subject to corporate income tax at a rate of 15.825% including a 5.5% solidarity surcharge.

The taxable basis for both income tax and corporate income tax as well as trade tax is in general net income, i.e. gross income less expenses such as amortization, maintenance, administrative expenses and also investment expenses such as interest on mortgage loans. The interest capping rules limit the deduction of interest expenses. Under the interest capping rules interest is only deductible up to 30% of earnings before interest, tax, depreciation, etc. There may be possibilities to mitigate the interest deduction limitations in a way that the full amount of interest expenses becomes deductible.

Depreciation in connection with buildings is based on the purchase price or the construction cost plus acquisition costs. Generally, depreciation is assessed under the straight-line method and varies between 2% and 3% (subject to special rules higher depreciation rates may apply). Certain add backs and additional deductions apply in the case of trade tax.

### 7.5 Taxation of dividends from a German company owning real estate

The net profits of a resident company can be distributed to its shareholders by way of dividends. Dividend income from resident companies is subject to German-source income tax.

Depending on the legal status of the shareholder, the German company must deduct 26.375% (including solidarity surcharge) of the dividend as withholding tax. In cases where the non-resident shareholder resides in one of the EU member states and meets the requirements of the Parent/Subsidiary Directive as well as the requirements of the German anti treaty shopping rules, no withholding tax becomes due (subject to certain formal requirements). The amount of any withholding tax actually withheld can often be refunded to the non-resident shareholder upon application to the Federal Tax Office. The same applies with regard to benefits of reduced withholding tax rates under applicable double taxation treaties. Most German double taxation treaties provide for limits on withholding taxes on dividends of between 0% and 15%. Even if no double taxation treaty applies, a refund down to the average German corporate income tax rate of approximately 15.825% is generally available (again subject to the anti treaty shopping rules).

### 7.6 Taxation of capital gains on German real estate

If a company irrespective of its country of residence generates a capital gain on the disposal of German real estate, the capital gain is subject to German corporate income tax. The capital gain equals the sales price less the book value for tax purposes and costs.

In the event that an individual disposes of real estate, the taxation of the capital gain depends on whether the real estate qualifies as a business asset or as private property. If the real estate is part of the individual's trade or business and a business asset, the capital gain from the sale is subject to income tax and trade tax. In contrast, a capital gain from the sale of real estate qualifying as private property is subject only to German income tax where it is sold within ten years of its acquisition. Capital gains are treated as taxable income from a trade or business if the individual operates a trade or business in real estate. For example, if more than three properties are sold within five years after their acquisition or redevelopment, this may suggest that the individual is operating a trade or business in real estate.

A capital gain generated by a partnership is in principle subject to tax at the level of its partners. Accordingly, the same rules as set out above apply depending on the legal status of the partner concerned. If the partnership operates a trade or business and constitutes a permanent establishment for its partners, the gain is also subject to trade tax.

Under most German double tax treaties, capital gains generated from the sale of real estate are taxable in the country where the real estate is located.



### 7.7 Taxation of capital gains from the disposal of shares in a German company

If a non-resident individual disposes of shares in a German company which are not an asset of the German permanent establishment of their trade or business, the capital gain is subject to German-source income tax where the shareholder held a direct or indirect stake of 1% or more in the company within the previous five years. If the shares disposed of are shares in a company which is an asset of the German permanent establishment of the taxpayer's trade or business, the capital gain is subject to income tax and trade tax regardless of the holding period or the size of the stake in the company.

If a non-resident corporation disposes of shares in a German company, generally only 5% of the capital gain is subject to limited corporation income tax and trade tax in Germany. However, this tax regime is affected by the German double taxation treaties. According to a number of German double taxation treaties, the right to levy taxes applies where 50% or more of the German company's value is based on German real estate and in this case the capital gain on disposal of the shares can be taxed in Germany. In most cases, the taxpayer is entitled to a tax credit in the country where it is resident. In other German double taxation treaties capital gains of this nature are subject to tax in the country where the selling shareholder resides and are tax exempt in Germany.

### 7.8 Taxation of gain on disposal of partnership interests in a German partnership

The disposal of a partnership interest in a German partnership which is not engaged in a trade or business is treated as the partial sale of the underlying assets of the partnership because the partnership is a tax transparent entity. The sale of a partnership interest in a partnership only holding real estate is therefore taxable in Germany in the same manner as mentioned above.

