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What to consider while buying shares of a real estate company

Introduction

When a private individual disposes of shares in a real estate company, the company remains registered as the owner in the land register. Although the shareholder transfer results in an economic change of ownership, this change does not appear in the land register. The potential tax implications of this discrepancy are set out below.

Economic change of ownership

As a general rule, the gain realized from the disposal of shares held as private assets (a so-called share deal) is tax-exempt. However, the transfer of a majority shareholding in a real estate company effectively results in the economic transfer of real estate rights. To prevent tax avoidance, such transfers are therefore subject to real estate capital gains tax in all cantons. Federal law further provides that the transfer of equity interests in real estate companies held as private assets may be taxed in the same manner as a direct disposal of real property, provided that the applicable cantonal law stipulates taxation in such cases. The relevant law for determining the tax consequences is the law of the canton in which the property is located.

Some cantons impose a real estate capital gains tax on the increase in the value of real property not only when a majority stake is transferred, but also when a minority stake is transferred. (e.g., LU, VD, NE, and GE). The tax liability rests with the seller, i.e., the private individual disposing of the shares of the real estate company - even if, for instance, a resident of Lucerne selling shares in a real estate company domiciled in Bern and holding property in Vaud is unaware of this obligation.

Consequences upon a Subsequent Disposal of the Porperty

By levying real estate capital gains tax on an economic transfer of ownership, a portion of the gain that will later be realized upon the sale of the property by the real estate company (a so-called asset deal) is already taxed in advance. The treatment of this previously taxed appreciation varies from canton to canton.

In monistic cantons (e.g., BE, BL, BS, NW, SZ, ZH), where all real estate gains - whether derived from private or business assets - are subject to real estate capital gains tax, the portion of the appreciation that has already been taxed (at the level of the private individual) is taken into account by increasing the acquisition cost basis (so-called step-up).

The situation becomes more complex when the property is located in a dualistic canton. In such cantons, real estate capital gains tax is likewise levied upon a preceding share deal. However, if the property is subsequently sold directly by the real estate company, the gain is not subject to real estate capital gains tax but to ordinary corporate income tax. The relevant gain is usually calculated based on the difference between the book value and the sale proceeds, including any appreciation generated in previous periods. Without an adjustment, this would result in appreciation that has already been taxed again - albeit under a different type of tax.

The capital gain that has already been taxed must therefore be treated as already recorded for tax purposes, thereby reducing the future assessment basis. This this the only way to avoid double taxation. Consequently, the cantons are required to acknowledge previously taxed hidden reserves. However, the specific implementation depends on the canton in which the property is located. In some cantons, the recognition of taxed hidden reserves is granted without difficulty, while others require extensive documentation, detailed transaction records, or even a prior tax ruling. This has far-reaching implications: previously taxed appreciation affects the valuation of the real estate company, the calculation of deferred taxes, and consequently, the purchase price in share-deal transactions.

Conclusion

Given the varying cantonal approaches and significant financial implications involved, it is advisable to consult a specialist at an early stage. This is the only way to ensure that the specific requirements of the relevant canton are met, that any potential step-up is granted, and that the tax implications are properly reflected in the purchase price negotiations.

Please do not hesitate to contact us in case of any questions

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