

Legislative novelties for German taxation on investment funds

The reform of the taxation on Investment funds 2018 – Impact on the taxation on mutual funds

With this newsletter we will give you a short overview on the reform of the taxation on mutual funds caused by the reform of the taxation on investment funds (InvStRefG). The new law became effective as of 01.01.2018 for the changes concerning investment and replaces the former fund tax regime.

The reasons for these legislative novelties are:

- Consideration of decisions of the European Court of Justice (ECJ)
- Current taxation regime is “too complicated”
- Prevention of backdated corrections
- Avoiding of formal arrangements

As result of this reform there will be no further tax-wise differences between German and non-German funds. Instead it will become necessary to differentiate between **mutual funds** and **special funds**, this means that there will be two systems of taxation on funds in parallel.

The previous changes caused by the AIFM tax amendment law and the special rules concerning the investment companies became inactive as of 01.01.2018. The extended interim arrangements published by the tax department on 07.04.2016 ensure the transition from the old to the new law.

As of 2018 new classifications and categories of tax relevant investment funds are introduced based on par. 1, 1 KAGB, including all UCITS and AIF that are already effective for German taxation on investment funds under the “old” tax regime. All funds for retirement provisions according to par. 5 or 5a of the Retirement Certification Act are included as well. Personal investment companies will be taxed like business partnerships and are no longer part of the taxation on investment funds.

Further, the following constellations are newly included into the scope of the new investment taxation (par. 1, 2 InvStG 2018):

- Investment funds with only one investor
- Non-taxable asset managers (corporations)
- Investment wealth managed by AIF capital asset managers (par. 2, sec. 3 KAGB)

Taxation in mutual funds – entry side

As of 2018 mutual funds are taxable for specific earnings and liable for corporation tax and solidary surcharge thereon with respect to German source dividends, earnings from German real estates and other German source income. For German dividends a special taxation with 14.218% withholding tax and 0.782 % solidary surcharge is used, therefore no corporation tax has to be paid on German dividends. The withholding tax has final effect for corporate tax purposes.

Precondition for applying the reduced withholding tax deduction rates is the provision of a respective status certification to the paying agent. The German tax authorities have published the official forms and guidelines for the status certificate on 26.07.2017.

The status certificate:

- will be issued by the appropriate tax authority for all German funds
- will be issued by the German federal tax office (BZSt) in Bonn for all foreign funds with German dividends only
- will be issued for all other foreign funds by the appropriate tax authority of the district, where the assets of the funds are determined
- can be issued backdated by max. 6 months from the tax authority
- can be claimed by the appropriate tax authority at any time
- is valid for max. 3 years, the business year can be different from the calendar year

The status certificate must be provided to the paying agent by original document. If the certificate has been presented to a provider for financial data, this provider has to ensure authenticity of the document. The paying agent can also obtain this information from a data provider, but the specific data of the document (e.g. place and date of issuance, identification number and tax number) has to be sourced and saved by the paying agents system. Without this specific certificate all earnings are subject to the full withholding tax of 25% plus solidary surcharge thereon.

If German dividends are provided to one account, that is used for more than one fund (e.g. omnibus accounts) all certificates of the status for all funds have to exist at the paying agents side so that the reduced withholding tax rate will come to effect. For all funds with domicile outside Germany the last paying agent in Germany is obliged to charge the German withholding tax. In this case the foreign custodian has to state (either in writing or electronic) towards the withholding relevant German paying agent, to which extend the respective positions refer to specifically named investment funds upon inflow date of the withholding relevant income, and has also to provide respective status certifications .

Since not for all funds a respective status certification was provided until 01.01.2018, the German tax authorities have granted as transition ruling an extension of the validity period of respective NV05 certificates until 31.12.2018.

If the paying agent has charged too much withholding tax and the investment fund provides the paying agent with a correct tax certificate within 18 months after the payment, the difference between the incorrect and the correct (new) withholding tax can be refunded. There are two practicable possibilities for this procedure according to the tax authorities:

- a) Return of the original tax certificate, refund of the overpaid tax and provide a new tax certificate to the fund. The new tax certificate has to include a reference to the refund of the overpaid tax.
- b) No correction of the tax certificate is required, if the issue is documented and the information of the correction can be provided to the fiscal authority if necessary. In this case the refund of the overpaid tax can be done as well.

