

Property Tax Reform - A Current Overview For The German Market

Steven Guttman, Vistra Munich, on status quo and the outlook for the real estate industry.

What is property tax?

Municipalities develop building areas, secure water supply, install street lamps and build roads leading to houses. Homeowners have to contribute to these costs by paying property tax. Property tax A is payable on agricultural and forestry property, such as fields. Land tax B applies to developed or developable land and buildings. In general, tenants also pay the property tax via their utilities costs - so far this has averaged 19 cents per square metre, i.e. 19 euros per month for 100 square metres.

Why the new regulation?

In April 2018, the German Federal Constitutional Court declared at least for West Germany the previous assessment bases unconstitutional. The unit values ("Einheitswerte") have not been updated since 1964 (in East Germany even since 1935). This was contrary to the universal principle of equality, the grounds for the judgment stated. Many cities and municipalities have undergone extreme changes since 1964/1935 and thus also the values of land and buildings, especially in urban areas. The legislator has until the end of 2019 to reform the property tax. By 2025 at the latest, the new valuation principles will have to be applied. This period of time will be at least required. Because a system must be developed and the data of approx. 36 million houses, residential buildings and properties must be re-evaluated.

Does the property tax then have to be revalued every year?

In the future, citizens will have to renew their property tax data every seven years. In this way, it is to be prevented that the assessment bases are again classified as outdated.

How high are the revenues so far?

Property tax is the third most important source of income for towns and municipalities after trade tax and wage, income and value added tax. It covers 15 percent of municipal tax revenues. In 2017, the total revenue from property tax was around 14 billion euros. The property tax A (forestry and agriculture) accounted for around 400 million euros and the property tax B for 13.56 billion euros.

How is the property tax currently calculated?

Three factors have to be taken into account: The unit value (Einheitswert) multiplied by the property tax measurement number (Grundsteuermesszahl) multiplied by the assessment rate (Hebesatz). Each municipality can determine the assessment rate and thus the actual amount of the tax itself.

What does the original reform proposal look like?

On 28 November 2018, German Finance Minister Olaf Scholz (SPD) presented two proposals for the reform of the property tax that have been drawn up so far:

The value-independent model (Wum): In this variant, the property tax is based solely on the size or area of the property and the building.

Advantage of this variant: Simple calculation. In addition, there are to be factors which are dependent on the use of the building and which, for example, are lower for residential buildings than for commercial buildings.

Disadvantage of this variant: For the 200 square meter single family house in the country the same property tax is due as for the 200 square meter villa in the inner city.

The value-dependent model (Wam): Here the property tax is based on the actual value of the property and the land.

Advantage of this variant: It is more social, since more valuable real estates are taxed higher than more favourable. In this case, the 200-square-meter villa in the city would be subject to a much higher property tax than the house of the same size in the country. In the future, the unit value will consist of five components: Net cold rent, living floor space, year of construction, land size and regional land value.

Disadvantage: Especially in large cities, the inclusion of net cold rent as a basis for calculation will result in a higher real estate tax burden for property owners. As a result, rent increases can be expected if landlords pass on the additional costs to the tenants. Apartment owners must also specify a "fictitious" rent for owner-occupied real estate - the Ministry of Finance wants to make regional rent levels available, which must then be entered. In case of rentals, the rent agreed in the rental contract is entered.

The Wam will meet the requirements of the Federal Constitutional Court, a fairer and more realistic, taxation of land in relation to each other, rather than the Wum. Although the Wum is the simpler solution from a bureaucratic point of view, there are doubts as to whether the principle of equal treatment and the requirements of the German Federal Constitutional Court would be complied with. Whether one of the proposed models for property tax will prevail remains to be seen.

Until an agreement has been reached, the finance ministers of the federal states will probably meet monthly with Federal Finance Minister Olaf Scholz. At the first meeting in January 2019, a further proposal was submitted:

The surface-layer model (Flam): The Flam probably represents a mixture of the Wam and the Wum. The model includes the ground value ("Bodenrichtlinientwert") - but not for individual land plots. Rather, the ground value should be averaged over zones. The average ground value of the respective municipality is to be determined by expert committees. Should large differences occur within a municipality, the municipality should be divided into different zones, within which the land guideline values should "only differ by a certain percentage". Zoning should be omitted if communities are below the average ground value of the entire country.

Reform proposal key issues paper February 2019

A key issues paper was released at the second meeting of finance ministers in February 2019. This paper states that in future a combination of the value of the land, the age of the property and the amount of rent will be used to calculate the tax. This seems to be a modification of the Wam, in which an elaborate individual valuation of all approx. 35 million properties is dispensed with and flat-rate data is to be used instead. With the ground values larger zones are to be formed, as it was already thought of in the Flam. For the age of the real estate there should be at least for houses, which were built before 1948, a lump sum evaluation. With the rent the actually agreed net cold rent, at least however 70% of the average net cold rent, is to flow into the property evaluation. It is unclear whether there is a cap for the case that the actually agreed net cold rent is higher than the average net cold rent.

Valuation of commercial properties and mixed-use properties

Business properties and mixed-use properties must also be valued using the capitalised earnings value method in accordance with the key issue paper. Only if there are no actually agreed rents and it is not possible to determine customary local rents, should a simplified tangible value method be applied instead of the capitalised earnings value method. In this case, only 8 instead of the previous 30 disclosures are to be necessary.

Can we expect rising costs and higher prices in metropolitan areas?

This can be assumed. In order to prevent this, the Ministry of Finance would like to lower the basic federal rate (Steuermesszahl) on the one hand and on the other hand expect the municipalities to adjust their collection rates at the same time, so that differences by the reform are cushioned for the citizens. Currently, tenants in demanded areas are expected to incur additional costs in the "mid double-digit euro amount more per year". However, this is a calculation with a few unknown factors.

For the tenants the property tax has so far only a meaning, because the tax can be added as operating cost on the rent. By resolution of the large coalition this could be changed however in the operating cost regulation (Betriebskostenverordnung). First critics complain however also this approach. The owners could, then, increase the cold rents for new rentals to compensate for the additional property tax costs, which would result in an increase in the local comparative rents and would thus lead to an additional burden on all tenants.

Prospects

A solution is not yet in sight. The Federal Constitutional Court gave politicians until the end of 2019 to reach a solution. Until then, it is likely that some shortcuts to Wam, Wum and Flam will be added. We will keep you up to date in our next newsletter.



Steven Guttman
Corporate Lawyer
Vistra Munich
steven.guttman@vistra.com