

Fund mergers and restructuring – German tax reporting obligations

Make the best of it for your investors

Recent changes in the market and continuing consolidation in the investment management industry have brought the restructuring of investment fund ranges on top of the agenda of nearly all fund promoters. Today's dominant topic are fund mergers aiming to minimise asset flight or drain.

Depending on the level of reporting made by the merging investment fund, the tax position of German investors can, especially in the light of the German Flat Rate Tax applicable to private investors as from 2009, vary significantly. In order to optimise the tax implications for German investors, fund promoters have to implement long lasting and complex measures for current and future annual German tax reporting.

The related German legislation was drawn up based on the conditions of the German investment fund industry. Transposing them into an international environment raises significant tax technical and practical issues. Therefore, international promoters and fund administrators are finding it very difficult to cope with these rules. Not applying them will however result in tax disadvantages for investors and weaken the market position of foreign funds compared to German vehicles.

In order to support our clients achieving the best results for their German investors, we thus have developed a full package of services related to fund mergers and restructurings.



Investor perspective

Generally, a merger of investment funds is seen as two transactions at the German investor level and from a tax point of view: a redemption of the units held in the transferring fund and a subscription of units in the receiving fund. This could trigger negative tax consequences at the investor level.

Under the Flat Rate Tax rules for private investors, capital gains from the redemption of investment fund units subscribed before January 1, 2009, are tax exempt (grandfathering) whereas all capital gains from units subscribed after December 31, 2008 are subject to the 25% Flat Rate Tax. As a consequence, a fund merger that does not allow this differentiation could have negative tax implications for private investors, especially for those investors who subscribed for their fund units prior to January 1, 2009, as capital gains from the “new” units could become taxable after the merger.

Business and corporate investors are less impacted as realised capital gains from fund units are taxable in any case – exceptions

exist only in relation to capital gains from equity holdings of the fund, i.e. the “Aktien Gewinn”. Investments in fund units are often used to accumulate capital gains over the holding period without taxation; the redemption, including realisation of capital gains and contingent taxation occurs when appropriate from a business/commercial or taxation perspective. Therefore, a fund merger might imply negative timing impacts for corporate and business investors.

The German Investment Tax Act (InvTA) provides for tax neutrality of a merger of investment funds under certain conditions. As a consequence, the “new” units step in the tax position of the old units and benefit from the grandfathering in respect of the Flat Rate Tax (private investors) and from a roll-over of unrealised capital gains for corporate and business investors.

The taxation consequences briefly outlined above, as well as the InvTA rules apply equally to mutual and corporate type funds for the merger of single funds, whole umbrella funds and sub-funds.

Obligations of the fund

The conditions for the tax neutrality of the merger under the InvTA are as follows:

- The fund is domiciled in the EU or in the European Economic Area (and the country of residence has adopted the Directive 77/799/EEC);
- The supervisory authority of the country of domicile confirms that local regulatory rules on mergers are respected;
- The merger date is considered for German tax reporting purposes as a financial year-end of the undergoing fund, implying for the undergoing fund a mandatory tax reporting towards German investors (Deemed Distributed Income) within four months after the merger date;
- For the determination of the taxable income under the InvTA, the receiving fund has to take over all assets from the transferring fund at their historical acquisition cost and a tax advisor/auditor has to confirm that this procedure has been respected;
- The merger shall have no impact on the “Aktiengewinn” share earnings or the “ImmobilienGewinn” of the receiving fund.

These rules provide fund promoters with the possibility to structure nearly all fund mergers in a tax efficient way for German investors. However, these requirements are challenging for the fund accounting. A transfer of assets at their historical acquisition

cost for accounting purposes is either not possible at all or linked to significant efforts and potential issues. De-connecting the calculation of capital gains on “received” assets for German tax reporting purposes from the fund accounting is often not an option as most fund administrators have built their German tax reporting solutions on the basis of the fund accounting system.

An additional challenge results from the recent circular on the InvTA, published by the Ministry of Finance on August 18, 2009. Section 299 of this circular requires that the rules for the amortisation of issuance premiums and discounts for bonds, which have been newly introduced as from 2009 onwards, will need to be applied in case of mergers also retrospectively. In practice this implies the re-calculation of amortisation for issuance discounts and premiums for the entire holding period of a bond held at the merger date. This rule is considered by domestic and foreign funds as a major hurdle for tax neutral fund mergers. Presently industry associations are strongly trying to achieve deletion or amendment of this requirement.

In the light of these very complex rules, various alternatives for structuring fund mergers are discussed in the industry. There is unfortunately no “one fits all” solution. Any re-structuring should therefore be carefully analysed from a tax technical, as well as from a cost benefit point of view.