Taxation in mutual funds – client's side

As of 2018 a new system of taxation for mutual funds is introduced on the client's side. This is also known as modified cash flow taxation and replaces and simplifies the old system. The multitude of tax relevant figures previously needed for income payments, transactions and accumulations have been replaced by only a few relevant figures. This results from the introduction of a taxation regime, which was in a similar way previously used for nontransparent funds. A new partial exemption ruling based on different types of funds will be introduced for the clients.

For these clients only three types of tax-relevant scenarios are relevant from 2018 onwards:

The cash distribution (cash-flow approach)

For cash distributions it is no longer necessary to differentiate between the specific types of distribution. Only the gross distribution will be taxable. For funds in liquidation respective distributions are only to be considered as far as they refer to actual earnings of the calendar year. Any taxes withheld can only be claimed as creditable tax as far as they refer to tax-relevant distribution amounts.

The new lump-sum advance payment ("LSAP")

The LSAP is a complete new figure relevant for taxation, which considers the annual accumulations so that funds with cash distributions only do not have an advantage in taxation. The LSAP will newly be used by each mutual fund and is calculated annually for each calendar year, so that the financial year of the fund will no longer be relevant for taxation. The LSAP has to be calculated using a so called "risk free market interest rate" which is based on long-term interest yield of civil loans. This interest loan will be published in the federal tax gazette and the official web page of the Ministry of Finance. The LSAP has to be calculated as follows:

- Determination of the "base income amount" " (multiplication of the first redemption price of the calendar year with 70% of the long-term interest yield, income-related expenses are already included in the reduced rate)
- Determination of the "increase in value amount" (difference between the first and the last redemption price of the calendar year, increased by the paid out cash distributions in the calendar year)
- Comparison of base income amount with increase in value amount; within this comparison the base income amount cannot exceed (cap!) the increase in value amount plus cash distributions made
- Base income amount less cash distributions results in the LSAP.
- Negative figures are not relevant for the client, in this case the LSAP is always processed with null.

For tax booking purposes the LSAP always accrues to the client on the first working day of the following year. As the LSAP is only a fictitious figure and base for the withholding tax the Ministry of finance has published a new regulation for debiting the clients' accounts (published on 03.05.2017). If the clients account balance does not permit the deduction of the calculated tax the approved limit of the bank can be used for booking the tax if the client did not object to this charge in advance. If the booking of the tax is not possible the respective tax office responsible for the bank has to be informed.

The sale or return of fund units

The taxation of any sale or disposal of fund units will be similar to the old system, but simplified due to the reduced number of tax relevant figures. As of 01.01.2018 the calculation of the taxable amount has to be adjusted by the following figures only:

- LSAP amounts for the relevant holding period recorded for the client must be subtracted from the calculated capital gain base by the full value (without exemption)
- Tax-free capital reductions of funds in liquidation are increasing the capital gain

The partial exemption

The partial exemption regulation applies the following rates depending on the type of fund:

Type of fund	Exemption, depends on type of wealth:		
	private	business	corporate
Equity-based funds (at least 51% of shares)	30%	60%	80%
Mixed funds (at least 25% of shares)	15%	30%	40%
Real property funds (at least 51% of German properties)	60%	60%	60%
Real property funds (at least 51% of non-German properties)	80%	80%	80%

These partial exemptions will be used for all three different types of new tax bases (distribution, LSAP und disposal). For calculation and booking of withholding tax the rates for private wealth are used in each case.

If the investor can prove, that the fund has actually crossed over its investment limits during the fiscal year, the partial exempted can be claimed within the annual tax declaration. Such scenario can occur, if the fund did not publish any investment limit or has published the correct figures too late, and the respective correct partial exemption has not been considered correctly within the withholding tax deduction.

