



G-REIT; ANOTHER "TRANSPARENT" INVESTMENT VEHICLE

On 30 March 2007, the Bundesrat, the upper house of parliament, passed the law introducing the new German REIT ("Real Estate Investment Trust"). The bill is expected to be signed into law by the president next week. The new law is effective retroactively from 1 January 2007 onwards.

The G-REIT is a new vehicle for indirect investments with a tax transparent status. In principle "transparent" real-estate investment vehicles, such as open-ended or closed funds, have always been available in Germany. However, the REIT concept is intended to provide an additional vehicle which avoids handicaps or defi-

ciencies of the already existing vehicles. Holdings in closed funds are typically non-disposable, whereas property companies in Germany still have a very low market capitalisation and total tax burden is higher than in case of direct investment. More importantly, open-ended investment funds are not accepted in foreign countries, whereas the REIT concept is an international standard; for example, the USA introduced the REIT concept as early as 1960, the Netherlands in 1969, Japan in 2000. Approximately 25 countries have already introduced a REIT or similar concept, most recently the UK, as of 1 January 2007.

Therefore, one of the major goals of the G-REIT is to make the German real-estate market more attractive, especially to foreign investors, as the available vehicles might have been a barrier to investing in German property in the past.

The aim of such "transparent" property-investment vehicles is taxation at the investor level only. Consequently, the G-REIT itself is exempt from income tax, provided it satisfies all necessary statutory requirements. The exemption applies starting in the fiscal year in which the G-REIT is entered into the commercial register.



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On the other hand, dividends of a G-REIT are not subject to the general dividend taxation on 50% of the dividend only, but are fully subject to tax at the level of the investor. In the case of a UK-resident investor, the dividends of the G-REIT are subject to withholding tax of 15%. Even if according to treaty or the Parent Subsidiary Directive, the requirements for a lower withholding tax are met in principle, under the new law, a reduction will not be granted. Whether this is in line with the existing tax treaty and/or EU Directives is doubtful. UK domestic law, however, provides a credit of the tax withheld against the UK tax liability, depending on the tax status of the investor

Main features of the G-REIT are:

- The G-REIT has to be set up as a German public limited company, what is known as a ‘REIT AG’.
- The minimum nominal capital amounts to €15 million.
- The minimum equity must not fall below 45% of the book value of the immovable property.
- The G-REIT must be registered on a recognized stock exchange within three (or, in exceptional cases, four) years after the registration as “pre-REIT”. The pre-REIT itself is not yet exempt from tax.

- At least 90% of the distributable profits must be distributed.
- Furthermore, at least 75% of the total assets must consist of property assets and at least 75% of the gross receipts must be derived out of property activities.
- The G-REIT is only allowed to hold shares in ‘property service companies’, or property companies, which hold foreign properties, or in case of German properties have the legal form of a partnership.
- At least 15% of the shares of a REIT AG must be held by shareholders who in turn do not individually hold more than 3% of the shares to ensure a certain free float. At listing, the percentage increases to 25%.
- Direct investments of single shareholders must not amount to 10% or more of the shares which would grant 10% or more of the voting rights.

Violation of these requirements leads to harsh sanctions and penalties, which – depending on the violation (such as failure to maintain the listing as a REIT AG; engaging in speculative property trading; exceeding the allowed leverage during three consecutive years, or failure to meet the asset or income test, or distri-

bution requirements during three consecutive years) – might even result in the loss of the tax-exempt status.

In order to encourage conversion or contribution into a G-REIT, the capital gains resulting from the transfer of real property which has been held by the transferor for a period of at least five years, are subject to income tax only on 50% of the amount. This exit tax applies only for a period of three years, namely from 1 January 2007 to 31 December 2009; however, it is also applicable in the case of a pre-REIT, if this is registered within four years as a G-REIT.



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