### 7.9 Real estate investment trusts

Only German-listed stock corporations listed on a regulated market can qualify as a German real estate investment trust (REIT). At least 75% of their assets must consist of real estate. On the listing date, 25% of its shares (15% after listing) must be in wide ownership, i.e. held by a number of different shareholders (each shareholder holding less than 3%); no shareholder may directly hold 10% or more of the shares. A German REIT may not own residential property unless it was built in 2007 or later. A stock corporation qualifying as a REIT is, upon application, exempt from corporation and trade tax. However, 90% of a REIT's annual profit has to be distributed to its shareholders. Distribution is subject to taxation as income from capital investment at the level appropriate to the shareholders. The REIT will have to deduct withholding taxes on dividends at a rate of 26.375%.

As no shareholder may hold more than 10% of the shares in the REIT, the Parent/Subsidiary Directive does not apply. For the same reason, most German double taxation treaties reduce the withholding tax rate to 15% only. Any withholding taxes exceeding such rate will be refunded to the taxpayer as long as the taxpayer meets the requirements under the German anti treaty shopping rules.

### 7.10 German open-end real estate funds

In Germany, open-end real estate funds have been used for decades and are intended to increase the liquidity of an investment in real estate assets. A fund's specific regulatory and institutional design differs significantly from the design of an investment via other investment vehicles such as partnerships (e.g. as closed-ended funds) or via corporations.

The fund is administered by an investment company. The investment company in cooperation with, and supervised by, the custodian bank is responsible for complying with the regulatory and tax rules.

The regulatory rules comprise a number of measures to limit the risk of a liquidity crises despite the funds' obligation of (generally) a daily redemption of shares. The rules are based on the AIFM Directive. An important measure in this respect requires German real estate funds to hold a cash reserve (liquidity management). Furthermore, the funds are allowed

to maintain only a certain leverage of their real estate assets' value (limitation on permitted leverage). Moreover, there are rules on the valuation of assets and the redemption of fund units.

Since 2018, the fund by default is treated as an opaque (i.e. non-transparent) vehicle for tax purposes. Only under various requirements can it qualify for tax transparent treatment (as a so-called special fund). Only for special funds, will investors be treated as if they had directly invested in the relevant assets held by the fund. Income resulting from the investment is allocated to the special fund unit holders and is

taxed depending on the individual circumstances of each special fund unit holder.

### 7.11 German closed-end real estate funds

According to the AIFM Directive as applicable under German law, closed-end real estate funds are subject to regulatory rules and supervision of the German regulatory body BaFin. Closed-end real estate funds are often structured as asset administering limited partnerships with a limited company as general partner (GmbH & Co KG). Like special funds, they are, from a commercial perspective, transparent for tax purposes. Under certain circumstances, the investors (i.e. the limited partners) can benefit

from depreciations, can off-set losses and realize tax exempt gains from the liquidation of the properties if certain requirements and holding periods are met. A downside is that the investment is illiquid, as often there is no secondary market available and frequently no redemption right. Furthermore, in retail scenarios, a number of regulatory requirements have to be observed.



## 8. Real estate finance

Real estate finance involves financing or refinancing the acquisition and/or development of real property where the principal debt is generally secured by the capital value of the property and the debt is serviced from the income generated by the occupation of the property.

It is highly advisable to carry out due diligence covering the financial issues prior to taking an investment decision. Such due diligence should cover:

- market and location analysis;
- review of profitability;
- tenant analysis; and
- recoverable and non-recoverable costs.

The final evaluation should be available by the time of the credit decision at the very latest.

### 8.1 Interest rate risks

Commercial property financing is possible with long-term and short-term loans. In both cases, there is a risk of rising interest rates. A decisive countermeasure is the selection of fixed interest periods. However, the risk of interest rate fluctuation still exists at the time of the extension of a loan or upon the conclusion of follow-up financing. This can be hedged against by derivatives, particularly interest-rate swaps.