Retroactive changes of the investment limits or in case of resp. discontinuation, the shares of the fund are deemed to be sold and newly purchased. Example: change of the investment limits / conditions. The tax relevant result of this transaction will only be considered when the shares are actually disposed by the client. The bank therefore has to maintain special note items.

Tax-exempt investors in mutual funds

For tax-exempt investors in mutual funds the fiscal authority has set special procedures. There are two types of tax-exempt investors, that are fully or partial exempted for the taxation on the fund entry side and the clients side:

- a) Fully tax-exempt investors (par. 8,1,1 InvStG 2018, legal persons, that are exempted on base of par. 44a, 7 EStG). In this case all earnings on the fund entry side are tax exempted.
- b) Fully tax-exemption based on par. 8, 1 No. 2 InvStG 2018, investors in certified pension contracts based on par. 5 or 5a of the Retirement Certification Act. In this case all earnings on the fund entry side are tax exempted as well.
- c) Partial tax-exempt investors (par 8, 2 InvStG 2018 - in this case only the earnings from German real estates are tax-exempted.

The tax-exemption can be obtained by tax reclaim or pre-exemption procedure (relief at source).

A pre-exemption procedure can only be granted under the following conditions:

- In accordance with the terms and conditions of the fund only tax-exempted investors can invest in this group of funds
- The terms and conditions do not allow a transfer of fund units to other clients
- The fund has to fulfill the conditions of par. 36a EStG ("cum-cum-regulation")

For applying the relief at source exemption the investors are obliged to submit documentation of the exemption status to the financial investment management company. The same applies in case of relevant products under the Retirement Certification Act.

Tax reclaim procedure:

Clients have to apply for respective refund by the financial investment management company and have to provide the tax exemption certificate (or comparable evidence for foreign investors). Further, a respective certification of the investment fund unit position holding (issued by the client's bank) has also to be provided. After checking the documentations the financial investment management company will claim the relevant tax issues at the paying agent or the responsible fiscal authority in which the claim at the paying agent always has priority. Finally the tax is reimbursed to the investor.

Transitional arrangements

For all funds and "capital investment companies" with a fiscal year not equaling the calendar year, tax-wise a deemed short fiscal year ending 31.12.2017 has been considered. In this connection the relating deadlines for publishing tax based information from funds have been extended as well. Basically all funds and capital investment companies will be treated as sold fictitiously by 31.12.2017 and subsequently newly purchased as of 01.01.2018. For mutual funds the accumulated deemed interest became tax-relevant as well in this context. The respective tax relevant result did not directly become subject to withholding tax deduction, since the withholding is postponed until the date of actual disposal of the fund units by the client.

As of 01.01.2018 capital gains realized upon disposal of „grandfathered positions“ (respective acquisition was made prior to 01.01.2009) are, only as far as the capital gain refers to the period 01.01.2018 – actual disposal date, a special allowance of 100.000 EUR applies (to be claimed within annual tax declaration only).

Fund mergers

Unchanged, fund mergers will still be divided into tax free fund mergers and tax relevant fund mergers. A tax free fund merger is generally not possible in a cross-border merger scenario. Respective precondition upon foreign fund mergers is, that all funds are subject to the law of a state in the meaning of par. 2, sec. 15 InvStG. Fund mergers between German and foreign funds are always tax relevant. For tax free fund mergers the LSAP for the year of the merger has to be calculated only on base of the new fund. If the partial exemption changes at the same time the new funds have to be sold fictitious by applying the old partial exemption rate and to be bought fictitious by applying the new partial exemption rate.

Please do not hesitate to contacting us for further questions.

Banking Concepts AG
Gartenstr. 59
CH- 4052 Basel
Tel.: +41 61 284 9080
Internet: www.bankingconcepts.com

Contact persons for further assistance:

André Schwarz
Partner
Mobile: +41 79 600 8574
andre.schwarz@bankingconcepts.com

Oliver Rhodius
Senior Consultant
Mobile: +49 151 465 411 91
oliver.rhodius@bankingconcepts.com