



Forum Juris Special

The German Real Estate Investment Trust

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With the Real Estate Stock Corporations with Listed Shares Act (REIT-Act) the German legislator has introduced an internationally established category of real estate interest with transparent taxation ("*transparente Besteuerung*"), the Real Estate Investment Trust – in brief: REIT – with retroactive effect as of January 1, 2007. With such law an additional investment vehicle has been created which interlinks the real estate with the capital markets and which shall enhance the further development of the domestic real estate sector. REITs are not only interesting for real estate companies or closed real estate funds and for national or international investors respectively. Substantial tax privileges may also arise for all companies which intend to sale (and lease back) their business premises to a REIT in order to optimize their liquidity position. However, such tax privileges are only limited for sales until the end of 2009. All in all, substantial impulses for the German real estate market are to be expected.

Corporate Structure

Only a listed German stock corporation (REIT-AG) having its legal seat and place of management in Germany and a minimum share capital of at least EUR 15 million can qualify as REIT. Its core business must be concentrated on the acquisition, the administration and the sale of real property or rights of use of real property, with the exception of domestic residential real estate if constructed prior to January 1, 2007. In addition, the REIT-AG is enabled to acquire interests in domestic real estate partnerships and to operate own foreign real estate subsidiaries.

The focus of the REIT-AG on real estate business must be duly reflected in the structure of the assets and income of the company: At the end of every business year, at least 75 percent of the assets must be attributable to the immovable assets ("*asset test*") and



at least 75 percent of the sales revenue plus other earnings must be generated from the renting, leasing or sale of immovable assets ("*income test*").

All the shares of the REIT-AG must be voting shares belonging to a single class of shares and must be listed with an organised market within the European Union or in a member country to the agreement creating the European Economic Area. Therefore, the REIT-AG cannot be listed in the Open Market of the German Stock Exchange ("Deutsche Börse") and in particular not in the Entry Standard (special segment which is less regulated). In fact, in Germany the REIT-AG may only be listed in the General Standard or Prime Standard of the German Stock Exchange, which brings about much higher transparency requirements for the listed companies compared to the Entry Standard.

With regard to the shareholder structure of the REIT-AG, the REIT-Act contains important regulations. At least 15 percent of the shares in the REIT-AG must be in free float permanently (shareholders directly or indirectly holding less than 3 percent are taken into account) and no shareholder is allowed to directly hold 10 percent or more of the voting rights of a REIT. The compliance with the shareholder structure is safeguarded by the regular notification requirements under the German Securities Trading Act (Wertpapierhandelsgesetz) and the specific regulations of the REIT-Act. As a consequence, the structuring of the REIT-AG and the monitoring of the aforementioned regulation on the shareholder structure by the managing board impose specific challenges.

On fulfillment of the regulatory requirements of the REIT-Act, the formation act consists merely of adding the designation "REIT" or "Real Estate Investment Trust" to the company's name. The obligatory filing and registration with the commercial register causes a status change of the company into a REIT-AG and triggers specific tax privileges.

Tax Framework

Generally, the REIT-AG is taxable without any limitations, but upon meeting the requirements as laid down in the REIT-Act, it is fully exempted from the corporate income and the trade income taxes. The distributable income of the company – 90 percent of which have to be paid out to the shareholders – is only taxed at the investor level. The distributions to the shareholders are completely taxable, the so-called half-income taxation system ("*Halbeinkünfteverfahren*") is not applicable. This construction avoids a double taxation of the company's income (on company and investor level) and eliminates a disadvantage of the already existing German real estate stock corporations compared with the open real estate funds.



Exit-Tax

In order to create an incentive to reverse hidden reserves, the REIT-Act provides for a specific tax privilege for transfers of real estate to a REIT-AG which take place until December 31, 2009. Such Exit-Tax shall help to enhance a temporary start-up financing for REIT-AGs and shall ensure a sufficient market spectrum. If German real property or buildings, which belong to the fixed assets of the transferor for a period of at least five years (due date: January 1, 2007) are sold to a REIT-AG or a so-called Pre-REIT (optional tax status in the preparatory phase before the final formation of the REIT-AG) only half of the capital gains realized upon the transfer of real estate will be subject to German income and trade tax.

