Asset & Wealth Management – Newsflash

*German Investment Tax Act*

The Reform in a Nutshell

*December 2015*
Legislative Process: Is the reform likely to be implemented?

Next steps of the legislative process

18 December 2015

- The Ministry of Finance has issued a ministerial draft bill. The public is invited to provide comments until 15 Jan 2016.

30 June 2016

- The adoption of the draft bill requires the approval of the lower and upper houses. There can be up to three readings in the lower house.

1 January 2018

- The adopted draft bill has to be signed by the ministers, Federal Chancellor and Federal President and finally promulgated.

How likely is the ministerial draft bill to become law?

There are still concerns amongst parliamentary groups that the intended reform will increase taxes, which would not be in line with the coalition agreement. However, it is fair to say that the current ministerial draft bill takes into account a couple of points being raised by the various associations. In particular the partial tax exemption amounts for certain products and investor types have been increased significantly and thus, has made the reform more likely to be implemented. The next steps of the legislative process should be crucial. If the cabinet resolves the draft bill, the reform is very likely to pass the parliament!
Key Facts

**Special Funds**
- No major changes, still regarded as transparent vehicle
- Tax reporting still required
- Taxation of domestic income can be relocated to investor
- Tax privilege on accumulated capital gains generally remains
- More complex equity gain calculation rules on the use of derivatives
- New daily reporting number reflecting partial tax exemption on non-transparent target funds

**Domestic & Foreign Funds**
- One level playing field. German source income taxable at 15%
- Administrative efforts on German WHT (for more detailed information see “WHT process” chart)

**Hedge, Infrastructure, Loan Funds**
- Moderate annual lump sum taxation (2015: 0.7% of NAV)
- For corporation-like structures, no CFC reporting required
- Current grandfathering for investment fund status extended until 31 Dec 2017
- Capital gain taxation on 1% German equity holdings abolished

**Non-Special Funds**
- Non-transparent vehicle
- Neither daily nor annual tax reporting required
- Moderate lump sum taxation for accumulating classes

**Equity Funds**
- Proof of equity fund status via legal documents or financial statements
- Partial tax exemption at investor level to avoid double taxation (30%/60%/80%)

**Retail Funds**
- Grandfathering for “old” shares of retail investors expires 1 Jan 2018. Change in value since 1 Jan 2018 becomes taxable, given tax free amount of 100,000 Euro

**Real Estate Funds**
- Proof of real estate fund status via legal documents or financial statements
- Gains from domestic real estate always taxable
- 10 year holding period abolished
- Partial grandfathering for assets bought 10 years before resolution date of the new GITA
- 60%/80% tax exemption at investor level to mitigate double taxation

**Private Equity Funds**
- Not in scope of new GITA, if set up partnership-like
- General tax rules apply
Two Tax Regimes

Comparison of tax regimes

Scope of the new GITA
- Entity for collective investments which collects capital from a number of investors to invest it following a defined investment strategy
- No operating company outside the financial sector
- Funds with one investor as well as captive investment funds are also covered
- Certain tax exempt corporations without operating business and not covered by the German Capital Investment Code (e.g. SPF's)

Special Funds
- Limited to 100 investors
- Generally only non-private investors (exceptions possible)
- Meets the remaining 9 investment fund criteria (comparable to the criteria of the current regime)
- Qualifies for trade tax exemption

Non-Special Funds
- All funds which do not qualify as a special fund

Taxation Fund Level
- German source income is taxable with a corporate tax rate of 15%
  - mainly German dividends and rental income
  - no capital gain taxation on 1% German equity holdings
- Exception: For domestic dividends and real estate income the taxation can be relocated to investor level (transparency option)
- Not subject to trade tax per definition

Taxation Investor Level
- Taxation upon distribution and redemption
- Ordinary income taxable upon (deemed) distribution
- Capital gains realised at fund level only taxable upon distribution
- Underlying capital gains from equity remain (partially) tax exempt
- Foreign WHT creditable at investor level
- Underlying income from foreign real estate remains tax exempt

Reporting
- Annual investor tax reporting required
- Real Estate Profit and Equity Gain reporting still required
- New reporting number for partial tax exemption on target funds
- Proof of fund status (if not opting for transparency) and investor exemption status must be submitted to depository banks
- Monitoring of compliance with special fund criteria

Transparent Tax Regime

Intransparent Tax Regime
WHT-Process: Is it that simple?

