

Annual Tax Law passed the Upper House of the German Parliament

19 December 2008

The Annual Tax Law 2009, as adopted by the Bundestag (the Parliament's Lower House) on 28 November 2008, passed the Upper House. It contains a number of changes which are relevant to the Investment Management Industry.

Due to the implementation of the flat rate tax regime for investment income providing for an equal taxation of income and capital gains, the German Government has considered changes to the Investment Tax Act necessary. These changes are intended to bring the rules on taxation of income from investment funds into line with those applicable to direct investments.

The version of the law finally adopted by the Lower and the Upper House differs considerably from the initial drafts. The most important changes are outlined below.

Calculation of the Deemed Distributed Income (DDI)

The new rules include a revision of the calculation of the Deemed Distributed Income. First, all investment income, i.e. "ordinary" income such as dividends, interest and "other income" as well as capital gains must be considered for the calculation of the Deemed Distributed Income.

Second, income from option premiums, capital gains from equities, derivative transactions and bonds are to be excluded from the Deemed Distributed Income. However, capital gains from bonds are to be excluded only if certain conditions are met.

As a result, capital gains from bonds, which have an issue yield, convertible bonds, exchangeable bonds, cum-traded warrants and *jouissance* rights are to be excluded from the DDI. Bonds bearing a variable coupon are to be excluded only if they have been issued with an *agio* or *disagio*, which does not exceed the limits provided for by so-called discount scale.

In contrast to earlier drafts, capital gains from certificates which mirror the price of a single equity or a published equity index are also to be excluded from the DDI.

Due to the numerous exceptions mentioned above, capital gains from bonds are actually to be included in the DDI only in specific cases, such as so-called full risk certificates (which do not mirror the price of a single equity or published equity index) as well as bonds bearing a variable coupon, which have been issued with a discount (*disagio*) exceeding the so-called *disagio* scale.

Under the new rules, in addition to coupons, agios and disagios at issuance must be accrued and included in the DDI. The accrual for agios and disagios must be calculated by application of the issuance yield. If the issuance yield cannot be determined easily and accurately, the market yield must be used as accrual method. Bonds issued with a disagio or agio, which does not exceed the limits defined by the so-called disagio scale as well as bonds not having an issue yield (especially bonds bearing a variable coupon) are not subject to this new rule.

New regulations concerning the Interim Profit (IP)

According to the abovementioned new rules, the definition of the Interim Profit was adjusted accordingly.

In particular, the abovementioned accrual for agios and disagios is to be considered also for interim profit calculation purposes.

Publication deadline for distributing investment funds

If a decision on a distribution is made within four months after the fund's business year-end, in the future, the four-month deadline for the publication of the tax reporting information within the meaning of Article 5 InvTA only starts on the day the distribution was decided on.

If the decision on a distribution is not made within four months after the financial year-end, the fund is treated as accumulating for tax reporting purposes and the DDI is taxable at investor's level as at the fund's year-end. Accordingly, the tax reporting information is to be published within four months after the financial year-end.

Accumulated Deemed Distributed Income ("ADDI")

The Accumulated Deemed Distributed Income (ADDI) represents the sum of Deemed Distributed Income generated since 1994. The ADDI is the basis for withholding tax upon redemption or disposal of fund units.

As from the year 2009 on, even if the investor transferred fund units between his / her accounts, only the ADDI accrued during the holding period of the fund units is subject to withholding tax. Until now, if the investor transferred fund units between his / her accounts, withholding tax was always levied on the full ADDI.

Tax optimised Money Market Funds

Specific grandfathering rules for the application of the flat rate tax have been adopted for so-called tax optimised money market funds. These are funds, whose investment policy seeks to achieve a money market oriented performance and which generate more capital gains on securities and derivatives than ordinary income.

Generally, capital gains from fund units subscribed for prior to 1 January 2009 are not subject to the flat rate tax. Under the revised rules, capital gains from units of the abovementioned money market funds will be subject to the flat rate tax if subscribed for or purchased after 18 September 2008.

For units purchased before that date and held beyond 10 January 2011, a virtual disposal and a virtual purchase will be assumed on 10 January 2011. As a consequence, only the change in value occurring after 11 January 2011 will thus be subject to the flat rate tax.

It should be noted that these specific rules only apply to private investors and not to corporate and other business investors.

Grandfathering rules applicable to fund units

By mistake, the annual tax law 2009 abolishes the general grandfathering rules applicable to fund units. As a consequence, capital gains realised at the disposal of all fund units (even those purchased or subscribed for before 1 January 2009) are subject to the flat rate tax. The German Finance Ministry acknowledged an editing error and formally confirmed by letter dated 5 December 2008 that the initial version of the law will still be applied until an amendment passes legislature.

Contacts

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

Oliver Weber

Partner
+352 49 48 48- 5712

oliver.weber@lu.pwc.com

Laurent Garzino

Partner
+352 49 48 48- 3171

laurent.garzino@lu.pwc.com

Mathias Wasemann

Director
+352 49 48 48- 3215

m.wasemann@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.