

# Real Estate

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## Newsletter Real Estate

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## **A. The German 2014/2015 Real Estate Market: Stable sales figures, increasing prices and foreign capital**

The previous real estate year 2014 ended with a renewed increase of transaction volumes. Due to investments in commercial properties, sales figures increased for the fifth time in a row, now amounting to approximately 40 billion Euros. Compared to the previous year this is an increase of ca. 30%.

The renewed rise of capital invested into real estate was accompanied by an increased purchase price level. The average prime yield for office premises further decreased throughout the traditional office centers with an average rate of 4.5% at the end of 2014. Similar developments were recorded for retail properties (prime yield between 4.5% and 5.6%, depending on the type of property) and storage/logistics properties (ca. 6.2%).

In 2014, the investors focused in particular on office premises (44%), followed by retail properties (ca. 22%) and storage/logistics properties (ca. 10%). More than half of the transaction volume has been invested in properties located in the classic real estate markets. However, there has been an increasing trend to switch to second-rate markets for lack of investment opportunities. Moreover, there is an increased readiness to invest in lower-quality properties or in properties with an above-average vacancy rate.

Foreign investors represent a major proportion of the transaction volume. With a volume of approximately 50% they were on par with domestic investors. With regard hereto, Asian, in particular Chinese, investors represent the most significantly growing group of investors.

For the current fiscal year 2015, we expect a sustained demand for direct real estate investments in Germany. Expecting a higher transaction volume than in 2014 can be considered as quite realistic. Demand is in particular driven by the continuing low interest rate level and the fact that Germany is perceived as reliable investment location due to a stable economic and political environment. The existing investment pressure and the resulting demand for real estate investment opportunities in Germany will be accompanied by a renewed decline in prime yields and further increasing purchase prices.

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## **B. Draft Law on tax-privileged energy-efficient refurbishments**

Together with the Federal Ministry of Finance (BMF), the Federal Ministry of Economics (BMWi) has submitted a term sheet on a tax relief for energy-efficient refurbishments. The term sheet is based on the National Energy Efficiency Action Plan (NEEAP) which has been passed by the Federal Government on April 3, 2014.

The present term sheet includes the general conditions on a tax relief for energy-efficient refurbishments which are intended as of 2015 for a period of at least five years. The term sheet provides inter alia for a tax depreciation of expenses over a period of ten years. However, the law shall **only promote owner-occupied properties**. The promotion shall be made by deducting the relevant amount from the tax base depending on the individual income.

Pursuant to the term sheet, the following energy focused measures will be promoted:

- Renewal of plant technology (inter alia combined heat and power, renewable energies),
- Renewal of external construction components (inter alia windows and entrance doors),
- Ventilation concepts,
- Insulation measures,
- Individual measures complying at least with the KfW Group's standards.

In general, individual measures are meant to be promoted with 11% for a period of ten years at a discount rate of 2% and maximum investment costs of up to € 25,000. Consequently, an individual measure costing € 6,500 would be subsidized with a total of € 642 (i.e., 11% of expenses for a period of ten years and a discount rate of 2% p.a.).

Moreover, the bill provides for subsidies of 27.5% and 22% respectively (depending on the energy-efficiency rate) as regards comprehensive refurbishments into a "KfW efficiency house"; the maximum eligible amount of investment costs shall be € 75,000.

Unfortunately, the term sheet does not provide for a fiscal promotion of energy-efficient refurbishments for rented property. Pursuant to the term sheet this is based on the fact that such measures are already promoted in terms of deductible income-related expenses or depreciations.

The fiscal promotion of owner-occupied property is meant to be partially financed by reducing the tax relief for craftsman services (Art. 35a EStG – German Income Tax Act) by € 300.

It remains to be seen how the legislative initiative will be implemented. We shall keep you updated on this issue within our Newsletter.

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### **C. 2014 Deadline for the application for real estate tax relief with regard to reduced income: March 31, 2015**

In particular with regard to vacant rentable areas, but also in case of reduced income for other reasons, Art. 33 GrStG (German Real Estate Act) provides – upon application – for a reduction of the real estate tax by 25% (in case of a reduction of the usual gross profit by more than 50%) or by 50% (in case of a reduction of the usual gross profit by 100%), provided the taxpayer is not responsible for the reduction of the gross profit.

The conditions for the application are subject to an annual review.

Deadline for submitting applications for a real estate tax relief is May 31, 2015. After expiration of this deadline, applications for a reduction of the 2014 real estate tax will no longer be accepted.

Further, the applicant has to provide evidence that he has taken appropriate measures in order to increase the gross profit.

