

Draft OGAW-IV Implementation Act in Germany: Conversion of issuer taxation to paying agent taxation for dividend payments as of 2012

Background

In the framework of implementing directive 2009/65/EG on provisions related to undertakings for collective investment in transferable securities (UCITS) by means of Germany's OGAW-IV Implementation Act, the withholding tax for dividend payments in Germany is set to be modified starting 01.01.2012.

It is foreseen not to have the withholding tax on the level of the issuer („Emittentensteuer“) anymore but with the paying agent (bank). Background of this planned ruling, according to the explanatory memorandum on the draft act, is the avoidance of abusive tax designs when short-selling shares after the ex-dividend date.

Currently the draft of the OGAW-IV Implementation Act is available as a decision by the German cabinet. Finalization of the legislative process is foreseen for mid-June this year.

The legislation planned for the new withholding tax procedure will be presented in the following. Other rulings of the OGAW-IV Implementation Act, i.e. the proper implementation of the Fund directive and its impact on the Fund industry, are not subject of this newsletter. The same applies to the special arrangements for 2011, concerning withheld tax on German letting income and tax rebates of withheld tax at the issuer on German dividends for German investment funds, which had already been communicated by the ministry of finance 15.12.2010 in anticipation of the OGAW-IV Implementation Act.

Current Regulations

On dividend payments by German corporations withholding tax (25% KEST and 5,50% SOLZ) is withheld by the respective distributing corporation („Emittent“) and not by the bank or agent that processes the final payment to the client (paying agent, „Zahlstelle“).

In the case of earnings of such dividends through German investment funds, the current withholding tax is withheld by the fund administration; prior to this the investment fund received a (usually) full tax refund by the distributing corporation. This taxation is equally applicable for distributed and accumulated earnings by the investment fund.

The paying agent of the client processes any tax refunds for tax residents in case of documented reasons for tax exemption. Furthermore the paying agent also withholds church tax as far as applicable to a client - except for accumulating funds.

For non-tax residents who have a portfolio in Germany or tax residents with a portfolio abroad respectively a possible tax refund of the withholding tax at the level of the issuer can be filed with the German ministry of finance, if appropriately documented.

Planned ruling starting as of 2012

For German dividend payments, paid starting 01.01.2012, the withholding tax (KEST, SOLZ and also KiSt) for direct ownership as well as for payments of such earnings through German investment funds, will be processed in a standardized way through the paying agent of the client. The respective bank will therefore in the future receive dividend payments as gross amounts.

This applies in a similar way to distributions of such dividend payments through German investment funds as of 01.01.2012. In the case of a German accumulating investment fund the respective fund administration must provide the maximum required amounts to the paying agents in order to ensure the operational implementation of withholding tax (i.e. processing a tax distribution). This tax distribution contains apart from KEST and SOLZ also a uniform 9% KiSt for all fund shares and thus amounts to 27,99% of the respective German gross dividend earnings. The withholding of church tax also in case of accumulation is new, as this was up to now a matter of the individual tax assessment of the client. The appropriate assessment of factual tax amounts on investor level including the processing of possible tax refunds will also be determined at the level of the paying agent in the future.

In case where the custodian of respective securities is located abroad, the withholding tax (KEST and SOLZ) will be managed by the last German depository in the depository chain and certified accordingly. By this process the taxation is meant to be ensured also in an international context.

Non-tax residents with a custodian in Germany or tax residents with a custodian abroad will obtain a possible tax refund through the German ministry of finance also in the future.

Finally it has to be pointed out that following earnings with withholding tax at the level of the issuer are not impacted by the new ruling concerning withheld tax in the OGAW-IV Implementation Act:

- Interest on German convertible bonds: withholding tax will continue to be processed by the issuer and not by the paying agent
- Earnings from German participation rights equity type and participation rights bond type: withholding tax will continue to be processed by the issuer and not by the paying agent
- Interest received by German investment funds (in the case of accumulating funds): withheld tax will continue to be processed by the fund administration and not by the paying agent

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