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## Financial Services

Info Letter # 10-2010 (31 March 2010)

### German Fund Tax Law – Upcoming 2010 Changes

On 30 March 2010, the German government published the wording of draft tax legislation, including changes to the German Investment Tax Act (Investmentsteuergesetz), the law governing (1) the determination of taxable income by German and non-German funds as well as (2) the taxation of German investors of (mutual / hedge) funds domiciled in Germany and of non-German funds marketed into Germany.

The revision of the German Investment Tax Act has not yet been enacted and the wording may be altered during the further legislative process. Until 26 April 2010, the German Ministry of Finance welcomes comments on the proposed changes.

In general, the amendments shall be applicable to the first fund business year that **ends** after the law has become effective, which WTS expect to happen in 2010. Consequently, funds with a BYE on 31 Dec 2010 are likely to be subject to the revised rules.

This WTS Info Letter highlights the main changes proposed, focusing on the interests of non-German fund promoters and their service providers.



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### **Business Evaluation for Fund Promoters**

The draft amendments to the Investment Tax Act provide non-German funds with an enhanced level playing field compared to German domiciled funds. Especially non-German pooling structures and funds investing in German equity will benefit. So far, the pooling of German pension money invested into German equity via non-German funds was unattractive because of a disadvantageous after tax return resulting from the fact that non-German funds cannot get a refund of German WHT levied on dividends distributed by German corporations, whereas German funds do. The draft changes would abolish this disadvantage.

Also, the draft bill increases the level of control and challenges tax driven fund structures, e.g. it brings the future non-recognition of losses bought in case of non-German Spezialfonds and a uniform approach to ongoing NAV related and business year-end G-Tax reporting becomes mandatory, especially with regard to equity funds. In the future, it will no longer be possible to distribute tax privileged capital gains from equity and then generate a corresponding tax deductible loss on business investor level. The reasoning of the draft law explicitly states that tax driven fund structures are subject to the general anti-avoidance rules, too.

### **Business Evaluation for Fund Administrators**

From the perspective of the fund administrator, the noteworthy items are that a uniform approach to ongoing NAV related reporting and the annual business year-end G-Tax reporting is required. In addition, the draft contains a number of intricate tax technical details triggering changes to the G-Tax data capturing and processing on fund level.

### **Details**

The following details are noteworthy, especially from the perspective of the non-German fund industry. The below list is not conclusive.

#### **1. Foreign Funds and German Dividends**

At present, German dividends received by a non-German fund do not allow the German fund investor to fully credit the German WHT imposed on the German dividend. This is a

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significant after tax return disadvantage of the non-German fund. In the future, the German investor – especially important for the German corporate investor – is entitled to fully credit or being refunded such WHT.

The improvement, however, requires that the administrator of the non-German fund can capture and process correctly such German WHT. In addition, it is likely that the fund will need to supply to its German investor additional information on the timing of the receipt by the fund of each single German dividend that suffered German WHT. This is the first time that the German legislator lifts the fund's tax veil in a US K1 tax reporting like manner and implements an individual investor based, pro rata temporis look through approach for G-Tax year-end reporting purposes.

In the light of this new development, the **WTS transaction based G-Tax Review** approach should assist in providing sufficiently detailed investor tax reporting.

### 2. Aktiengewinn and Dividend Income

According to the new draft, dividends and capital gains from equity are (partly) tax-exempt on corporate / business investor level only if the fund publishes the Aktiengewinn (equity gain) for every valuation day.

This amendment to the existing rules (at present, there is no such link between the publication of the equity gain and the (partial) tax exemption of a fund distribution as far as it is sourced from dividend income / equity capital gains generated on fund level) makes the publication of the Aktiengewinn even more important for German investors.

As a consequence, funds that do not publish Aktiengewinn yet can opt for the publication within a transition period of two months after the German government formally initiated the legislative process. The initial value of the Aktiengewinn has to be zero.

### 3. German Paying Agents

For the first time, German paying agents who are in charge of levying German WHT on fund distributions and upon the sale of non-German fund units, have to communicate to

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the tax administration (in specified electronic format) the identity of the German fund investor together with the tax identification number of the German tax payer, if the German paying agent has abstained from levying German WHT. The individual tax identification number was introduced only at the start of 2008. This first time obligation to use the individual tax ID of the investor shows that the German fiscal authorities are increasing the control density, not only with regard to external third parties (like Switzerland or Liechtenstein) but internally, too.

