Circular of the Federal Ministry of Finance on the German Investment Tax Act 2018 (partially) finalized

August 6, 2019

On May 21, 2019, the Federal Ministry of Finance published a Circular on sec. 1 - 24, sec. 50 and sec. 56 of the German Investment Tax Act (BMF May 21, 2019, BStBl. I 2019, 527). With this publication, the administrative regulations on investment funds (chapter 2), the transitional regulations and the tax withholding regulations for special investment funds (chapter 3) are now available in their final version (for the time being). The tax authorities will apply these rules to all open cases from 2018 onwards. For matters covered by these regulations, previously published BMF Circulars and written replies to associations are thus obsolete. We would like to inform you about some of those regulations that seem of particular importance.

The regulations on special investment funds (chapter 3) as outlined in the third draft of the Circular (dated June 15, 2018), however, are currently still being revised or amended and will probably not be published in their final version until the beginning of 2020.

Material breach of investment quota and 20-business-day-rule

According to sec. 2 para. 6, 7 and 9 of the German Investment Tax Act, an investment fund's status as an equity fund, balanced fund or real estate fund ends at the point in time at which the investment fund materially breaches its investment terms and thereby falls short of the respective investment quota. Since such loss of the status as an equity, balanced or real estate fund should only occur as a last resort, it is of decisive importance in which cases the materiality threshold is exceeded.

The Circular therefore explains under which conditions a harmful material breach can be presumed to have occurred. In particular, in the case of a passive breach, no material breach will be deemed to have taken place if the investment fund takes reasonable measures to restore the required investment quota immediately after becoming aware of the breach. Such measures have to be assessed depending on the respective asset and its tradability (BMF May 21, 2019, marginal no. 2.18).

Documents to beinformed:

- 2019-05-21_BMF_Anwendungsfragen_InvStG_2018

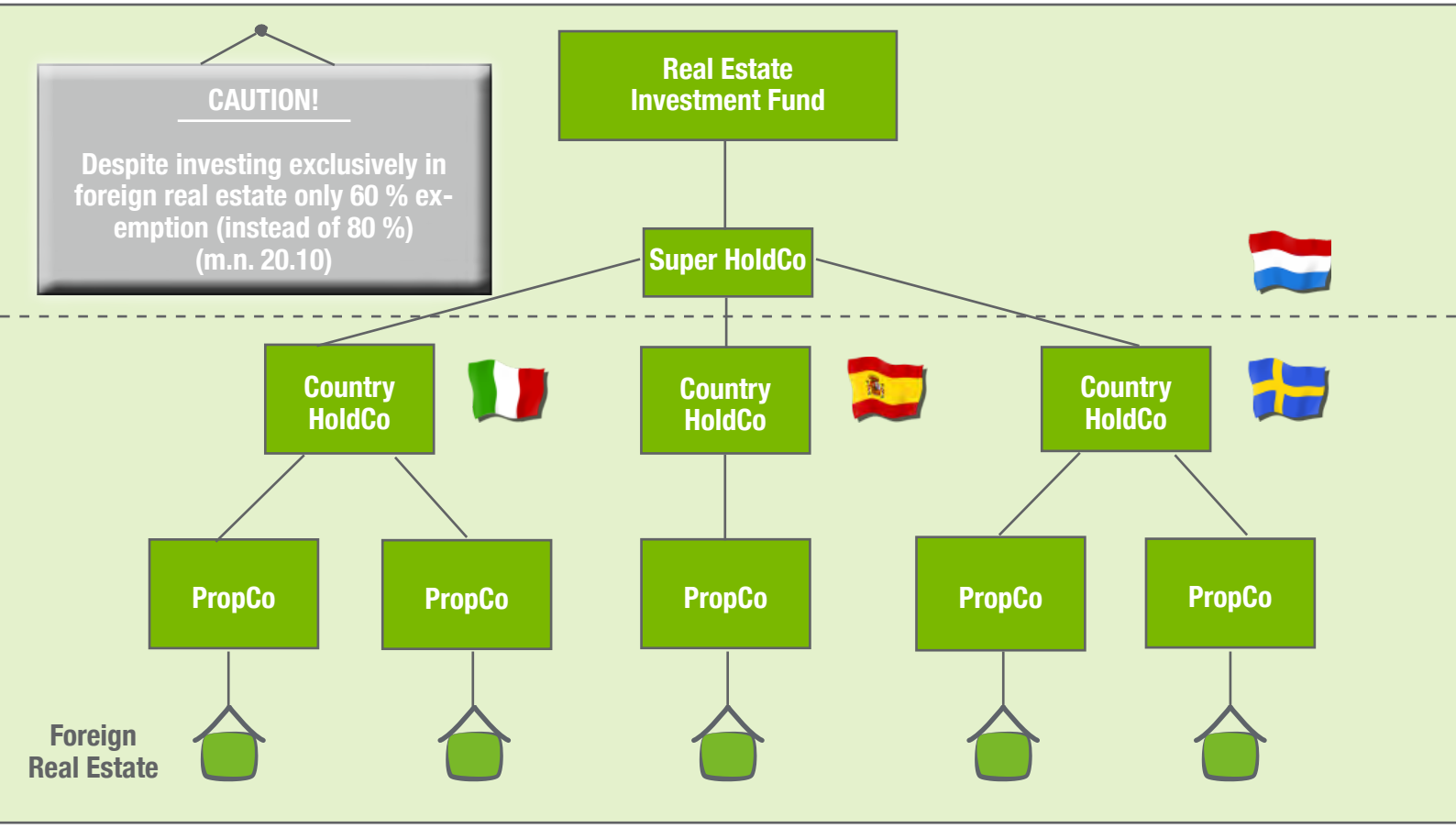
All circumstances must always be weighed in the context of the examination as to whether a breach is "material", especially in cases that may not be classified as a passive breach. In the opinion of the tax authorities (BMF May 21, 2019, marginal no. 2.18), particular consideration should be given to the following criteria:

- the degree of fault of the investment fund or its fund manager at the time of the occurrence of the breach,
- the duration of the breach,
- the relation of the breach in terms of value to the total value of the fund assets, and
- the extent of efforts aimed at eliminating the breach.

This weighing of all circumstances can, however, be costly and uncertain to dispute in individual cases. Thus, in order to simplify the procedure and to provide a reliable and rapid handling in practice, the tax authorities have stipulated that in principle no material breach is assumed if an investment fund falls short of the investment quota on a total of not more than 20 separate or consecutive business days during a business year (BMF May 21, 2019, marginal no. 2.19 and marginal no. 20.15).

(Foreign) real estate companies

For foreign real estate companies, the Circular clarifies that other assets, which are related to foreign real estate and are economically insignificant in relation to the real estate value, do not prevent the qualification as a foreign real estate company (BMF May 21, 2019, marginal no. 20.10). As the German Investment Tax Act defines foreign real estate companies as real estate companies, which invest exclusively in foreign real estate, this clarification is welcomed. Based on that definition, equipment required for the management of real estate does not prevent the classification as a foreign real estate company. It remains unclear, however, when such equipment must no longer be regarded as economically insignificant in relation to the real estate value.



Unfortunately, the fiscal authorities do not recognize a real estate holding company, which in turn invests in other real estate holding companies, as a foreign real estate company (BMF May 21, 2019, marginal no. 20.10). According to this narrow understanding, an investment structure using more than two tiers cannot be classified as a foreign real estate company. As a result, within the typical Luxembourg real estate fund structure consisting of a Super HoldCo, Country HoldCos and PropCos, the Super HoldCo would not be classified as a foreign real estate company. In the opinion of the tax authorities, this classification would apply even if none of the PropCos hold any domestic property, i.e. even though the fund invests exclusively in foreign properties.

In our opinion, this interpretation contradicts the meaning and purpose of the partial tax exemption that is granted to real estate investment funds according to sec. 20 para. 3 sent. 1 no. 2

of the German Investment Tax Act (BeckOK InvStG, Bödecker/Ernst/Hartmann § 2 marginal no. 213 f.). This provision will ensure that the partial tax exemption of 80 percent is only granted if more than 50 percent of the assets are invested in foreign real estate, whether directly or indirectly via foreign real estate companies. If this condition is fulfilled, however, then the partial exemption of 80 percent must also be applied. This increased partial exemption rate is necessary if investments are made predominantly in foreign real estate, since an exemption of only 60 percent is not sufficient to take into account the foreign tax burden suffered. Therefore, in our opinion, the interpretation by the tax authorities, which leads to the conclusion that in a typical structure of a foreign real estate fund, even if 100 percent of the investments are made in foreign real estate, only the lower partial exemption rate of 60 percent will apply, is an unacceptable disadvantage for foreign fund structures. Rather, the qualification as a foreign real estate company should rightly be prevented if it also invests, directly or indirectly, in domestic real estate.

Individual partial tax exemption via partnership

The Circular confirms our opinion that the amount of the applicable partial exemption for income tax and corporation tax purposes depends on the respective shareholder, not only in the case of a non-business partnership, but also in the case of a business partnership. (BMF May 21, 2019, marginal no. 20.5).

Proof of investment quota

The requirements for an individual evidence pursuant to sec. 20 para. 4 of the German Investment Tax Act in the event that the investment terms of an investment fund do not contain a sufficient statement regarding the minimum investment quota for an equity fund, balanced fund or real estate fund have been tightened significantly. To date, a written confirmation from the investment fund that the respective investment quota has been maintained throughout the entire business year is considered sufficient evidence. From next year onwards, i.e. for confirmations issued after December 31, 2019, these confirmations must, however, include a list in which the actual achieved investment quotas are indicated for each and every business day of the business year in question (BMF May 21, 2019, marginal no. 20.13). The preparation of such a list would thus require the implementation of corresponding calculation procedures in order to determine the investment quota according to the rules set forth in sec. 2 para. 9a of the German Investment Tax Act. This will be challenging for foreign real estate funds in particular, for which a daily valuation is rather unusual.

be in touch: Any questions? Please do not hesitate to contact us!

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