A reduction of gross profits might result from lower rents per square meter or (partial) vacancies. In order to calculate the deficiency in income from rented property, the actual rental income will be compared with the rent index.

The decrease in profits will be calculated for the entire building. If one story of a five-storied office building is vacant (1/5 of the entire space) and the other stories are rented at usual market conditions, the decrease in profits for the entire building only amounts to 20% and does not qualify for an application for a real estate tax relief.

However, a decrease in profits does not qualify for a (partial) exemption of real estate tax if the decrease in profits can be taken into account by an adjustment of the assessed value or could have been taken into account if the application for an adjustment of the assessed value had been submitted in due time.

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## **D. Federal Ministry of Finance (BMF) rejects stay of execution due to doubts as to the so-called earnings stripping rule's ("Zinsschranke") constitutionality**

Pursuant to the decision of the Federal Tax Court (BFH) of December 18, 2013 (I B 85/13), by which the court granted a stay of execution due to doubts as to whether the denial of interest expense limitations pursuant to Art. 4h EStG (German Income Tax Act) is in line with the constitution, the BMF now rejected the general applicability of such decision beyond the relevant individual case in its letter of November 13, 2014.

Due to the possibility of carry-forwards, the BMF deems the BFH's doubts on the constitutionality as not justified. Moreover, the BMF sees a contradiction with current BFH decisions on the minimum taxation pursuant to Art. 10d Sec. 2 sentence 1 EStG and Art. 10a sentence 2 GewStG (German Trade Tax Act).

The Ministry further stated that until now, neither the BFH nor another financial court had submitted the so-called earnings-stripping rule pursuant to Art. 100 GG (German Constitution) for a decision of the Federal Constitutional Court.

Irrespective of the above, a stay of execution may be granted pursuant to Art. 361 Sec. 2 sentence 2.2 Alt AO (German Fiscal Code, old version) and Art. 69 Sect. 2 sentence 2.2 Alt FGO (German Tax Court Code, old version) if the execution would impose an undue hardship on the respective party that cannot be justified with an overriding public interest.

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## **E. Real Estate Market in Slovakia – General Legal Notes**

### **Types of and titles to real properties**

Slovak law distinguishes two types of real property: (i) plots of land (built-up areas, forests, gardens, vineyards, etc.) and (ii) structures connected to the ground by solid base (different kinds of buildings, apartments, non-residential premises, etc.).

The main titles to the real property are:

- a) ownership,
- b) lease,
- c) encumbrances.

**Land and mortgage register**

Immovable property in Slovakia is registered at the Cadastral Office, which is the public authority administering the real estate register, i.e. cadaster („kataster nehnuteľností“). Anybody is entitled to get a relevant extract from the cadaster called ownership certificate („list vlastníctva“) for a fee amounting to EUR 8. The extract shows identification data of relevant immovables, ownership details, encumbrances including mortgages (if any). The cadastral register is freely accessible online, while only originals of ownership certificates in paper form may be used for legal purposes.

Lease of land plots for more than 5 years is also registered in Cadastral Register.

**Alienability of properties**

Real property in Slovakia is freely transferable to another owner, in the sense that they may be purchased, sold, inherited and encumbered.

Contractual transfer of ownership (such as purchase, donation, and exchange) must be of course executed in written form, while signatures of transferors must be verified by a notary.

Registration of a transfer of ownership by the Cadastral Office takes one (1) month, if a higher fee is paid, one (1) week; these limits are duly observed by the relevant authorities.

**Acquisition of properties by foreigners**

Before Slovakia became a member state of the European Union, foreign entities were not allowed to purchase any kind of real estate within territory of Slovak Republic. Foreign entities could only become owner of Slovak immovable by inheritance.

Since Slovakia entered the European Union, i.e. from May 1 2004, foreigners were free to own and/or purchase real estate in Slovakia, except for agricultural land and woodland.

The latest change in principles for acquisition of Slovak real estate by foreigners came into effect as of May 1 2014, by latest amendment of the Act no. 180/1995 Coll. on Some Measures for Settlement of Ownership to Lands (“Act”). The Act provides the rules for purchasing real estate by foreigners, who can only purchase Slovak real estate once the conditions of the above Act are duly fulfilled. Potential buyers of agricultural land or woodland should be primarily such entities with a temporary residence or seat of their company in Slovak Republic for at least 10 years and they have to be entrepreneurs in agriculture according to relevant Slovak legislation. Before purchasing agricultural land or woodlands by foreigners, the seller of real estate has to register an offer for such a sale in the Register for publication offers of a transfer of ownership of agricultural land kept by Ministry of Agriculture and Rural Development of Slovak Republic. Domestic purchasers have priority over foreign purchasers; however, if no domestic purchaser shows interest to buy the offered real estate, foreign purchasers are entitled to do so.

