

## Operational Tax News

### German Investment Tax Act (2018) – Taxability of income in the context of securities lending / real repo transactions

**21 June 2018**

On 15 May 2018 the German Ministry of Finance issued a circular letter giving some guidance with respect to the newly introduced taxation of income from securities lending/repos on investment fund level.

#### **Background**

Under the new Investment Fund Tax Regime (InvTA 2018) that has come into force with effect from 1 January 2018, investment funds are subject to German corporate tax to the extent that they generate income from German equities (sec. 6 para. 2 and 3 InvTA 2018).

This taxable income does not only include dividend income, but—in order to prevent tax avoiding schemes on German sourced dividend income—also all income in connection with securities lending/ real repo transactions on German equity.

#### **Scope**

According to the circular letter all income in the context of securities lending/real repo transactions on German equity is subject to corporate taxation on the level of an investment fund:

- Manufactured dividends
- Lending fee
- Income from securities serving as collaterals

#### **Limitations**

The income mentioned above is only subject to taxation if the securities lending/real repo transaction period includes the relevant dividend record date. In other words: If the investor is not entitled to receive the “real” dividend payment from a German equity during the securities lending/real repo transaction period, then there is no risk of replacing this dividend payment with a manufactured dividend and/or compensation payments with the intention to circumvent taxation.



**Lending 1:** income in the context of this lending is **in scope** (taxable on fund level)

**Lending 2:** no dividend claim during the lending period, income in the context of this lending is **not** in scope

**Lending 3:** no dividend claim during the lending period, income in the context of this lending is **not** in scope

In addition, the taxable income in the context of a securities lending/real repo transaction on German equity is limited to the gross amount of the “real dividend” from this equity.

Example:

Gross dividend: 100  
Manufactured dividend: 100  
Lending fee: 5



TAX BASIS: 100

Gross dividend: 100  
Manufactured dividend: 90  
Lending fee: 5



TAX BASIS: 95

## Tax collection

The circular letter clarifies that in general the tax on income according to sec. 6 para. 3 InvTA 2018 is levied by the way of withholding. In case of income in context with securities lending, the German law obliges the borrower—the entity that pays the lending income to the lender—to withhold the tax.

In this context the circular letter also clarifies that “central counterparties” (like Eurex Clearing AG) that are handling most of the securities lending transaction are in general not obliged to withhold tax if they comply with certain provisions; the tax collection obligation remains with the initial contracting parties.

The German tax authorities are aware that they will not always be in a position to enforce the withholding obligation in case of a non-German borrower. Therefore, the circular letter provides that in cases of a non-German borrower (or in any other case where the borrower did not comply with the withholding obligation) the lender has to notify the competent German tax authority if income in accordance with sec 6 para. 3 sent 1 no 2 InvTA 2018 has been received and

- No tax has been withheld
- Tax withheld was too low

The competent tax authority—for non-German investment funds the Federal Central Tax Office—will then start an assessment process and depending on the outcome might request a tax payment. Potential tax reclaims according to double tax treaties can be treated within this assessment process.

Contrary to the draft version of the circular letter the final guidance imposes a notification procedure rather than the mandatory filing of a corporate tax return. The final guidance does not include any details of formal requirements or deadlines for this notification procedure, but it seems reasonable to assume that they would be similar to what would be applicable in the context of a corporate tax return filing.

We will keep you posted in case of further clarifications.

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