

Changes to the tax consequences of fund mergers under the German Investment Tax Act

The Upper House of the German parliament (Bundesrat) has adopted on Friday, 10 July 2009 a revision of the Investment Tax Act. Under the new rules, mergers of or with funds in the form of a SICAV can also benefit from a tax neutrality on investor level.

Mergers involving (sub) funds in the form of a SICAV triggered very often negative tax consequences on the level of German investors. The merger of two SICAVs, two sub funds of a SICAV or the merger of a (sub fund of a) FCP with (a sub fund of a) SICAV and vice versa was not covered by the tax neutrality granted by the Investment Tax Act. Under the new rules, mergers implying FCP and SICAV type funds can benefit from the same tax advantages on investor level if some conditions are met.

Generally, a merger of (sub) funds is considered on a German investor level taxwise as a disposal/redemption of the units/shares in the undergoing (sub) fund and a subscription of units/shares in the overtaking (sub) fund. Especially in the light of the introduction of the Flat Rate Tax as from 2009, this could trigger negative tax consequences on investor level: capital gains from the redemption/disposal of fund units/shares acquired/subscribed before 1 January 2009, remain tax exempt (grandfathering); all capital gains from units/shares subscribed after 31 December 2008 are subject to the 25% Flat Rate Tax. In consequence, a fund merger can be very harmful especially for investors who subscribed their fund units/shares prior to 1 January 2009 as capital gains from the "new" units/shares become taxable.

Article 17a of the German Investment Tax Act (InvTA) provides for a tax neutrality of a merger under certain conditions. As a consequence, the "new" units/shares step into the tax position of the old units/shares and benefit from the grandfathering in respect of the Flat Rate Tax.

Up to now, Article 17a InvTA was applicable only to funds of a mutual/contractual type, e.g. Luxembourg FCPs. The revision of the InvTA now allows also investors in corporate type funds such as Luxembourg SICAVs to benefit from the tax advantages. Explicitly, the new rules apply to the following cases:

- The merger between two sub funds of the same SICAV or FCP
- The merger of a FCP into a sub fund of a SICAV
- The merger of a sub fund of a SICAV into a FCP
- The merger of a FCP into a SICAV or vice versa
- The merger of two SICAVs or two FCPs
- The merger of a sub fund of a SICAV or FCP into a sub fund of another SICAV or FCP

The conditions for the tax neutrality of the merger under Article 17a InvTA generally remain unchanged:

- 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;
- For the determination of the taxable income under the InvTA, the overtaking fund has to take over all assets from the undergoing fund at their historical acquisition cost and a tax advisor / auditor has to confirm that this procedure has been respected.

Investors can apply the new rules for all mergers, which occur after the publication of the law in the German Gazette (Bundesgesetzblatt), which is expected for mid July.

The extension of the scope of Article 17a InvTA does provide fund promoters with the possibility to structure nearly all fund mergers in a tax efficient way for German investors. However, the requirements set by Article 17a InvTA are challenging especially for the fund accounting. A careful cost-benefit analysis is therefore recommended.

It should be noted that the merger of a (sub) fund is considered by the German tax administration as a financial year-end of the undergoing (sub) fund. In consequence, the undergoing (sub) fund will need to make the mandatory tax reporting towards German investors (Deemed Distributed Income) within four months after the merger date.

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