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German Parliament Makes it Easier for Property Funds to Invest in Renewable Energies

- ◆ Partial exemption limit for active entrepreneurial management raised from 5.0 to 10.0 percent
- ◆ Greater margin for generation or delivery of electricity by special investment funds – but capped still
- ◆ 2022 Annual Tax Act to be passed by German parliament today means modest improvements
- ◆ But no game changer: Property funds still risk losing tax transparency status by exceeding limit

Germany's lower house, the Bundestag, is expected to pass the 2022 Annual Tax Act after its second/third reading today. It represents the Federal Government's bid to improve the options for property funds to invest in renewable energies. In future, certain funds would be able to earn not just 5 percent but 10 percent of their revenues from PV plants without risking to lose their tax transparency status, which is essential for them. Whenever a given fund exceeds the previous limits of 5 percent, all excess earnings from this source will be subject to trade tax. For many thousand assets held in German property funds, this will pave the way for larger-scale rooftop photovoltaic systems, among other things. The investment fund industry itself came forward with various initiatives for including more flexible regulations in the draft act. If passed, Germany's upper house, the Bundesrat, would yet have to approve the law.

Michael Schneider, Managing Director at INTREAL, commented: "Policymakers have taken a step forward by raising the de minimis limit. We are ready to acknowledge that. Property funds will have an easier time to invest in photovoltaic system on rooftops, and may do so more liberally. Especially large-scale retail and logistics properties offer plenty of potential in this regard. However, the reform is not a game changer. We would have wished for yet more flexibility. One issue concerns partially or fully vacant properties, for example. In their case, income from rooftop PV plants would violate the limit immediately – and cause drastic economic consequences on the fund and investor levels."

Carina Berberich, Head of Taxes at INTREAL, added: "The body politic is acting erratically. On the one hand, it believes that we are at the eleventh hour in terms of climate change, and is making huge efforts to curb carbon emissions. With the Annual Tax Act, it has admittedly taken a step in the right direction, but we feel it could have been a slightly bolder one. A small-scale fiscal policy and political patronage are preventing the swift expansion of renewable energies in this context, and thereby jeopardise the main goals."

Carina Berberich went on to say: "Property funds are not interested in generating tax-free income from solar power. They do not mind paying trade tax on any energy they sell on the market. Rather, the issue is the disadvantage created if a fund were to lose its status as a fiscally transparent special investment fund, which would be the case after exceeding the limit. Those affected, by the way, would include the general public. The bulk of the fund assets is held by retirement plans such as superannuation schemes and pension funds."

The issue outlined above is well known: Most property funds have so far qualified as special investment funds under German tax law and are tax transparent as a result – which means taxes are only paid by the investors and not on the fund level. Funds risk losing this tax status as soon as they generate more than 5 percent (or 10 percent under the new law) not from letting and leasing but from so-called “active entrepreneurial management.” Producing and selling solar power would fall into the latter category.

The consequences of losing its tax status would be dramatic for a fund. Not only would it have to pay trade tax on its earnings, but corporate income tax as well, and it would also be taxed for its hidden reserves—meaning the appreciation of its assets in recent years—without a simultaneous inflow of liquidity.

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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 every service an AIF management company (KVG) provides without having to form one of their own. Options include the launching of open-ended and closed-end property funds or the outsourcing of AIFM back offices to INTREAL. Employing 482 staff, the INTREAL Group offers long-term real estate know-how along with detailed and highly professional fund management expertise.

INTREAL collaborates with a large number of third-party fund partners to administrate 292 investment funds with a combined investment volume of c. 59.2 billion euros (all figures as of quarter-end Q3 2022).