The most common type of interest rate swap is a Plain Vanilla Swap. It is available through the lending institution itself or a third-party financial institution. Within the scope of the Plain Vanilla Swap,

the borrower agrees to pay a fixed rate to the counterparty, while receiving a floating rate indexed to a reference rate (i.e. three-month Euribor). With the money received by the counterparty, the floating loan interests are paid to the lending institution. In this way the borrower eliminates the risk of rising interest rates. Concurrently the advantage of sinking interest rates is given up and now lies with the counterparty.

### 8.2 Land collateral

Loan agreements with financial institutions specializing in property finance need to be balanced between the interests of the parties involved. In order to ensure this, financing is usually granted against land collateral. A distinction is made between mortgage (*Hypothek*) and land charge (*Grundschild*). To be valid, both must be registered in the Land Register. In order for the registration to be effected in the Land Register, notarization is required.

The usual land collateral is the land charge being a non-accessory nature security right. It can be assigned separately and also be linked to any loan claim via a security purpose agreement. Due to the accessory nature (*Akzessorietät*) of the mortgage, the validity of the mortgage is conditional upon the existence of an underlying claim and cannot be assigned to a third party without such underlying claim.

### 8.3 Further collateral agreements

In line with the financing and refinancing of real estate property, further agreements and means of collateral are of importance.

#### 8.3.1 SECURITY PURPOSE AGREEMENT

As explained above, the existence of the land charge is not conditional upon the existence of an underlying loan claim (no accessoriness). Therefore, the loan claim needs to be secured and the land charge needs to be linked via contractual agreement through the Security Purpose Agreement. Furthermore, the Security Purpose Agreement stipulates under which conditions the enforcement of the land charge can be claimed. It is recommended to explicitly regulate the reassignment of the land charge due to the lack of statutory provisions.

#### 8.3.2 SHARE/INTEREST PLEDGE AGREEMENT

Share and Interest Pledges can also be used as collateral for loan claims. The Pledge of Shares in a limited liability company (GmbH) requires notarization before a German notary (Section 1274 II BGB in conjunction with Section 15 III GmbHG), whereas a Pledge over Interest in a limited partnership (KG) does not usually require notarization. Furthermore, it is important to check that Share/Interest Pledges are not prohibited by the articles of association or partnership agreements of the respective company. Also, the articles of association/Partnership agreement of a company may provide a requirement for the company's approval.

#### 8.3.3 GLOBAL ASSIGNMENT AGREEMENT AND ASSIGNMENT OF LEASE RECEIVABLES

Another way of providing collateral is through Global Assignment Agreements. This term describes



the assignment of a plurality of present and future claims in one transaction. The prerequisite is the determinability of the individual claims. It must also be ensured that the assignment is not considered excessive from the start, otherwise it is deemed invalid according to Section 138 BGB. In addition, no assignment prohibitions must exist. Often the Global Assignment Agreement is not made public and the assignor is authorized to continue to collect the assigned claims.

Typically, the lease receivables, meaning all present and future, conditional and unconditional claims, rights, title and interests under and in connection with the lease agreements (including, but not limited to, any claims for the payment of rent), are assigned to the lending institution.

#### 8.3.4 BANK ACCOUNT PLEDGE AGREEMENT

Bank Account Pledges as collateral are possible over bank accounts run by the lending institution itself (lending bank) or a third party (account bank). The existence of the Account Pledge depends upon the existence of the underlying claim and can only be assigned together with it (accessoriness). A notification of the account bank is required for the effectiveness of the security. It should also be noted that the account bank usually has a first ranking pledge under its general business terms. A waiver/ subordination is needed if the lending bank wants a first ranking security. The right of the pledgor to still access the pledged accounts can be stated in the Account Pledge Agreement.

#### 8.3.5 DUTY OF CARE AGREEMENT

The lending institution has a reasonable interest in the preservation of the value of the real estate property not only because it is used as land collateral, but also because it provides the required income for the owner under the lease agreements. Against this background, the Duty of Care Agreement is a way of providing extra security.

In case the real estate property is rented out and managed by an agent, the lending institution has little control over the day-to-day running. The property manager only owes a duty of care to the property owner under the management agreement. With the Duty of Care Agreement, the duty is extended to the lending institution. Typically, the property manager is also obliged to provide the lending institution with documents and information related to the property, upon reasonable request.



