



Investing in German Real Estate from abroad – Taxation of corporate and private investors

Overview for potential foreign investors

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The German real estate market offers business opportunities for foreign investors. Tax efficient structuring can amplify the after tax cash flow generated by the investment for capital investors as well as for companies wanting to operate businesses. In reverse, German tax law can adversely affect forecasted profitability if taxes are not taken into account when structuring an investment in Germany. In the following article we will give an overview on general taxation of investments in German real estate and show opportunities arising for foreign private and corporate investors.

General allocation of taxation rights between source and residence country

Private investors or corporations buying real estate in Germany are generally liable for German income tax on income earned by letting, leasing or selling said investment. Applicable double taxation agreements (“DTA”), which allocate taxation rights between the investor’s country of residence (“residence country”) and the country in which the income arises (“source country”, here: Germany), often assign the right to tax income from immovable property to the source country, as it is proposed by OECD’s model DTA.

Corporate income tax or personal income tax

The German tax system differentiates between natural persons, which are taxed with personal income tax, and corporations, which are taxed at corporate level with corporate income tax. Private companies are disregarded, instead the members of private companies will be liable for the income tax according to their share in the company.

Overview of taxation for investors qualifying as corporation

If the investing entity is regarded as a corporation by German fiscal authorities, the extent of taxation differs between companies, which are purely investing in German real estate and companies, which create a permanent establishment due to their business activities in Germany. In the course of investing into real estate a permanent establishment could



be established in Germany if the company is offering additional services, e. g. housekeeping or manages their rental business nationally.

If no permanent establishment arises in Germany, the investor in Germany becomes limited tax liable only for the income directly resulting from the real estate. The thusly taxable income is limited to rents, leases and proceeds from property sales. Starting from 01.01.2019, income from changes in the value of business assets, which are related to the investment, e.g. debts for purchasing real estate are included into the corporate tax base from "income from sale". Even with such value changes now included, the tax base as compared to the case in which the property is held within a permanent establishment is still more narrow.

Income, which a foreign investor earns from German real estate without a permanent establishment isn't liable to local trade tax. Local trade tax is levied by the municipalities on local businesses and averages at a rate of 14%. This means that the total rate of profit taxes in Germany is solely determined by corporate income tax, which is a flat rate of 15%, and solidarity surcharge of 5,5% on the corporate income tax amount. **The applicable tax rate for letting, leasing and profits from sale totals for corporate foreign investors at a rate of 15,825%.** Additional (foreign) tax applies for profit distribution payments which will be made by the corporation to its shareholders.

Overview of taxation for private investors

The limited tax liability for foreign natural investors again includes income from letting and leasing, which are taxed at their applicable individual personal income tax rate. The sale of immovable property is generally not taxable as soon as the tax payer has held the property for at least ten years. **Following this, the income from the investment can include tax free income, while the income from letting and leasing is taxed at an individual tax rate within a progressive income tax tariff of up to 47,475% (45% plus solidarity surcharge of 5,5% on the personal income tax amount).**

If the investment is made by a private company, which is a disregarded entity for tax purposes, the treatment depends on whether or not an permanent establishment arises. The tax is charged at the level of the investor and equals the aforementioned treatment for natural persons. Local trade tax again does not need to be paid as long as no permanent establishment exists.



Summary & Takeaways

If no permanent establishment exists, taxation stands at the following rate:

Tax rate on....	Corporate investor	Private investor
Income from letting & leasing	15,825% + (foreign) dividend distribution tax	Up to 47,475%
Profits from sale of real estate	15,825% + (foreign) dividend distribution tax	Not taxable after holding period (10 years)

As the table shows, the effective tax on investment in German real estate depends on the investors legal structure and the intended holding period of the real estate investment. The tax treatment also differs significantly when the investment case involves the creation of a permanent establishment: This will influence the scope of income which is included in the German tax base and is the deciding factor whether or not the investment is liable to trade tax.

A qualified German tax advisor can help potential investors in structuring the investment most tax efficient for the intended investment case and can help to identify the emergence of a permanent establishment to avoid unfavorable tax outcomes which may deteriorate the investment's economic advantages.