Taxable investor
1. Fund provides legal documents to FA to request “fund status” certificate. Fund provides DB1 with certificate. DB1 applies reduced WHT rate of 15%.
2. DB1 pays 15% for taxable investor to FA. Taxation at fund level is settled. No refund, no tax credit.
3. If “fund status” certificate is submitted late, overpaid WHT can be claimed back within two years.
4. DB2 checks “equity fund status” (at least 51% equity investments) to apply 30% tax exemption and pays 25% WHT plus 5.5% solidarity surcharge on 70% of investor's earnings to FA.

Tax-exempt investor
5. DB2 needs to provide participation quota and holding period (minimum of 3 months) of the specific investor to the fund for tax exemption at fund level.

Upon investor request DB2 needs to submit non-assessment certificate to the fund which submits it to DB1.

Fund has to prove legal and beneficial ownership according to the „45-day rule“.

For foreign tax exempt investors proof of comparability is required to avoid taxation.

6. The fund has to pay the tax benefit directly to the privileged investor.

Special Funds – Transparency Option
No taxation at fund level if fund declares to DB1 that a tax certificate should be issued directly to the investor (transparency option). DB1 pays non-reduced 26.375% WHT directly on behalf of the investor.
**Gift List 2018**

<table>
<thead>
<tr>
<th>Comment</th>
<th>Private Investor</th>
<th>Institutional Investor</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Long Only Equity &amp; Mixed Funds</td>
<td>✓</td>
</tr>
<tr>
<td>2</td>
<td>Fixed Income</td>
<td>✓</td>
</tr>
<tr>
<td>3</td>
<td>Mixed Fund (&lt;25% equity)</td>
<td>x</td>
</tr>
<tr>
<td>4</td>
<td>Long/Short Equity</td>
<td>✓</td>
</tr>
<tr>
<td>5</td>
<td>Hedge Funds (no L/S Equity)</td>
<td>✓</td>
</tr>
<tr>
<td>6</td>
<td>Real Estate Fund</td>
<td>?</td>
</tr>
<tr>
<td>7</td>
<td>Infrastructure</td>
<td>✓</td>
</tr>
<tr>
<td>8</td>
<td>Fund of Funds</td>
<td>x</td>
</tr>
<tr>
<td></td>
<td>Special Fund</td>
<td>✓</td>
</tr>
</tbody>
</table>

1. Partial tax exemption should overcompensate the double taxation effect.
2. Only low double taxation effects, if any; annual lump sum tax base generally (much) lower than DDI (High Yield Bonds!).
3. No CFC rules applicable; moderate annual lump sum tax only.
4. Partial tax exemption should not always compensate missing tax treaty benefits; capital gains from German real estate are always taxable for funds.
5. Equity thresholds difficult to monitor and partial tax exemption harder to achieve; above comments on single strategies apply.
6. For institutional investors: partial tax exemption should not always compensate the abolition of Equity Gain reporting.
7. No partial tax exemption to mitigate double taxation effects and to compensate for Equity Gain abolition.
8. Benefits from transparency privileges.
Appendix
Adjustments 2016

**Aggressive Tax Planning**

- Annual tax reporting certificate needs to disclose any indication for aggressive tax planning, tax evasion and unjustified tax refunds
- Extended liability for tax advisors; administrative fine up to 1 million euros

**Cum-Cum Trades**

- Cum-Cum trades will become less attractive
- To apply for a tax credit on domestic income received after 31 Dec 2015 investor has to prove legal and beneficial ownership of at least 45 days for the period ex-date +/- 45 days
- This also applies to funds with respect to tax benefits on German dividends
- German stocks need to be captured according to the First In-First Out principle for documentation purposes and the impact of corresponding hedging positions needs to be quantified
- Given tax planning is on top of the political agenda it might be worth to screen the past for disputable transactions and to reassess their tax treatment

**Van Caster**

- For EU-Funds tax transparent taxation can be achieved even after expiration of 4 month deadline

**Grandfathering for Investment Funds**

- Current grandfathering for investment fund status extended until 31 Dec 2017
- In particular helpful for hedge funds, loan funds and other non-UCITS products

**Tax Exemption on Equity Gains**

- Capital gains from sale of equities remains 95% tax exempt in the hands of corporate investors
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