Besides the rules described above, another rule has to be applied in order to avoid disintegration of the land: the carve of the purchased agricultural land has to be at least 2000 m<sup>2</sup> and the carve of the purchased woodland has to be at least 5000 m<sup>2</sup>.

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## **F. Real Estate Market in Slovakia – General tax guide on immovable property in Slovakia**

### **1. Indirect tax**

VAT treatment of supply of the immovable property and provision of services related to immovable property.

#### **VAT exemptions for immovable property**

According to Slovak VAT Act, supply and leasing of immovable property shall be exempted from VAT under certain circumstances described below:

- Supply of a construction or a part of construction, including building land, if the supply is carried out five years after approval of the building or five years from the day when the building was put into use; (VAT payer can decide not to apply exemption from VAT)
- Supply of land, except for supply of building land; (if building land is supplied with construction, it shall be exempted from VAT according to exemptions for constructions)

- Leasing or subleasing of immovable property or its part, exempt for:
  - accommodation services,
  - rent of parking places for vehicles,
  - rent of permanently installed equipment and machinery,
  - rent of safes.

Since April 1, 2009, the lessor may decide to not apply exemption from VAT, if the lessee is a taxable person. Leasing of immovable property billed to individuals shall be exempted from VAT.

#### **Domestic VAT reverse charge mechanism applied for supply of immovable property**

Since October 1, 2012, a domestic taxpayer, who is recipient of the supply of immovable property or a part of immovable property located in the territory of the Slovak Republic, shall be obliged to pay tax, if the seller, also a domestic taxpayer, decides to not apply the exemption for supply of immovable property construction described above.

#### **VAT deduction**

Taxpayer shall not fully deduct tax on goods and services being used for supplies of goods and services exempted from VAT. Provision of exempted supplies triggers pro rata VAT deduction via coefficient calculated by taxpayer or adjustment of deduction in respect of use of investment property for supplies exempted from VAT.

#### **Place of supply of services related to immovable property**

The place of supply of services connected with immovable property, including the services of estate agents and of experts, accommodation services, the granting of rights to use immovable property and services for the preparation and coordination of construction work, such as services of architects and of persons providing on site supervision, shall be the place where the immovable property is located.

## **2. Direct Tax**

Income taxes in connection with business operations with immovable property



## **Income Tax**

Taxable parties with unlimited tax liability (Slovak tax residents) shall be levied from worldwide income having source in the territory of the Slovak republic and abroad.

Taxable parties with limited tax liability (Slovak tax non-residents) having income from the leasing of real estate, other use of real estate or sale of real estate located in the territory of the Slovak Republic shall be levied at tax rate stipulated by Slovak VAT Act or appropriate double tax treaty.

Corporate tax rate shall be 22% of the tax base, less any tax losses.

Personal income tax rate shall be 19% of part of the tax base not exceeding EUR 35,022.31. Personal income tax rate of 25% shall be applied for tax base exceeding EUR 35,022.31.

Under certain circumstances the sale of immovable property by individuals can be exempted from personal income tax.

## **Local taxes**

Real estate tax is administrated by municipalities and comprises:

- land tax,
- tax on buildings,
- tax on apartments and non-residential premises within apartment buildings.

Generally, taxpayer shall be:

- land owner as per extract from Land Registry,
- lessee, if leasehold in respect of the real estate lasts or is expected to last at least five years and the lessee is registered in the Land Registry.

Tax rates and other conditions on local taxes shall be stipulated in the generally binding regulation approved by appropriate municipality.

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## **G. Purchaser of a property must not be committed to his offer for an unreasonably length of time**

Property law: A four-month commitment period for a purchaser's offer which has been preformulated by the seller by using a standard form limits the purchaser's freedom to dispose and is therefore ineffective.

BGH, decision of October 17, 2014, ref-no.: V ZR 289/13

### **The case**

In 2002, the purchaser had submitted his purchase offer for a condominium by way of a notarized declaration which had been preformulated by the seller. The declaration included an irrevocable commitment period of four months. The seller accepted the offer – by means of notarized declaration – about three months after submission of the notarized offer. Subsequently, the purchaser claimed for the sales contract to be invalid and sued the seller for repayment of the purchase price. In the first instance, the lawsuit was only partially successful; the court of appeal rejected it in full. The BGH has now set aside the appeal decision and has referred the case back to the court of appeal.

