

Tax treatment of fees related to the management of investment funds

Dated 29 October 2010

In the circulars of 8 June 2010 and of 1 July 2010, the German Federal Ministry of Finance (BMF) comments on the tax treatment of fees relating to the management of investment funds that are invoiced directly to investors. As per the BMF, such management fees or equivalent charges have to be considered on the level of the fund's tax reporting according to the Investment Tax Act (InvTA) even if directly paid by the investor - a consideration on investor level is not possible.

Background

In particular, German Specialized Investment Funds ("Spezialfonds") often conclude arrangements with the fund investors under which management fees are not charged to the fund but are taken on by the investor. Luxembourg fund promoters also have, primarily for institutional investors, established share classes for which the management fees are negotiated and invoiced directly to the individual investor. These arrangements in the light of the BMF circulars may become very tax disadvantageous.

Circulars of the BMF as from 8th June 2010 and 1st July 2010

In its circulars from 8 June 2010 and from 1 July 2010, the German tax administration states that fees relating to the management of an investment fund do not qualify as tax deductible expenses on the level of the investors. Instead, any fee concerning the management of an investment fund has to be treated as indirect expense when determining the taxable income according to the InvTA on the fund level. Such fees would accordingly be deductible from the fund's taxable income at 90 %, 10 % of the expenses may not be considered for tax purposes.

This gives rise to various practical questions. In particular, it is not clear how these rules can be implemented for share classes with several investors, each having an individual fee arrangement with the fund promoter. Respecting the BMF rules would require establishing an individual tax reporting under InvTA rules for each individual investor. In case this is not possible, investors will not be allowed to deduct the management fees charged directly to them for tax purposes.

The BMF does not foresee a transition period regarding the application of these circulars. From the BMF perspective, the circulars clarify existing rules. It is therefore very likely that the rules will be applied to all open tax assessments of investors.

Client risk and need for action

In order to avoid or at least minimize tax disadvantages for German investors, we highly recommend conducting an analysis over your fund range, whether such fee arrangements have been implemented and to which extend share classes concerned are held by German investors. Potential further actions and solutions will need to be assessed on a case by case basis.

Particularly in relation to past years, you should also consider investor communication to make them aware of the situation.

How PwC can support you?

PwC can advise you with regard to potential reporting restructuring options available in order to ensure an advantageous taxation for your German investors.

Contacts

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