# Glossary

TERM	EQUIVALENT
Altlastenverzeichnis	Cadastre for contaminated sites
Baulastenverzeichnis	Register for public easements
Belastungsvollmacht	Power of attorney by the property owner to grant mortgages for the purpose of financing a purchase
Beschränkt persönliche Dienstbarkeit	Limited personal easement
Bruchteilsgemeinschaft	Co-owners in property/land
Bundesbodenschutzgesetz	German federal soil protection act
Einheitswert	Rateable value
Erbbaurecht	Hereditary building right (long lease)
Gesellschaft mit beschränkter Haftung (GmbH)	Limited liability company
Grundbuch	Land register
Grunddienstbarkeit	Easement
Grunderwerbssteuer	Real estate transfer tax (RETT)
Grundschuld (mit Brief)	Land charge (certified)
Gutgläubenserwerb	Acquisition in good faith; bona fide
Hypothek (mit Brief)	(ordinary) Mortgage (certified)
Kommanditgesellschaft (KG)	Limited partnership
Mietvertrag	Lease
Notwendige Bestandteile	Constituent parts of the property/land
Pacht	Ground lease
Rentenschuld	Annuity charge
Vereinigungsbaulast	Public easement restricting construction on two neighboring properties bound by the easement
Wohnungseigentumsgesetz (WEG)	German Condominium Act
Zwangsversteigerung	Public auction, auction sale, foreclosure
Zwangsvollstreckungsunterwerfung	Submission to immediate enforcement

# Contacts

## HAMBURG

### DLA Piper

Jungfernstieg 7  
20354 Hamburg, Germany  
T +49 (0)40 1 88 88 0  
F +49 (0)40 1 88 88 111

## MUNICH

### DLA Piper

Maximilianstraße 2  
80539 Munich, Germany  
T +49 (0)89 23 23 72 0  
F +49 (0)89 23 23 72 100

## COLOGNE

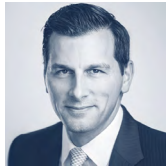
### DLA Piper

Augustinerstraße 10  
50667 Cologne, Germany  
T +49 (0)221 277 277-0  
F +49 (0)221 277 277-10

## FRANKFURT

### DLA Piper

Westhafenplatz 1  
60327 Frankfurt am Main  
Germany  
T +49 (0)69 271 33 0  
F +49 (0)69 271 33 100



### Lars Reubekeul

#### Partner

[lars.reubekeul@dlapiper.com](mailto:lars.reubekeul@dlapiper.com)  
T +49 89 23 23 72 140  
F +49 89 23 23 72 100



### Antoine Mercier

#### Partner

**Global Co-Chair, Real Estate**  
[antoine.mercier@dlapiper.com](mailto:antoine.mercier@dlapiper.com)  
T +33 1 40 15 24 09  
F +33 1 40 15 24 01



### Fabian Mühlen

#### Partner

[fabian.muehlen@dlapiper.com](mailto:fabian.muehlen@dlapiper.com)  
T +49 69 271 33 321  
F +49 69 271 33 100



# About DLA Piper

With more than 600 lawyers globally, DLA Piper boasts the world's largest real estate practice and is consistently top-ranked around the world. As real estate develops into a truly global industry, the ability to quickly and efficiently provide legal services in structuring cross-border investments and transactions is paramount. Our clients value the team's global resources, regional strength and local delivery,

and include private and public companies, institutional investors and government entities.

In Germany DLA Piper has a large team of lawyers in offices in four major cities – Cologne, Frankfurt, Hamburg and Munich – with years of experience in the local real estate industry. They advise on issues affecting all stages of the real estate investment and development cycle

and work with a large number of German and international clients. Our lawyers are also active members of and contributors to the business communities and industry associations that have a key role in shaping the future of the German real estate industry.

In short, we are one team, no borders, providing a real advantage to clients in Germany and beyond.

This guide was prepared in July 2018. Subsequent changes in law are therefore not taken into account. This guide cannot be considered as a substitute for obtaining specific legal advice in individual cases. DLA Piper does not assume any liability in connection with this guide.

Visit [www.dlapiperREALWORLD.com](http://www.dlapiperREALWORLD.com) – DLA Piper's online guide to international real estate.