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German legislator eventually agrees on amendment of German Investment Tax Act

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Last Friday, November 29, 2013, the German legislator eventually agreed on the Act Amending the German Investment Tax Act and Other Acts (AIFM Tax Amendment Act, or "GITA–AIFM"). A period of unease and uncertainty for German investors in foreign investment funds has thus come to an end as the German Investment Tax Act ("GITA") scope was hanging in limbo after the German legislator, during the last legislative period, failed to base the scope of application of the GITA on the new German Investment Code (Kapitalanlagegesetzbuch or "KAGB"), which implemented the European Alternative Investment Fund Managers Directive ("AIFMD") into domestic law, and thereby repealed the German Investment Act as of July 22, 2013 (see beinformed, dated September 5, 2013).

Although the German Federal Ministry of Finance had issued an Ordinance on July 18, 2013, stating that the previous scope of application of the GITA would continue to apply to investment funds that comply with the current requirements of the GIA until a new statutory regulation of the GITA's scope of application enters into force, it is more than welcome that said new statutory regulation now has passed – and will enter into force before year-end - and thus provides legal certainty.

The GITA-AIFM implements the differentiation between open-ended and closed-ended funds within the GITA's new scope of application (see beinformed, dated January 30, 2013). On the one hand, UCITs and open-ended AIFs that comply with the requirements of the new Sec. 1 (1b) GITA ("qualifying AIF") all qualify as "Investment Funds" under the GITA-AIFM and remain subject to the principles of investment taxation. On the other hand, AIFs that not do comply with the requirements of the new Sec. 1(1b) GITA ("non-qualifying AIF") will now be defined as "Investment Vehicles" and will be subject to the general German tax rules. Thus, while the GITA introduces new definitions and new distinctions for German tax purposes, the general principles of taxation for different fund types will generally remain under the GITA.

Under the new regime, foreign Investment Vehicles are divided into Investment Partnerships and Investment Corporations. Each Investment Vehicle that does not qualify as an Investment Partnership will then automatically qualify as an Investment Corporation. Thus, the first step for determining the qualification of a foreign Investment Vehicle is by applying the so-called "partnership test". If the Investment Vehicle fails this test, it will then by default qualify as a corporation for German tax purposes. To everyone's great relief, the plan to introduce a lump sum taxation (comparable to the rules for nontransparent investment funds) on retained earnings of Investment Corporations at the level of the German investors has been abolished. Private equity funds set up as Luxembourg SICAV S.A./SCA, in particular, would have been hard hit under said lump sum taxation. However, this detrimental rule still can come back to haunt us if the German legislator deems lump sum taxation to be appropriate in the future.

The new distinction between Investment Funds and Investment Vehicles will enter into effect as of 22 July, 2013. At the same time, funds that were established before 22 July, 2013, will be grandfathered for a transition period of at least 3 years. Under the grandfathering provision, an investment entity that qualifies as an investment fund under the old investment tax rules, i.e. either the entity is subject to investment supervision or annual redemptions are permitted, will continue to qualify as an Investment Fund after 22 July, 2013, and enjoy the same tax treatment as before until the business year ending after July 22, 2016. The same is true for an investment entity, which was set up after July 21, 2013, but before the AIFM-GITA entered into force, provided these investment entities also comply with the requirements under the old regime.

be in touch: If you have any questions, please do not hesitate to contact us!

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