### **Consequences**

The BGH confirms its case-law according to which a four-month commitment period which has been formulated by means of a standard form is deemed ineffective. Pre-formulated clauses comprise – even with regard to a notarial deed – general terms and conditions pursuant to BGB (German Civil Code). If such clause impairs the contractual partner's freedom to dispose in an unreasonable manner, it is deemed ineffective pursuant to Sec. 308 No. 1 BGB. The ineffective clause shall be replaced by the relevant legal provision. According to such provision, the buyer shall be bound by its offer (which has not been submitted in the seller's presence) only for such period of time during which a reply can reasonably be expected under normal circumstances. Pursuant to settled BGH case-law, a period of four weeks can be deemed appropriate with regard to real estate issues. Consequently, an acceptance after three months is deemed delayed and merely constitutes a new offer on the part of the seller. The BGH denied for the new offer to have been accepted by the buyer. The seller had no reason to rely on the binding effect of the clause, as even in 2002 such commitment periods were deemed ineffective by large parts of legal commentaries.

### **What needs to be done?**

Preformulated clauses should be treated with caution as such clauses constitute general terms and conditions and are subject to a test of reasonableness of contents pursuant to Sec. 307 et seq. BGB. Any seller using such clauses should formulate regulations which might (unreasonably) impair the other party very cautiously. The risk of a general condition's invalidity will be exclusively borne by the user. Relying on the clause's correctness is legitimate only in exceptional cases; the mere lack of case law

rulings from the highest courts at the date of conclusion of the contract does not legitimate such reliance. Due to settled case-law of the BGH, a maximum commitment period of four weeks should definitely not be exceeded.

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## **H. IAS 40 (investment property) – property owners**

Depending on the future utilization of a property, IFRS regulations provide for different disclosure and valuation standards. Consequently, the classification is of vital importance. The following types of utilization exist:

- resale
- owner-occupation
- renting
- mixed use

If property is held for the purpose of a later resale, it has to be balanced as inventory (IFRS, IAS 2). The IFRS does not stipulate during which period the resale must take place. The period depends on the business purpose and the relevant industry. The property has to be quoted at purchase value or production costs at the date of acquisition. The subsequent measurement process does not require any scheduled depreciation, the acquisition costs rather have to be compared with the realizable net value as of every balance sheet date. Such value results from the estimated sales profit (realizable in the normal course of business) less distribution costs and costs of completion. Besides of the total book value of inventories, the notes must also include the book value of inventories which have been quoted at realizable net value.

In case of owner-occupied property, e.g. in the form of an administrative building, such property has to be balanced as fixed assets (IAS 16). The initial valuation has to be based on the acquisition or production costs. If the individual parts of the property are subject to different depreciation methods, acquisition or production costs have to be allocated depending on the component approach. With regard hereto, a rough breakdown is admissible (e.g. shell construction, equipment, technology). As regards the subsequent measurement, the IFRS provides for an option right between a measurement at amortized cost (at-cost model) and a measurement at fair value (fair-value model). The cost model requires a linear depreciation over the average useful life (20-80 years, depending on the building). It also requires an impairment test as of the balance sheet date. Impairments resulting from such tests have to be recognized in

profit or loss. Besides of book values, accumulated depreciations, depreciation methods and useful life, the notes must also include the recognized impairments. Application of the fair-value model is subject to a reliable determination of the fair value and regular revaluation. Any increase or impairment of the book value resulting from a revaluation must be indicated in the notes.

Rented property has to be balanced as investment property (IAS 40). The initial valuation has to be performed analogous to owner-occupied property. The subsequent measurement provides for an option right between a measurement at amortized cost (at-cost model) and a measurement at fair value (fair-value model), whereas listed companies as well as investment vehicles will generally be subject to the fair-value model. The fair value has to reflect the current market situation and the circumstances as of the balance sheet date. Generally, the best fundamental indication of the fair value is provided by current prices of similar properties quoted on an active market. If such information is not available, one can revert to current prices of different types of property or of property being subject to different contracts, prices that have recently been quoted on less active markets or discounted cash flow forecasts. Due to the forecast uncertainty, income-related methods provide only a small degree of objectivity and are influenceable due to the underlying assumptions (vacancy rate, interest rate, maintenance backlog, etc.). Investment property requires comprehensive information in the notes: on the one hand the disclosure requirements for lessors pursuant to IAS 17; on the other hand, IAS 40 requires information on the applied model, rental income and operating expenses as well as information on cumulative amendments of the fair value. In addition, the fair-value model requires the preparation of a reconciliation indicating the development of the book value.

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