

Extension of the transitional period for the scope of applicability of the Investment Tax Act

In its circular of 25 July 2011, the Federal Ministry of Finance **extended the transition period for the scope of applicability of the (German) Investment Tax Act by two years.**

Background

The need for the introduction of amended provisions was caused by the changes to the administrative practice of the Federal Financial Supervisory Authority (BaFin) which, in its circular 14/2008 of 22 December 2008, had stipulated a number of new and somewhat formal requirements for a fund to be classified as a "foreign investment vehicle" as defined by the Investment Act.

More stringent requirements are now in place, including as regards:

- Eligible assets: e.g. shares in real property companies will only be accepted as eligible assets if the company's objective is narrowly defined in its articles of association,
- Minimum portion of eligible assets: BaFin increased the minimum rate from more than 50% to more than 90%,
- Diversification of risks, and
- Investment limits for certain assets.

For the purposes of the Investment Tax Act, the tax authorities adhere to BaFin's administrative practice as outlined above (see circular issued by the Federal Ministry of Finance on 18 August 2009, marginal note 5).

As a consequence, a number of funds are or were at risk of not being covered by the scope of applicability of the Investment Tax Act. The tax authorities did, however, grant the funds a certain period of time to take requisite actions.

Existing transitional period

According to the existing transitional period certain foreign funds are covered by the Investment Tax Act up to (and including) the financial year which started prior to 31 May 2011 (see circular issued by the Federal Ministry of Finance on 18 August 2009, marginal note 297).

New transitional period

This transitional period has now been extended. **It is now applicable up to (and including) the funds' business year which starts prior to 31 May 2013** (circular issued by the Federal Ministry of Finance on 25 July 2011).

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However, this transition period only applies to so-called old funds which had been issued prior to the change of BaFin's administrative practice. Funds which have been or are issued at a later point in time have to comply with the new and stricter requirements from the outset.

Whether the extension of the period of applicability is available in the individual case has to be examined on a case-by-case basis. Anyway, for the applicability of the transition period the foreign fund needs to continue to comply with the tax reporting requirements pursuant to section 5 Investment Tax Act, as was the case under the previous scheme.

The wording of the current transition provision partially deviates from the existing scheme. While the existing transitional provisions specified the changes of the (stricter) practice which caused a foreign fund to no longer be covered by the Investment Tax Act and only granted the transitional protection to those funds, the current transitional provisions do no longer specify the reasons for the non-eligibility. It remains to be seen whether this will result in a substantive change to future administrative practice.

Relevance and Outlook

A provision stipulating an unlimited preservation of the status quo had been discussed among the interested parties as would have been desirable. This would have ensured absolute legal certainty for the practice and spared the affected foreign funds from having to carry out restructuring efforts/measures. However, the fiscal authorities couldn't bring themselves to agree on a final preservation of the status quo.

Therefore, foreign funds which are to be covered by the Investment Tax Act for business year starting after 31 May 2013 have to comply with the stricter requirements as set out in the BaFin circular 14/2008 and may, in addition, have to change their investment strategies, their documentation or their structure.

Those investing in foreign funds which are unable or unwilling to meet the stricter requirements will cease to be covered by the Investment Tax Act as of the end of the funds' business year that starts after 31 May 2013 and will be subject to the "general" taxation rules as of that point in time. Rules on the taxation or tax treatment of this change of scheme do not exist. Therefore, uncertainties and disputes are likely to arise, for instance on the issue if and how consequences from the Investment Tax Act period will occur in the individual case.

For the vast majority of foreign investment funds which are admitted to public distribution in Germany or comply with the material requirements of the UCITS Directive in their state of origin there will be no need to adapt their funds prospectuses.

All other foreign investment funds, in particular those which are distributed by private placement to German investors, should be examined for compliance with the formal requirements regarding the funds prospectus before the extended transition period expires.

It remains to be seen if and in which form the scope of applicability of the Investment Tax Act will be adapted to foreign funds vehicles in the future in the course of the national transposition of the AIM Directive.

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