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July 12, 2016

Reform of the German Investment Tax Act offers opportunities for foreign funds

http://docs.bepartners.pro/2016-06-08-bundestag-ds-1808739.pdf

On 8 July 2016, the German Bundesrat agreed on the reform of the German Investment Tax Act (the "Reform"). The law will enter into force as of 1 January 2018. The Reform will put German and foreign funds on equal footing. One of the reasons of the Reform was that foreign funds in Germany are currently disadvantaged vis-à-vis German funds. This violates the EU doctrine of equal treatment. Therefore, as a result of this Reform, it can be concluded that tax advantages enjoyed by German funds as opposed to foreign funds will not longer exist as of 2018. Furthermore, some new rules will change the landscape of inbound investments in Germany by offering new and interesting options.

1. What is a fund?

The scope of the Investment Tax Act will change under the Reform. Whereas today, in order to qualify as a fund, very detailed requirements must be met, as of 2018 every OGAW or AIF, regardless of whether it is open-ended or close-ended, will qualify as a fund for purposes of the Act. The fund qualification is granted no matter which legal form is chosen as long as it is not a partnership.

2. What are the consequence of being a fund?

Following the Reform, both German and foreign funds will be taxed only on certain German source income and capital gains: German income from participations (dividend income and equivalent compensation payments under stock lending and security repurchase agreements), German real estate income (real estate income and real estate capital gains) and certain other German income (inter alia income and capital gains attributable to a German permanent establishment of an enterprise). Both German and foreign funds will suffer a tax at a rate of 15 percent on this income and gains. There will be no German trade tax on top of that as long as certain requirements are met. These requirements are far more relaxed than what needs to be currently satisfied for a foreign fund to avoid trade tax on its German investments, e.g. real estate investments. This changes the world of foreign funds for the better.

Furthermore, while for every income or capital gains, which are taxable under the new rules, tax benefits of the foreign funds may be claimed in the same way as under the current rules, for all other amounts that do not fall into this category, treaty benefits are no longer needed as the fund will not have to pay taxes on these amounts anyway.

There are three different types of income:

- domestic income from participations
- domestic real estate income
- other domestic income

Icing on the cake

There is an exemption for the taxation of a fund, which exemption also applies to a foreign fund, if its investors are certain German tax-exempted vehicles, e.g. certain German pension funds. This privilege is also granted if the investors are foreign investors comparable to a German pension fund. This privilege is available not only to foreign EU investors (e.g. a Finnish pension fund) but to foreign non-EU investors as well (e.g. a US pension fund). The foreign investor merely needs to meet the comparability test. This means that such foreign investor can invest into German real estate without suffering any German tax on its real estate rental income or on its real estate capital gains!

3. Tax exemption for German investors in funds

German investors receive a tax discount on income and capital gains generated out of their fund investments regardless of whether they have invested in a German or a foreign fund. The discount will only be granted if the funds provide for a certain minimum quota for their investments. For example, there will be a discount of at least 30 percent (depending on the tax status of the investor in Germany) if at least 51 percent of the fund assets are comprised of shares; a discount of 60 percent if the fund assets are comprised of real estate and a discount of 80 percent if the fund assets are comprised of non-German real estate.

4. Take away

The new concept of fund taxation may have an impact on all funds investing in German assets, especially real estate assets. Furthermore, it offers new opportunities for certain investors, such as certain foreign pension funds investing in such funds, as it allows these investors to avoid German tax. If you are either a fund investing in German assets or if you are a foreign pension fund aiming to invest in German real estate, you should take a close look at this new set of rules. Please contact us - we are happy to assist you.

be in touch: If you have any questions, please do not hesitate to contact us!

Dr. Carsten Bödecker
Partner . Steuerberater . Rechtsanwalt

Tel. +49 211 946847-51
Fax +49 211 946847-01

carsten.boedecker@bepartners.pro

Carsten Ernst
Partner . Steuerberater

Tel. +49 211 946847-52
Fax +49 211 946847-01

carsten.ernst@bepartners.pro

Holger Hartmann
Partner . Rechtsanwalt

Tel. +49 211 946847-53
Fax +49 211 946847-01

holger.hartmann@bepartners.pro

Alexander Skowronek
Steuerberater . Rechtsanwalt

Tel. +49 211 946847-62
Fax +49 211 946847-01

alexander.skowronek@bepartners.pro