PricewaterhouseCoopers solutions

Our PwC Fund Mergers and Restructurings Tax Services comprise pre-and post-merger tax consulting to investment fund promoters, assistance to fund administrators in coping with the requirements of the InvTA, review and audit of the merger process and procedures and the issue of required certification.

Consulting

Pre-merger, we assist in evaluating the benefits of making it tax neutral for German investors and the related efforts required. Based on the individual case, we will discuss and analyse structuring options. We can also assist in the pertinent investor communication.

In case the fund has opted for a tax neutral merger we may support the fund administrator in taking the necessary steps.

PwC GTax merger tool

Based on our experience, the consideration of assets of the undergoing fund at their historical acquisition cost is the most challenging from an administrator’s point of view. We have therefore developed a tool, which will deal with this requirement independently from the fund accounting. This tool can be adapted to meet the individual fund administrator requirements.

The fund administration will provide us with specific data on the holdings of the transferring and of the receiving fund on the date of the merger as well as with detailed transaction data at each following financial year end of the pertaining investment fund. On this basis, we will determine the capital gains under InvTA standards, which will need to be considered for the ongoing annual German tax reporting. Depending on audit independence rules, we might also make this tool available to fund administrators for their own use.

Review

Post-merger, we review whether or not the historical acquisition cost of the transferring fund has been considered correctly by the receiving fund and provide for the certification required by the InvTA.

To provide fund promoters and administrators with additional comfort, we propose to perform consistency and process checks following the fund merger. Flexibly scale this review could for example include a review of the receiving investment fund’s daily German tax figures (“Zwischengewinn”, “Aktiengewinn” and “ImmobilienGewinn”), which must not change due to the merger. Further reviews and analysis can be defined based on the promoter’s and/or administrator’s individual requirements.

Your benefits

German investors are known to be tax sensitive. As the number of fund mergers is expected keep growing, tax implications become increasingly important. Whereas investment funds domiciled in Germany are probably coping with the InvTA requirements to tax neutral mergers in most of the cases, only a small number of foreign funds are enabling their investors to benefit from these rules. In consequence German investors start to see foreign funds as tax-wise less attractive than local funds.

Our support framework developed in this context aims at supporting fund promoters and administrators in a most advantageous way for them and the investors. Even in case the fund opts for a taxable merger, effective communication might have a very positive impact on the investors' perception.

Why PricewaterhouseCoopers?

To assist investment funds based outside of Germany in complying with German tax reporting provisions, and thus to ensure an attractive investment option for German investors, PricewaterhouseCoopers provides a tax consulting and compliance service offering through a dedicated hub which aims to:

- Provide fund managers, promoters and administrators with information on tax reporting requirements and deadlines, including new developments as they arise;
- Provide assistance in the preparation of the tax reporting of the fund's financial year results and upon dividend distributions;
- Issue the certification of the tax reporting;
- Ensure the filling of tax returns with the German tax authorities, as required.

As these services require significant input from the fund's administrator, they will be provided in a tailored manner in order to meet the promoters' requirements and to respect the administrator's operational capabilities.

Based on our vast experience in this area, we offer a comprehensive, bespoke and efficient tax reporting service for funds looking to satisfy these tax reporting obligations. Our approach involves close cooperation with fund promoters and their administrator operations. PricewaterhouseCoopers Luxembourg has a dedicated German tax team consisting of 25 specialists working exclusively in this area. In addition, we have developed during the past years a strong German tax reporting experience in other service lines, such as audit and consulting. This allows us to provide our client with experienced multi-disciplinary teams. Our close cooperation with teams from other countries, e.g. Austria, allows us to also support our client within one assignment on the tax reporting for various jurisdictions.

Apart from ensuring the satisfaction of the tax reporting obligations, part of our role is to help minimise the related administrative and operational burden of all parties. To achieve this, we work closely with our PricewaterhouseCoopers experts and competencies, including the fund's statutory audit teams.

Recent example from the field

The challenge:

A client is restructuring his fund range and is thereof merging two umbrellas (incl. merger of several sub funds inside the two umbrellas), which have a broad range of investors and have major distributions in Germany.

Negative tax implications for German investor can emerge in this scenario.

The approach:

- Analysis of potential tax implications for investors
- Analysis of possible measures
- Cost benefit analysis
- Support to the fund administrator regarding the historical cost
- Certification of the fund merger

The outcome:

The funds are merged tax neutral for German investors.

PricewaterhouseCoopers Luxembourg (www.pwc.com/lu) employs more than 1,950 professionals from 53 different countries. PricewaterhouseCoopers (www.pwc.com) provides industry-focused assurance, tax and advisory services to build public trust and enhance value for our clients and their stakeholders. More than 163,000 people in 151 countries across our network share their thinking, experience and solutions to develop fresh perspectives and practical advice.

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