#### 4. Adjustment Item

For the first time the draft law contains rules on a mismatch between the fund level generated income attributed to the fund investor and the cash amount of the income received by the investor. Such mismatch can result from a difference between the fund accounting and the German tax rules, e.g. in case of (partially) accumulating funds, 10% non-deductable expenses. The draft law requires business investors to work with adjustment items which carry forward such mismatches up to the sale of the fund unit. Such adjustment items are likely to require an enhanced reporting by the fund (administrator), exceeding the minimum (standard) reporting foreseen in the law.

#### 5. DDI from Prior Business Years

At present, the wording of the law requires the fund that distributes out of the G-Tax bucket of “Deemed Distributed Income from prior Business Years” to separately disclose the BY in which such income was deemed distributed. According to the new draft version, this requirement is dropped, i.e. a specification of the business year, in which such income was generated on fund level, is no longer needed.

The proposed change results in a simplification on fund level, which makes it easier to comply with the reporting requirements of the law.

#### 6. WHT suffered on the Input Side of the Fund

In addition to the current reporting obligation, the draft stipulates that funds have to publish the gross amount of WHT suffered on the input side of the fund **less** the related amount of WHT refunds of the current or prior business years. If and to what extent this

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will cause additional effort on fund administrator level depends on whether the fund already ascertains and records the respective figures.

### 7. Statement on Income Equalization

In addition to the existing formal requirement of the tax certificate, the draft stipulates that the certificate explicitly states whether income equalization was applied when the bases of taxation were ascertained. This new requirement results from the fact that the Ministry of Finance accepts income equalization employed for only German fund tax law purposes (also see WTS Info Letters # 7 and # 9).

This mere formal requirement has to be observed in the course of future certifications but should not lead to additional effort on fund level.

### 8. Income Equalization and Interim Profit

The fund can employ income equalization, whether a fund accounting or a mere G-Tax equalization. If so, then the draft bill requires the fund to apply income equalization in a uniform manner to both, Interim Profit (Zwischengewinn) and G-Tax year-end reporting.

In addition, the new draft obliges the fund to include in the publication of Interim Profit (Zwischengewinn) a statement on whether income equalization was applied by the fund when calculating the Interim Profit. As the tax authority accepts the investor level deduction of Interim Profit bought only if income equalization, whether fund accounting or mere G-Tax equalization, is applied on fund level, such application should – according to the legislator – be ascertainable from the Interim Profit publication.

### 9. Non-German Spezialfonds and Loss Carry Forwards

According to the draft, loss carry forwards of a foreign special investment fund cannot be used by a new investor who has bought the fund units. This new regulation corresponds to the rules for Spezialfonds domiciled in Germany.

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### 10. Non-German Spezialfonds and the G-Tax Certificate

The new draft stipulates that a non-German Spezialfund with at least one German investor is obliged to provide to the Federal Central Tax Office a certificate (issued by a tax advisor) that the tax information has been determined in accordance with the rules of German tax law within four months after the end of the business year. This certificate does not need to be published in the eGazette.

This new formal requirement basically corresponds with the certification process for retail funds and is in line with the increase of the control density expressed in the current draft bill.

Sincerely yours,

Robert Welzel

Steffen Gnutzmann

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In case of queries, please do not hesitate to contact:

Robert.Welzel@wts.de	- Tel. +49 69 1338 45680
Christian.Bischler@wts.de	- Tel. +49 69 1338 45620
Guido.Dahm@wts.de	- Tel. +49 69 1338 45610
Steffen.Gnutzmann@wts.de	- Tel. +49 40 3208 66613
Christiane.Schoenbach@wts.de	- Tel. +49 69 1338 45670
Stefan.Zwiesele@wts.de	- Tel. +49 69 1338 45630

Issuer:

WTS Aktiengesellschaft Steuerberatungsgesellschaft  
[www.worldtaxservice.com](http://www.worldtaxservice.com)  
[www.wts.de](http://www.wts.de)

WTS Düsseldorf  
Peter-Müller-Straße 18  
40468 Düsseldorf  
Germany  
Tel.: +49-211 20050 5  
Fax: +49-211 20050 950

WTS Frankfurt/M.  
Taunusanlage 19  
60325 Frankfurt/M.  
Germany  
Tel.: +49-69 1338 45695  
Fax: +49-69 1338 45699

WTS Hamburg  
Neuer Wall 30  
20354 Hamburg  
Germany  
Tel.: +49-40 320 8666 0  
Fax: +49-40 320 8666 29

WTS Munich  
Thomas-Wimmer-Ring 3  
80539 München  
Germany  
Tel.: +49-89 286 46 0  
Fax: +49-89 286 46 111

WTS World Tax Service B.V.  
Conradstraat 18  
Unit E6.178  
3001 BE Rotterdam  
Netherlands  
Tel.: +31 10 217 9171  
Fax.: +31 10 217 9170

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