

Real Estate Transactions and Beneficial VAT Treatment – German Tax Authorities Clarify Conditions for an Effective VAT Option

In real estate asset deals between entrepreneurs, the purchaser seeks to reclaim the transaction-related VAT under the same conditions as the seller previously had. On the other hand, the seller wants to avoid any later correction of his previous VAT-input tax deductions. Therefore, the parties treat such a transaction as a non-VATable sale of the whole business under the German VAT Act (*Geschäftsveräußerung im Ganzen*). This treatment allows the purchaser to step into the footsteps of the seller and claim for a VAT input tax deduction for any consulting, legal or other fees in connection with such transactions.

The Issue: Denial of a Sale of the Whole Business and Acceptance of Unconditional VAT Option Clauses

There is a certain risk that the tax authorities deny a transfer of the whole business for VAT purposes. Instead, the transaction may be qualified as a VAT-exempted real estate sale requiring a correction of the VAT amounts previously reclaimed. Therefore, as a precaution, the parties regularly opt for the application of the VAT regime safeguarding the existing VAT status and avoiding a later correction. Such a VAT option is usually conditional on the detrimental treatment of the tax authorities. However, as the tax authorities allow the exercise of VAT options only up until the formal VAT assessment has been made, the exercise of the VAT option at a later time is invalid for VAT purposes.

For example, if certain criteria are met (i.e., transfer of the property with the entire lease agreements), the parties to the relevant notarial asset purchase agreement usually treat the transaction as a transfer of the whole business for VAT purposes. Conditional upon the denial of such treatment by the tax authorities (i.e., certain lease agreements not being transferred), the parties opt for the application of the VAT regime in such contracts. After the formal VAT assessment, a tax audit takes place and rejects the qualification as a sale of the whole business. Consequently, the parties seek for the application of the VAT regime under a conditional VAT option. However, as the formal VAT assessment has already taken place, the tax authorities would not accept a conditional option and would rather reclaim the property-related input VAT tax deductions.

Therefore, the discussion arises regarding treating a real estate transaction as a sale of the whole business and simultaneously implementing an unconditional VAT option clause in the asset purchase agreement. However, as the tax authorities have never accepted this legal drafting practice explicitly, there was a lot of uncertainty.

Statement of the Tax Authorities: Acceptance of Unconditional VAT Options

In two recent circulars, the tax authorities of Hesse and Lower Saxony accept such unconditional VAT options (cf. Regional Finance Office (*Oberfinanzdirektion, OFD*) Frankfurt, dated March 11, 2013 – S 7198 A – 25 – St 111 and OFD Niedersachsen, dated February 14, 2013 – S 7198 – 117 – St 173).

According to the competent tax authorities, the beneficial tax treatment is acknowledged if the parties agree on the treatment of the real estate sale as a transfer of the whole business and at the same time on an unconditional VAT option clause in the notarial deed. Furthermore, all VAT-relevant information must be disclosed to the tax authorities, thus allowing the VAT assessment, if the sale of the whole business is denied later on during a tax audit.

Practical Consequences

Therefore, if a formal VAT assessment has not taken place yet, existing asset purchase agreements containing conditional VAT option clauses should be amended by a supplementary notarial deed. In particular, this might require the review of group property transactions, and should be also relevant for third-party contracts. New purchase agreements require careful legal drafting of the VAT option clause and the treatment as sale of the whole business. Furthermore, the obligation of both parties to provide the relevant documentation for VAT purposes to the tax authorities must be considered in the notarial deed as well.

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