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The Real Property Tax in Germany under Scrutiny

The real property tax (*Grundsteuer*) is levied by local municipalities on all real estate in Germany and affects all property owners and renters. It is one of the largest income sources for municipal authorities generating a total of 14 billion Euros in tax revenue and ensuring the provision of municipal infrastructure. The real property tax had long been a subject of hefty criticism. Its calculation relies on antiquated, over 50 years old assessment criteria causing injustices in the tax system and raising questions about its conformity with the constitution. The real property tax is currently being reviewed by the Federal Constitutional Court (*Bundesverfassungsgericht*).

The real property tax is levied on all real estate in Germany (with the exception of listed buildings) and is paid annually by property owners or, in case the property is rented, is usually borne by tenants as a part of their operational cost.

This tax should not be confused with the real estate transfer tax, which is paid only once when a property changes hands.

There are two type of the real property tax and the one that is relevant in this context is the real property tax B (*Grundsteuer B*), which is applicable for any land with a developed property or that is suitable for building development (while the *Grundsteuer A* is levied on agricultural and forestry land).

The real property tax — outdated and unjust

The annual real property tax burden is determined by the authorities by multiplying:

- the *taxation value (Einheitswert)* - assessed value of the real property (however, based on historical data rather than current market values)
- the *tax base (Grundsteuermesszahl) - as* specified in the tax code; varies depending on location (east or west), type (detached, semi-detached, apartment; new or old building etc.) and use of property.
- the *assessment rate / municipal multiplier (Hebesatz)* - as stipulated by the individual municipalities.

The first issue with the real property tax in Germany arises from the assessed values of properties (taxation values). These data were last compiled in 1964 in West-Germany and 1935 in the East, but are continued to be used until today.

The initial intent to re-assess the data every six years, was never followed through because re-evaluating 36 million properties in Germany would be a very tedious and expensive process.

Because not all historical data from 1964/1935 are available, different methods are used to determine the tax value.

For example, the income based approach (*Ertragswertverfahren*) is usually used for assessement of detached and semi-detached houses, apartments or mixed-use property. It is based on the annual rent income as of 1964 or 1935 (West or East, respectively) times a factor that considers .

To illustrate, a building in Berlin-Kreuzberg (with a current rental income of 120,000 Euros p.a. and an area of 1600 sqm) would have had an annual income of 50,000 DM in 1964. This value is multiplied with a factor specified by local authorities (that takes into account certain features that appreciate or depreciate the property such as size, facilities etc.; in this case it is 6.68). The result of 334,000 DM is multiplied with the *tax base* of 0.35% in this case. The result of ca. 617 Euros (converted from DM) is multiplied with the *municipal multiplier* of 810% in Berlin. The real property tax is then 5,000 Euros.

However, the annual rent value is not always identifiable. In those cases, another method is applied that uses asset values (*Sachwertverfahren*) of the ground, building and outdoor facilities - based on values/construction costs from 1964/1935. A special regulation exists if these historical cost data are not available and a substitute value (a lump sum based on floor space or usable area) is then used to determine the taxation value.

Basically, the taxation values are extremely outdated and unjust as the current approch neglects important aspects, e. g. the fact that ground values have been developing very differently since they were determined in 1964/1935; adjacent properties on the same street crossed by a former east-west border like in Berlin are being taxed completely differently; evaluations of new construction types are forced into the scheme of old criteria that would not be valid today.

Another point of criticism is that the natural depreciation of property with time not taken into account (while changes to properties like expansions, conversions, redevelopment etc. affect the tax burden).

The second major issue with the real property tax is the fact that each municipality stipulates its own assessment rate (municipal multiplier), which means that they are free to raise their rates and can use this power when facing financial needs (the property tax is the third highest source for tax income for municipalities).

The municipal multiplier varies between 80% and 910% across Germany. The assessment rate for properties in Berlin is 810% (up from 660% from 2007).

As the German Chamber of Industry and Commerce (*Deutsche Industrie- und Handelskammer, DIHK*) shows, this tax was raised by 36 percentage points in the past five years to the average of 534% in 692 communities with more than 20,000 inhabitants.

The vast differences in the assessment rates suggest that this approach is not compatible with the principle of equal treatment.

The federal states and the government have been debating about a potential reform of the law for more than two decades. In their last coalition agreement the ruling parties CDU/CSU and SPD had pledged to "modernise" the tax in a "timely manner", but failed to take any concrete action.

The Federal Finance Court (*Bundesfinanzhof*) had questioned the constitutionality of the real property tax a few times. In its latest judgement of 22 Oktober 2014 it declared all real property tax assessements issued from 2009 (latest) as unconstitutional.

The *Bundesfinanzhof* has submitted the matter to the Federal Constitutional Court (*Bundesverfassungsgericht*) for a final decision on the constitutionality of this tax.

Conclusion

In its first hearing in January this year, the *Bundesverfassungsgericht* has already signalled that it is likely to declare the real property tax unconstitutional. On the basis of this scenario, the court will probably set a deadline for the government to issue an amendment.

The government would also need to decide about how to deal with the tax during the transitional period (as well as the provisional assessments issued since 2009) until the amendment will come into force.

The most interesting question, however, is how the real property tax would be determined in future as there are several methods in discussion.

Most of the the federal states (14) favoure the cost value approach (*Kostenwertmodell*). It combines ground values with the investment costs for buildings as generalized construction costs less impairment. Many experts criticise the approach as overly complicated. Prof. Dr. Johanna Hey, director of the Institute for Tax Law at Cologne University who evaluated the approach, had found that it is not conform with the constitutional law in several aspects. Additionally, the data required for this approach is yet to be compiled via submitted tax declarations of citizens and would only be complete by 2027.

A much simpler solution could be the land value tax (*Bodenwertsteuer*) that taxes land only. One of the proponents for this approach is the Building and Construction Minister of the current coalition, Barbara Hendricks (SPD). She argues that if undeveloped plots would be taxed higher, it would prevent speculative behaviour and alleviate the housing crisis. Apartment buildings, on the other hand, would benefit from a lower tax burden, since a plot is shared among numerous residents. This is probably why the German Tenants´ Association is also supporting this approach. This could actually be a way for the new government to act in favour of tenants.

Another approach in discussion is the market value approach (*Verkehrswertmodell*), which would require a complete re-evaluation of all property. According to the relevant authorities, valuating 36 million properties could take up to ten years and at the cost of 1.8 billion with additional 220 million each year for updating the information.

The most beaurocracy saving method is one that is not value oriented, but considers land and living area only. While this method could save a lot of beaurocracy and is advocated by the federal states Bavaria and Hamburg, it is not very likely to prevail.

Which approach will succeed in the end, also depends on the deadline set by the *Bundesverfassungsgericht* for the amendment - the shorter it is, the less likely it is that the most complicated, costly methods can compete. The final decision is expected in a few months.

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