PRESS RELEASE

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German Investment Tax Reform 2018:
Special funds can still offer tax transparency

- Special funds with insurance companies as investors should choose transparency option
- Investment conditions for all special AIFs must be amended
- Abolition of tax income equalisation increases costs to fund management companies enormously

Providers of special property funds according to German law and their investors need to be prepared for some changes from next year: All German income from property fund has been taxed transparently to date. This means that the fund itself does not pay taxes, and instead taxation takes place at the level of the investor. In the 2018 investment tax reform, the German legislator has largely abolished fiscal transparency as a principle of fund taxation. The only exception is the option to design regulatory special funds with a transparent taxation structure (so called “special investment funds”). As a special investment fund for tax purposes, taxation can be almost identical to the way it is under current law. However, if investment fund status is chosen, domestic income will be subject to regular taxation, in the form of investment and property gains at fund level in particular.

It is important for insurance companies as investors in particular that they only invest in funds with transparent taxation. Otherwise there is the threat of taxation at fund level, which cannot be credited or reimbursed at investor level. As returning to special investment fund status has been ruled out, benefits still possible in connection with trade tax today could be extremely risky for investment funds.

By contrast, pension funds will continue to benefit under both regimes as they have done in the past, as there will be no taxation at fund level and the gains at investor level are generally tax-free anyway. This also applies to churches and charitable trusts.

Michael Schneider, Managing Director of IntReal International Real Estate, commented: “We very much welcome the fact that lawmakers have preserved the option of tax transparency for special AIFs. The special investment fund regime (tax transparency) will nearly always be first choice for income from German properties held by a German fund. However, this will entail greater expense for a series of investment limits.”

Comprehensive risk controlling required

A special challenge for the fund initiator – or the fund management company – is adhering to the restriction on “active business management”. Carina Berberich, Head of Investment Management & Tax at IntReal, added: “Property funds generate income from renting and leasing, and are therefore essentially pure play asset managers. However, a small share of their income can come from active business management.” If this income accounts for more

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than 5% of a fund's total income, the fund is disqualified from the transparent regime and, as an investment fund, this income becomes subject to trade tax. "More comprehensive risk controlling than before is therefore needed here: The difficulty for fund managers lies in monitoring the 5%-ceiling over the entire life cycle of the fund. Both rental income – the main component of total income – and income from active business management can fluctuate over time," Berberich continues.

A further consequence of the amendment that will mean more work for fund initiators and management companies is the adjustment of investment conditions. These have to be amended for all special AIFs, regardless of which tax regime they will fall under.

Abolition of tax income equalisation exponentiates costs to fund management companies

The consequences of the abolition of the tax income equalisation procedure will be particularly far-reaching. Tax expert Berberich explains: "This will hit the fund industry very hard and will cause considerably greater expense to fund management companies."

What does this procedure involve? Income equalisation is an investment law instrument by which the unit price and the earnings per unit are kept constant despite continuous investor fluctuation in open-ended funds.

Tax income equalisation will be scrapped under the new law. As a result, special funds will have to calculate the earnings share of a distribution individually for every single investor moving ahead – taking into account the exact dates on which an investment begins and ends. In addition, a whole series of other tax figures will have to be calculated for individual investors.

"Distinguishing between specific investors in this way is extremely labour-intensive, and will be a major challenge to the respective accounting systems," said Schneider.

About IntReal

As a third-party AIFM, IntReal concentrates exclusively on the business of launching and managing regulated real estate funds on behalf of third parties under the German Capital Investment Act (KAGB). The platform lets clients take advantage of all the options of a real estate AIFM without having to set up one in their own right. Options include the launching of property funds or the outsourcing of AIFM back offices. Employing 161 staff, the IntReal Group offers long-term real estate know-how along with detailed and highly professional fund management expertise.

IntReal collaborates with a number of third-party fund partners to administrate 99 investment funds with a combined investment volume of c. EUR 15.9 billion (all figures as of 30/06/2017, not including the business mandates of IntReal Solutions).

IntReal is a fully-owned subsidiary of Warburg-HIH Invest Real Estate GmbH in Hamburg,and part of the HIH Real Estate Group.

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