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Operational Tax News

Germany Update

Reform of the German Investment Tax Act: Ministry of Finance publishes draft discussion paper

On 22 July 2015 the German Ministry of Finance published a discussion draft of a law on the intended reform of the German Investment Tax Act with the aims to

- eliminate EU-legal risks;
- make investment funds less susceptible to aggressive tax planning strategies; and to
- reduce the administrative workload.

The paper provides for a fundamental reform of the taxation of income from investment funds which would mean the largest decisive turning point since the introduction of the German Investment Tax Act in 2003.

With our newsletter, we do not only summarise the content of the discussion draft but have already analysed it for you and provide first practical information.

Scope of the new regime

The new tax regime might be applicable to all types of undertakings for collective investments that are not operational companies outside the financial sector, insofar as they collect capital to invest it in accordance with a predefined investment strategy. Thus, the new regime should apply to undertakings for collective investment in transferable securities (UCITS) as well as alternative investment funds (AIF), provided that the latter are not launched in the legal form of a partnership.

In addition, the amended regime might also cover certain types of tax exempt companies launched under a foreign company law as they are used, for example, for wealth management purposes (the reasoning of the draft discussion identifies by name the Luxembourg Société de gestion de patrimoine familial (SPF), a foreign company that might fall into the scope of the new regime).

The new regime would further differentiate between investment funds (UCITS and AIF, not launched as partnership) and special investment funds, i.e. investment funds whose shares are exclusively distributed to a maximum of 100 investors which are not private individuals.

Replacement of fiscal transparency by an opaque tax regime

In the course of the reform, foreign and German investment funds might become subject to German corporate income tax with any type of income for which Germany has, according to international agreements, the right to tax.

Shareholders might be taxed on (1) any distribution paid by investment funds, (2) lump-sum amounts, in the case of capitalizing funds and determined on the basis of redemption prices at the beginning of calendar years and by application of reference interest rates as defined under the amended German Investment Fund Tax Regime; and (3) any capital gains realised by the disposal of shares of the investment fund.

As shareholders would exclusively be taxed on cash flow or lump-sum basis, a reporting of annual or daily tax figures would not be required under the new regime.

Taxation of income for which Germany has the right to tax

Under the new tax regime, foreign and local investment funds would become subject to German corporate tax with any type of income for which Germany has the right to tax according to international agreements. This includes

- dividends as well as corresponding compensation payments paid by corporations located in Germany for fiscal purposes;
- real estate income from real estate assets located in Germany; and
- certain types of German source income.

The applicable rate would be 15 percent which already includes the German solidarity surcharge of 5.5 percent. German shareholders will benefit from a 20% tax exemption for equity funds (at least 51% equities) or 40%/60% tax exemption for real estate funds (at least 51% German/Foreign real estate).

To avoid discrimination and to benefit from the reduced tax rate of 15 percent, foreign investment funds would be entitled to opt for a tax relief at source or the refunding of German withholding taxes on dividend payments (local withholding tax on dividend income: 26.375 percent) on the basis of the new German investment fund tax regime provided that relevant provisions are met and independently of the existence of any corresponding double tax treaty.

In turn, however, investment funds might be required to file tax returns for German corporate tax purposes in relation to any type of income other than dividend income.

Partial exemption from German corporate income tax

Institutional or individual investors holding shares of investment funds might benefit from a (partial) exemption from German tax. To avoid that such investors suffer from taxation at fund level, the current draft discussion paper provides for a procedure that allows the refunding of German tax insofar as eligible investors, as defined under the new Investment Fund Tax Regime, hold shares of an investment fund.

To avoid discrimination, the procedure will apply to both local and foreign investment funds and it would be applicable in relation to German tax exempt investors as defined under the new regime as well as in relation to comparable foreign investors.

It remains to be seen how practical aspects of the procedure such as the identification of investors that are entitled to benefit from a refunding of German taxes, the handling of cash flows generated under the procedure as well as dedicated reporting requirements against German tax authorities would influence the fund administration.

Further application of fiscal transparency

The principle of fiscal transparency would remain applicable in an updated form only for special investment funds. It is therefore expected that the reform of the German investment fund tax regime would not lead to material changes in the fiscal treatment of special investment funds and their investors.

Entry into force

It is unclear whether the current process will finally lead to an official legislative procedure and whether the current draft discussion paper transforms into a draft law subject to parliamentary discussion in the course of the legislative procedure.

However, if the German legislator starts the legislative procedure, the reform of the German investment fund tax regime might enter into force on 1 January 2018. In this context, it is worth mentioning that the current draft discussion paper does not provide for a gradual transition from the current to the new investment fund tax regime.

It is rather intended to introduce the new rules for investments funds in form of a “big-bang-scenario” which might mean that investment funds are required to finally determine and publish annual tax figures for the calendar year-end 31 December 2017 independently from the end of the actual fiscal year.

The discussion draft is currently subject to controversial discussions and concerned associations are invited to provide their comments on the suggested changes until 1 September 2015. For these reasons, it is currently unclear whether the current initiative to reform the German investment fund taxation will lead to a legislative procedure and finally to a comprehensive reform of the German investment fund tax regime.

We will follow up the progress of this initiative and continue to keep you updated in the case of any new developments.

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

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