This privileged taxation applies to all purchase contracts on real estate concluded since January 1, 2007 with legally binding effect, subject to the condition that the purchaser is already a REIT-AG or has the Pre-REIT-Status at the time of the transfer of the economic, i.e. beneficial ownership ("*wirtschaftliches Eigentum*") in the real estate. As a result of this regulation, a vendor may have the opportunity to retroactively profit from the Exit-Tax by transferring real estate on the basis of a purchase contract which he already concluded this year.

The Exit-Tax is also applicable upon the reversal of hidden reserves in the occasion of the change of the company's status into a REIT-AG and, furthermore, in transactions on the basis of the German Reorganization of Companies Act ("*Umwandlungsgesetz*"), e. g. in case of a spin-off concerning the transfer of real estate to a subsidiary-REIT-AG.



Your Opportunities

Real estate companies may use the REIT-AG as an alternative to the already existing indirect forms of real estate investments. The REIT-AG can be incorporated as a new entity or can be formed by way of a reorganization of an existing entity – various constellations are possible. In particular a shell company, which is organized as a stock corporation and already listed with an organised market in an EU or EEA member state, can be purchased. Subsequently, this company can be restructured in accordance with the requirements as constituted in the REIT-Act.

Existing real estate stock corporations specialized in commercial real estate as well as closed real estate funds can be transformed into a REIT-AG and in particular the funds might identify interesting opportunities: Due to the fact that an efficient secondary market for interests in closed real estate funds has not been established yet, the REIT-AG – under certain conditions – may allow an attractive exit strategy.

In the course of the incorporation or transformation process for setting up a REIT-AG, the asset structure, in particular the real estate portfolio of the company, must be reorganized due to the fact that the REIT-AG must not hold domestic residential real estate which has been constructed prior to January 1, 2007. In addition, the portfolio regarding commercially used real estate should be examined and, if necessary, adjusted in accordance with geographical and/or other selection criteria: The expectations of the capital markets require the presentation of a convincing Equity Story on the occasion of the IPO. The Exit-Tax facilitates the restructuring and the completion of the existing real estate portfolio.

Companies not directly related to the real estate markets which own commercial properties (e. g. industrial companies with business premises) also have additional options due to the existence of the Exit-Tax. They are able, e. g. in the course of a sale-and-lease-back-process, to sell suitable real estate to a REIT-AG in order to activate existing liquidity reserves, without having to fully tax the capital gains. However, special attention needs to be paid to the drafting of the real estate purchase contract. Under certain conditions the tax advantages can be inapplicable retroactively, even though the reasons for the loss of the tax privileges usually cannot be allocated to the vendor's sphere. The vendor has to take precautions concerning the risk of subsequent taxation. Therefore, appropriate compensation mechanisms should be agreed upon in the contract with the REIT-AG or the company with the Pre-REIT-Status.

Domestic and foreign investors can resort to an alternative to the cost-intensive direct purchase of real estate by investing into a REIT-AG. In particular, the so-called "Topic-REITs", e. g. focused on hotels or shopping centers, feature a high degree of specialization as well as a high level of diversification. This development probably will be accompanied by a further degree of professionalism of the German real estate market and – due to the legal requirements for the distribution of profits (at least 90 percent) – attractive dividend returns.

Our Services

The legal team of Raupach & Wollert-Elmendorff has broad expertise on Corporate, Capital Markets and Real Estate Law. Our co-operation partner Deloitte can support you with tax advice meeting the highest standards.

We would be happy to advise you on

- the checkup of your company concerning its capability to be transformed into a REIT-AG also with regard to the real estate portfolio and the legal structure of your company (feasibility study)
- the incorporation of a REIT-AG or the transformation of an existing company into a REIT-AG
- the adjustment of the real estate portfolio of your company with regard to the requirements constituted by the REIT-Act, in particular on the purchase of adequate real estate or on the sale of real estate not qualifying for the REIT or of corporate assets strategically not suitable for the portfolio
- the sale of commercial properties to a REIT or a Pre-REIT
- the mandatory IPO of the REIT, in particular on the preparation of the prospectus and on the compliance with the admission procedure
- the monitoring of the regulatory requirements of the REIT-Act in order to avoid adverse tax consequences
- the compliance with the general rules of conduct and transparency according to German capital markets law (being-public-regulation)
- the purchase of shares of a REIT-AG



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