

Germany

Taxation

HEDGE FUNDS 2009

Hedge fund managers/advisors

Taxation

Tax rates applying to hedge fund managers/advisors

The tax rates depend on the legal structure of the German hedge fund manager.

If the German fund manager is incorporated as a company it will be subject to German corporation tax on its taxable profits. As a result of the Business Tax Reform 2008 the corporate tax decrease from 25 percent to 15 percent plus solidarity surcharge of 5.5 percent results in a tax rate of 15.825 percent. Additionally, trade tax must be paid, amounting to a total tax rate of approximately 30 percent.

If the German fund manager is established as a commercial partnership (Mitunternehmerschaft), it is regarded as a transparent entity for tax purposes and the taxation liability will be up to the members of the commercial partnership. A corporate member will be subject to corporation tax as described above. An individual member will be subject to income tax at the individual marginal rate (currently the maximum income tax rate is 42 percent plus solidarity surcharge of 5.5 percent however, a top income tax rate of 45 percent plus solidarity surcharge of 5.5 percent applies on income amounts exceeding EUR 250,000).

The effective tax rate usually suffered by hedge fund managers/advisors

As yet, only a small number of hedge funds have been established in Germany. Notwithstanding this, most hedge fund managers are individuals subject to a tax rate of currently up to 42 percent plus solidarity surcharge of 5.5 percent (resulting in a tax rate of 44.31 percent). A tax rate of 45 percent plus solidarity surcharge of 5.5 percent applies on income amounts exceeding EUR 250,000.

Tax concessions, allowances, or exemptions specifically available to hedge fund managers/advisors

There are no tax concessions, allowances, or exemptions that are specifically available to German hedge fund managers.

Details of anti-avoidance tax rules that could bring the profits of an offshore hedge fund into tax

The offshore fund's profits will – in principle – not be brought within the charge of German tax if the hedge fund manager operates from Germany.

However, the taxation of the hedge funds themselves is governed by the so-called principle of transparency, pursuant to which the fund's investor (shareholder) is fiscally treated as if he held the investment instruments himself and received the income generated by the investment fund firsthand. This principle implies that the fund itself is not subject to tax in terms of a taxpayer status in Germany. On the level of the investor, the income from the investment fund is subject to the new flat tax on capital income (Abgeltungsteuer) introduced for private investors in Germany with effect from 1 January 2009 on. With a deduction of 25 percent plus solidarity surcharge and church tax – if applicable – the personal income tax is cleared. However, the hedge fund manager is legally distinct from the hedge fund. Accordingly, the tax liability of the hedge fund manager is irrelevant for the purpose of assessing the hedge fund's/ the shareholder's tax liability and its income respectively et vice versa.

In addition, due to the amendment of the Investment Act enacted on 27 December 2007, funds where the investors do not have the right to redeem their units (open-ended funds) or - in case of a closed-ended funds - which are not subject to a qualified investment supervision in their country origin, are no longer regarded as investment funds in the meaning of the German Investment Act/Investment Tax Act. For those funds, the Foreign Tax Act (cfc-rules) has to be considered in principle. There has been issued a Circular on 22 December 2008 by the German Federal Financial Supervisory Authority (BaFin) in order to clarify the scope of the amended Investment Act and the definition of Foreign Investment Fund Units respectively.

Requirements to charge VAT (or equivalent sales tax) and the rate

Investment management services provided to a German hedge fund are generally exempt from VAT. In the case of an offshore hedge fund, German VAT is generally not charged in Germany with regard to investment management services since the place of delivery regarding the management services is deemed to be at the recipient's location, that is, the place where the offshore fund is established. The service should therefore not be subject to VAT in Germany.

Hedge fund structures

Taxation

Tax rates applying to the fund

Onshore funds are not subject to taxation in Germany (due to the principle of transparency, please see above). The same applies – in principle – to offshore funds. However, in the case of offshore funds, the fund's or its shareholders' limited tax liability in Germany (depend from the legal structure of the offshore fund) may apply if the portfolio of the fund contains German real estate.

Access to double tax treaties

The question whether the fund will fall within the scope of a double tax treaty primarily depends on its classification as a transparent fund. While double tax treaties – in principle – are applicable to tax transparent funds, the taxable income derived from non-transparent funds are excluded from benefits granted under a double tax treaty.

Funds will only be regarded as tax transparent if:

- the fund determines taxable income in accordance with German tax law.
- the fund or an advisor calculates and publishes (in the German Federal Gazette) the German taxation basis for the fiscal year's (deemed) distribution(s).
- the fund's taxation basis is certified by such as, a German tax advisor.
- In the case of German tax transparent hedge funds, the application of the double tax treaty between the origin state of source and Germany is granted for German investors regarding the income deriving from the origin state.

Value-added tax registration and charging requirements

Investment management companies (Kapitalanlagegesellschaft) of German funds (Sondervermögen) are required to register for VAT purposes. Generally, German funds are an integral part of the investment management companies in terms of the VAT law. However, according to a decree of the German tax authorities, supplies of the investment management company in connection with the fund are deemed to be provided to the investors. Whether the services rendered by the investment management company trigger German Value-added tax will depend on the nature of service provided to the investors. In the case of investment management services for which the investment management company is engaged (please see above) no VAT should be

charged. The same should apply to investment management services supplied by a third party hedge fund manager to the investment management company. Other potential services provided either by the investment management company to the investors or by the third party hedge fund manager to the investment management company should be VAT able in Germany at a rate of 19 percent. Please note that input VAT suffered can only be claimed if the incoming services can be directly attributed to outgoing services which apply VAT.

Offshore funds are not obliged to register and charge VAT in Germany.

Withholding tax on dividends or interest payments

In the case of a German hedge fund the dividend income is – in principle – subject to withholding tax of 25 percent (applicable as of 1 January 2009; before: 20 percent), regardless of whether the dividend income is retained by the fund or distributed. Non-residents may claim a refund from the German fund.

There are no withholding tax requirements in Germany for the offshore hedge fund itself. Withholding tax of 25 percent on interest income may be charged (before 2009: 30 percent), if the fund's income is distributed and paid out by a paying agent in Germany (such as, a bank). Such distributions are tax exempt for non-residents. Interest income, received by the fund on bonds with a German principal is not subject to withholding tax in Germany.

Tax return requirements

In order to qualify for a tax transparent status, funds have to file a tax return that contains the computation of the distribution or deemed distribution. For the German principle of tax transparency, please see above.

Investors

Taxation

Specific anti-avoidance tax legislation applying to an investor in an onshore fund

There is generally no anti-avoidance tax legislation that may apply to German investors investing in a German hedge fund.

Specific anti-avoidance tax legislation applying to an investor in an offshore fund

Anti-avoidance tax legislation may be applicable for a German investor in an offshore fund in certain circumstances if the offshore fund invests in shares of a low taxed non-German corporation, not qualifying as a (target-)fund (cfc-rules may be applicable).

Tax information needs of investors

Different tax reporting obligations apply to offshore (as well as onshore) funds.

First, the fund or an advisor needs to calculate and publish the German tax basis for the distributed or deemed distributed income. Furthermore this German tax basis has to be published in the electronic version of the German Federal Gazette upon each distribution or within four months after the fund's business year end in case of a deemed distribution.

In addition the hedge fund can opt to calculate and publish the equity gain (Aktiengewinn) on each day, a redemption price (NAV) is calculated (on a daily, weekly, or monthly basis).

The fund needs to obtain a tax certificate, such as, from a German tax advisor, stating that the German tax basis (neither the interim profit nor the equity gain figures) has been calculated in line with the Investment Tax Act.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.