

German Flat Rate Tax – Extension of the specific transition rules for specialised investment funds and tax-optimised money market funds dated November 6, 2008

By means of its letter dated October 22, 2008, the German Ministry of Finance has extended the specific transition rules applicable to specialised investment funds (e.g. Luxembourg SIFs) to other investment funds.

Furthermore, as per the recent proposal for the adjustment of the draft of the “Jahressteuergesetz 2009”, investors in tax-optimised money market funds will also no longer benefit from the transition rules for the application of the Flat Rate Tax.

Specialised Investment Funds

Capital gains from the redemption or disposal of fund units, which have been acquired or subscribed before January 1, 2009 and held for at least twelve months will generally be tax-exempt for private investors, even if sold or redeemed after the introduction of the flat rate tax regime (i.e. January 1, 2009).

However, under specific rules implemented in November 2007 in Article 18 Paragraph 2a Sentence 2 of the Investment Tax Act (InvTA), capital gains from the redemption or disposal of units in domestic (German) or foreign specialised funds (“Spezialfonds”) as defined by the InvTA, which have been subscribed or acquired after November 9, 2007 cannot benefit from the above-mentioned grandfathering rules. Capital gains from such fund units will therefore be subject to the Flat Rate Tax of 25%. This applies accordingly to the redemption or disposal of units in other investment funds, for which the participation of natural persons depends under legal provisions, bylaws, articles of association or contractual terms on the expertise of the investor or for which a minimum investment of EUR 100,000 or more is required.

The Ministry’s circular dated October 22, 2008 refers to the conditions, under which the above-mentioned specific rule could also be applied in case neither an expertise of the investor nor a minimum investment of EUR 100,000 is required by legal provision, bylaws, articles of association or contractual terms; Issues which have been raised following practical experience.

The Ministry states that, if the majority of the fund’s assets can be allocated to a small number of maximum 10 investors, the specific regulations on specialised funds are also applicable to investors, who have actually invested at least EUR 100,000 even in case the legal requirements are not met. For those investors, it can be assumed that a minimum investment of EUR 100,000, as well as an expertise are required.

These rules are not in line with the legal provisions, which require these conditions to be explicitly set out by legal provision, bylaws, articles of association or contractual terms as mentioned above. The Ministry states therefore that contrary agreements (e.g. the contractual terms require no expertise of the investor and no or a lower minimum investment) are overruled by actual circumstances.

Resistance from market players against the extension of the specific rules for specialised funds set out by the circular dated October 22, 2008 is to be expected. Especially the retroactive effect and the question whether the legal provision can be significantly extended by a circular will need to be further analyzed. It remains to be seen how the tax administration will gather the information on the funds' investors necessary for the application of circular.

Tax-optimised money market funds

As per the proposal of Germany's ruling parties for a "Jahressteuergesetz 2009" capital gains from the redemption or disposal of fund units, which have been subscribed or acquired after September 18, 2008 shall also not benefit from the grandfathering rules (i.e. capital gains are subject to the Flat Rate Tax as from January 1, 2009) under the condition that:

- the fund's investment policy aims at a money market return;
- the realised capital gains on securities and derivatives (after offsetting against related losses but prior to deducting any cost and without equalisation) exceed the ordinary income such as interest and dividend income (before cost deduction and without equalisation).

Units of such funds, which have been subscribed or acquired before September 19, 2008, will be deemed to be sold and re-purchased by the investor on January 10, 2011. In consequence all capital gains accrued as from January 10, 2011 will be subject to Flat Rate Tax when the units are actually sold at a later point in time.

This proposal is based upon a request by the upper house of the German parliament and is, as the entire Flat Rate Tax regime, limited to private investors only.

Contacts

For further information, please contact the following PricewaterhouseCoopers Luxembourg Tax experts:

Oliver Weber

Partner
+352 49 48 48-3175

oliver.weber@lu.pwc.com

Laurent Garzino

Partner
+352 49 48 48-2018

laurent.garzino@lu.pwc.com

Mathias Wasemann

Director
+352 49 48 48-3215

mathias.wasemann@lu.pwc.com

Kerstin Boernecke

Senior Manager
+352 49 48 48-5468

kerstin.boernecke@lu.pwc.com

PricewaterhouseCoopers

400, route d'Esch, B.P. 1443
L-1014 Luxembourg
Telephone +352 49 48 48-1
Facsimile +352 49 48 48-2900

PricewaterhouseCoopers cannot be held liable for mistakes, omissions, or for possible results obtained further to the use of this document, which is issued for information purposes only. No reader should act on or refrain from acting on the basis of any matter contained in this publication without considering and, if necessary, taking appropriate advice upon their own particular circumstances.

© 2008 PricewaterhouseCoopers S.à r.l.. All rights reserved. PricewaterhouseCoopers refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.