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Operational Tax News
Germany Update

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German Investment Tax Act – Fundamental changes have become effective

Foreign investment vehicles distributing in Germany should carefully consider whether they will continue to qualify as being subject to tax reporting in terms of Art. 5 of the regulations in the new German Investment Tax Act ("GITA"). The following overview will highlight the **new definition of investment funds** in terms of the GITA and the requirements that have to be met.

Introduction

On 24 December 2013, following the introduction of the AIFM directive ("*Kapitalanlagegesetzbuch* – KAGB"), significant changes of the German Investment Tax Act ("GITA") became effective. Now, for the first time, investment vehicles that intend to (further) qualify as an investment fund from a tax perspective must meet the tightened definition under the new GITA regime set out under Art. 1 (1b) GITA. The new provisions not only have an impact on the AIF and UCITS vehicles that have already been established, but also on all (sub-) funds, that will be set up in future.

Generally, if the conditions cannot be met, the investment scheme might be classified as an investment company which is not entitled to report tax information according to Art. 5 GITA.

Conditions to be met

In order to qualify as an investment fund in terms of Art. 1 (1b) GITA, the following requirements must be met **cumulatively**:

- **Supervision:** The UCITS / AIF investment vehicle or its Management company must be subject to supervision in its country of residence
- **Right of return:** A right of return (at least on an annual basis) of the units/shares in the UCITS / AI-fund must have been granted to the unit-/shareholders.
- **Risk spreading:** The investment vehicle is obliged to invest in more than three different assets with a different level of investment risk. In certain

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cases, also indirect investments may be entitled to qualify.

- **Acquirable assets:** The investment vehicle must invest at least 90% of its funds into suitable assets that are listed exhaustively in Art. 1 (1b) No. 5 GITA.
- **Passive asset management:** The object of business of the investment vehicle must be limited to the management and investment of its funds. No active business activity is permitted, but for investments in Real-Estate companies that are performing regular business activities an exemption has been granted.
- **Selected Investment restrictions:**
  - Investment vehicles are in general no longer allowed to invest in shares of partnerships, unless they qualify as securities, shareholdings in Real-Estate companies or shares/units in other investment funds (Art. 1 (1b) No.5).
  - A maximum of 20 % of the assets may be invested in shares of capital companies that are not listed. However, investment vehicles whose investment requirements allow Real-Estate investments may invest up to 100% in RE-companies (Art. 1 (1b) No. 6).
  - Limited borrowing: The investment vehicle is only entitled to short-time borrowings, whereby the amount must not exceed 30% of the fund's total assets (Real-Estate funds are entitled to long - term borrowings up to 50% of the market value of the Real-Estate invested in) (Art. 1 (1b) No. 8).

According to Art. 1 (1b) No. 9 GITA, the investment vehicle has to disclose the investment regulations in its respective investment requirements documentation (prospectus / statutes).

Grandfathering rules

In general, the new regulations are applicable as from 24 December 2013. Nevertheless, transitional rules are currently being granted in specific cases if the conditions of Art. 1 (1b) GITA cannot be met (Art.22 (2) GITA).

Investment funds, established before 24 December 2013, may further maintain their status to qualify as an investment fund up to business years ending after 22 July 2016 at the latest, provided that the respective conditions of the previous GITA as well as those of the German Financial Supervisory Authority ("BaFin") to qualify as investment funds have been and will continue to be met during this time period.

Nevertheless, even funds that have not met the conditions of the old law in the past may be in scope of grandfathering rules until financial years beginning before 31 May 2014 if certain conditions are met. In this regard the German Ministry of Finance ("BMF") has issued a letter on 21 May 2013 which modifies point 297 of the circular issued by the BMF on 18 August 2009.

Investment vehicles that do no longer meet the cumulative requirements set out in Art. 1 (1b) GITA (please see above) for whatever reason (and are not grandfathered), will be considered as investment company for a period of at least 3 years after the German Federal Tax Office has confirmed the non-compliance with the provisions.

Legal consequences and current taxation

In case the investment vehicle will fulfil all the conditions set out above, it will be subject to tax reporting according to Art. 5 of the new GITA regulations.

UCITS / AIFs, that fail to meet the requirements of Art. 1 (1b) GITA and therefore cannot qualify as investment funds in terms of the new GITA, will be classified as (domestic or foreign) investment companies either under Art. 19 GITA for capital investment companies (such as Luxembourg SICAV or FCP) or under Art. 18 GITA for those considered as partnership investment companies.

According to Art. 18 GITA, the income has to be determined separately and uniformly under Art. 180 (1) No. 2 of the German General Tax Act, whereby only the investors are subject to income tax in terms of the regular provisions of the German Income Tax Act (GInTA).

Investors in investment schemes within the scope of Art. 19 GITA, will generally be taxed on the distributions received. In case the Controlled Foreign Corporations
("CFC") rules of the German Foreign Tax Act (GFTA) regime applies, additional income components regardless of any distribution might be taxable at investor level. Under this regime, certain foreign passive income would be directly attributed to the income of the German investor being subject to tax in Germany, whereby the existence of the foreign investment vehicle would be disregarded for tax purposes.

Last but not least, investors aiming to benefit from tax allowances under German law (i.e. partial-income method or participation exemption) have to prove that the investment scheme is subject to minimum taxation in its state of residence, Art. 19 (2) GITA.

We will keep you updated in case of any further developments in this area.

If you have any queries regarding the above, please do not hesitate to contact us.

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