The Impact Of EU ATAD Directive On Real Estate Investment On The German Market

I. Application, purpose and essential content of ATAD

From 1 January 2019 on the EU member states have to apply the regulations of the EU Anti-Tax-Avoidance-Directive ("ATAD") from July 2016 by transposition into national law. Further ATAD regulations from May 2017 will have to be implemented later.

The EU Commission's Anti-Tax Avoidance Directive is part of the EU Anti-Tax Avoidance Package. Its aim is to ensure fairer, simpler and more efficient corporate taxation in the EU. It is thus aimed at implementing the OECD recommendations on dealing with the planned reduction of tax bases and cross-border profit transfers (so-called OECD Base Erosion and Profit Shifting ("BEPS") - action plans) adopted in autumn 2015, however, it goes beyond that as well.

The Directive includes a total of six legally binding tax avoidance measures to be applied by all EU Member States. By the end of 2018, initially only three measures had to be implemented, namely the regulations on the interest barrier (Article 4 ATAD), add back taxation regime (Articles 7 and 8 ATAD) and General Abuse Prevention (Article 6 ATAD).

From a German tax law point of view, this does not seem new at first, as national tax law already largely complies with these requirements with the interest deductions restriction rules in § 4h German Income Tax Act (EStG), the controlled foreign corporation rules ("CFC-rules") in §§ 7 ss. Foreign Tax Law (AStG) and the general abuse rule of § 42 General Tax Code (AO). In this respect, Germany may refer to the grandfathering rule, according to which a member state that already has comparable regulations in place may continue to apply them until 1 January 2024.

Thus, it is not surprising that the need for implementation in Germany is not as great as in other states of the EU. Regardless, there are doubts as to whether, e.g. the German interest deduction regulation is really suitable as a model for smaller EU member states in particular.

II. Essential regulations for the real estate industry

Of particular importance for the real estate industry are the interest deduction restrictions (Art. 4 ATAD) and the additional taxation (Art. 7 and 8 ATAD).

Interest deduction restriction

ATAD's interest deduction restriction is designed to prevent companies from using tax-deductible interest expenses to shift and minimise profits. In doing so, the EU-Commission closely followed the existing German regulation of the interest deduction restriction (so-called Zinsschranke). Accordingly, the deduction of net interest expense in the year of its creation is generally limited to 30% of EBITDA. In addition, there is an unlimited tax deduction of net interest payments of up to EUR 3.

The individual member states of the EU have adopted the "Safe Harbor Rule". The differences refer in this respect not only to the absolute amount subject to this rule, but also to its specific form: in part, the amount is - as in the current German scheme - designed as a tax exemption. However, the majority of states opted for a real tax exemption (e.g. Czech Republic and Estonia). Some states, on the other hand, have completely avoided the implementation of a "safe harbor rule" (e.g. Italy).

For taxpayers who are members of a consolidated group for accounting purposes, Art. 4 (5) ATAD contains an exemption clause. Accordingly, the taxpayer - similar to the equity comparison in the current German interest deduction restriction regulation - is allowed to deduct the loan interest in full if the own equity ratio is at least as high as that of the entire group.

In light of the interest deduction restrictions applicable in the whole EU since 1 January 2019 both existing and planned debt financing (bank and shareholder loans) for real estate investments abroad should be reviewed.

CFC-rules

Revenues that domestic companies shift to dominated foreign companies or permanent establishments in low-taxed countries are subject to additional taxation according to the ATAD CFC-regime – similar to the German AStG-regulations. Foreign income is taxed at a low rate if the actual foreign tax burden on that income is half that of the hypothetical domestic tax burden. This will lead to an increased use of additional taxation, since many EU member states have to introduce CFC regulations for the first time.

Unlike the current AStG rules, the Directive also classifies dividends and all profits from the sale of shares in corporations, which a foreign intermediary obtains, as passive income. This can have an impact on global foreign real estate funds with holding structures in particular. However, the German tax authorities intend to stay with the previous concept of a catalog of active income, i.e. neither to switch to the ATAD system of a passive income catalog nor to the alternative approach of the general clause in accordance with Art. 7 para. 2 lit. b) ATAD and to adapt the catalog to the requirements of ATAD.

In case the real estate investment falls under the scope of the German Investment Tax Law (InvStG) such regime will according to § 7 (7) AStG prevail over the German CFC-rules.

Investors should therefore check whether their real estate investment through EU foreign companies might be subject to the ATAD CFC regime in place as of 1 January 2019.

III. Conclusion: Need for action for investors and AIFM

Real estate investors and AIFMs of real estate funds should consider the following two aspects in the context of ATAD, especially for foreign real estate investments:

- Reviewing the interest deduction potential against the background local interest deduction restrictions applicable since 1 January 2019.
- Reviewing the activities of foreign companies, in particular to what extent they could qualify as intermediate companies in the future due to the new definition of passive income.

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