

## Operational Tax News

### New German InvTA

4 July 2017

The German Ministry of Finance has issued a short circular letter on 14 June, which addresses a small range of questions regarding the partial exemptions and asset ratio<sup>1</sup>. We have summarized the points that we think are the most relevant for you:

#### **Qualification as equity or mixed fund (sec 2 paras 6 and 7 InvTA)**

- **Synthetic replication** of the performance of equity participations through financial derivatives (completely or partly) **does not suffice** to qualify as an equity or mixed fund, except where the investment conditions specify in addition a minimum direct investment of 51 percent in equity in the sense of the law.

From a tax technical point of view this seems to be appropriate, because the income derived from these types of financial instruments does not lead to a tax burden at the level of the investment fund, therefore there is no need for compensation by way of a partial tax exemption for the investors.

- No adverse consequences for the qualification as equity or mixed funds if investment funds hedge risks resulting from their investment in equity participations.
- Qualification as equity or mixed fund is initially based on the investment strategy and restrictions stated in the investment conditions, especially the minimum equity investment ratio (minimum asset ratio). According to the law, the investment fund must also be continuously compliant with those investment restrictions, i.e., each day of the financial year.

A **severe breach** will result in the loss of the status as equity or mixed fund.

Nevertheless, **minor breaches** will not directly trigger a status change. A minor breach would be a short-term breach due to market developments or an incorrect qualification of an asset as an equity participation. The same applies in case of passive breaches, provided the investment fund takes immediate and appropriate action to restore compliancy.

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<sup>1</sup> Please note that we use the term "asset ratio" instead of "equity ratio" in order to avoid any confusion with the equity ratio existing under the current law.

- A severe breach has to be reported to the competent tax authority. The investment fund has to communicate any change in the applicable partial exemption rate to the investors through a publicly available source (fund website etc.). Furthermore, the fund is obliged to amend immediately incorrect information about the applicable partial exemption that has been provided to paying agents and data providers (like WM).
- In case of non-German investment funds (only) it will be accepted if, according to the investment conditions, the fund has to be invested predominantly (“überwiegend”) in equity participations. Nevertheless, it seems questionable whether this will prove in practice sufficient for a qualification as equity or mixed fund.
- A **transition period** of six months is granted to reach the “continuous investment” into more than 51%/25% equity **for newly launched funds** and for funds in liquidation (for the last six months a violation of the “continuous” investment will be accepted).
- For the determination of the asset ratio the **total assets** (“Aktivvermögen”) should be relevant, but
  - For UCITs (and other funds with similar limitations on borrowing) determination in relation to total net assets will be accepted
  - For all other funds, a reference to the total net assets in the investment conditions will be accepted until 31 December 2018 if the fund continuously observes the minimum asset ratio calculated on the basis of the total assets and communicates this to the investors directly or makes it publicly available (internet) or communicates it to a provider like WM
- In principle, a **fund-of-fund** can determine the asset ratio by using the minimum asset ratios specified in the target funds’ investment conditions
- Determination based on the real asset ratios published by the target funds for each valuation date will also be accepted
- For a **transition period** until 31 December 2018 the fiscal authorities will accept a “**self-declaration**” of the fund with regard to the fund classification relevant for the applicable partial exemption rate on investor level, if the fund classification does not emerge from the constituting documents. Practically speaking, the funds can communicate the classification to WM and paying agents etc. can rely on it. This is valid for equity and mixed funds. As it is still not clear whether the prospectus will always be accepted as the right place to specify the limits (>51% for equity fund, >25% for mixed fund) this reduces the pressure at least for the moment.

## **Equity participations (sec 2 para 8 InvTA)**

- Typically assets that have already been subject to taxation on fund level
  - German or foreign stocks listed on a stock exchange
  - Other participations in German or foreign corporations under certain conditions
  - Units of equity funds with 51% of their value
  - Units of mixed/balanced funds with 25% of their value
- NOT: Derivatives on equity
- NOT: REITs

## **Qualification as real estate fund (sec 2 para 6 InvTA)**

- The provisions outlined above for sec. 2 paras 6 and 7 InvTA with respect to the definition and implementation of the investment conditions apply by analogy
- Transition period of 4 years for newly launched real estate funds to reach compliance with the condition of “continuous” investment in real estate and real estate companies, but there has to be a first investment within 12 months after the launch.
- The provisions outlined above with respect to severe/minor breaches and the determination of the asset ratio (equity ratio) for equity and mixed funds apply by analogy to real estate funds and their asset ratio (real estate ratio).

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