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The cover features several large, dark green leaf-like shapes scattered across the background, creating a natural, organic feel. The leaves vary in size and orientation, with some pointing upwards and others downwards.

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# Investment Funds

Germany  
P+P Pöllath + Partners

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## Law and Practice

Contributed by P+P Pöllath + Partners

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**P+P Pöllath + Partners** has around 30 P+P professionals who contribute to one of the largest and most experienced fund structuring practices in continental Europe, with locations in Berlin, Frankfurt and Munich. P+P, which maintains strong relationships with local law firms in jurisdictions outside Germany, is a market leader in the structuring of private equity funds in the country. The firm advises initiators of and investors in private equity funds and worldwide fund participations in the area of alternative investments. The team has extensive expertise in fund structuring; advice regarding the Alternative Investment Fund Managers

Directive (AIFMD), the German Capital Investment Code (KAGB) and the Markets in Financial Instruments Directive II (MiFID II); asset management; and secondary transactions. This includes all relevant fund structures in private equity (buyout, venture capital), mezzanine/private debt, distressed debt, real estate, infrastructure, natural resources/energy, education, hybrid funds, hedge funds, crypto/digital assets funds, captive funds, master-feeder structures, separate accounts, annex funds, specialised funds, as well as primary and secondary fund of funds.

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## 1. Fund Formation

### 1.1 Formation of Investment Funds

Germany is frequently used by advisers and managers for the formation of venture capital, private equity and similar closed-ended alternative investment funds wherever the manager of the respective investment fund is located in Germany; ie, Germany is generally not used as a domicile for structuring investment funds by non-German advisers or managers. Typically, German private equity or venture capital funds are structured as limited partnerships which are transparent for German tax purposes.

German funds investing in listed securities, such as Undertakings for Collective Investments in Transferable Securities (UCITS), or in real estate assets are common and are often set up by the manager as contractual funds (*Sondervermögen*). A contractual fund has no separate legal personality from the manager. The contractual fund is a pool of assets separated by statute and contract from the (other) assets of the manager.

### 1.2 Raising Capital from Investors

German-resident institutional investors, as well as German family offices, are a frequent target of the fund-raising activities of venture capital, private equity and similar alternative investment funds located in Germany or various other jurisdictions around the world.

### 1.3 Common Process for Setting Up Investment Funds

The process for setting up an investment fund in Germany has to be described separately for registered managers and fully licensed managers of these alternative investment funds. For the licence process on the manager, see **3.1 Regulatory Regime**.

The typical core documents required for setting up an investment partnership in Germany are the limited partnership agreement of the fund (LPA) and a private placement memorandum (PPM) (which is, however, not legally mandatory in an institutional investors context).

The contractual fund is established by the fund manager on a contractual basis with the investor. The investment guidelines for contractual funds set out the details of the contractual relationship between the manager and the investors, in particular the applicable investment restrictions. The investment guidelines of retail funds require the approval of the Federal Financial Supervisory Authority (BaFin).

### 1.4 Regulation of Fund Structures

There is no strict legal requirement that a German investment fund has to be managed within Germany. The Alternative Investment Fund Managers (AIFM) Directive and the German Capital Investment Act (KAGB) do, however,

stipulate certain requirements for cross-border management of an Alternative Investment Fund (AIF) in Germany. In this firm's experience, German-based investment funds are commonly managed by a manager located within Germany. See **3.2 Territorial Reach of Regulators**.

### 1.5 Limited Liability

Investors admitted to investment funds in Germany do typically benefit from limited liability. As limited partners of a limited partnership, the most frequently used structure for alternative investment funds in Germany, their liability in relation to third parties for obligations of the fund is limited to their respective liability amount registered with the commercial register of the respective fund partnership which is typically a small portion (ie, 0.1%) of their capital commitment. Once this portion of their capital commitment has been contributed to the alternative investment fund, their liability in relation to third parties ceases to exist. In relation to the alternative investment fund itself, the liability is restricted to the unpaid portion of their respective capital commitment. For fund structures other than limited partnerships, a similar limitation of liability applies. Legal opinions are commonly issued to confirm this limitation of liability.

### 1.6 Common Tax Regimes

The most common tax regime for alternative investment funds in Germany is a tax transparent limited partnership. If the partnership qualifies for non-business treatment, the investors are taxed on their level, in accordance with their personal tax status in the jurisdiction of their tax residency (see **5 Tax Environment** for further details). The contractual fund is subject to the special tax regime of the German Investment Tax Act (see **5.1 Tax Framework**).

### 1.7 Investment Sponsors

Germany is particularly popular for investment sponsors from Germany and for investments in Germany or other German-speaking regions of Europe (ie, Austria, Switzerland and northern Italy). The reason for this is that many investments of the respective alternative investment funds require ongoing supervision and support and for this reason it is more convenient to place the fund management within Germany.

### 1.8 Disclosure Requirements

In respect of usual AIFs which are marketed to non-retail investors, there is no legal requirement to issue a PPM; however, the Article 23 AIFM Directive disclosures must be provided if the fund is marketed under the AIFM Directive. In any case, a PPM is commonly produced for generally all AIFs in order to ensure that the investors are completely, correctly and, in a non-misleading manner, informed about the respective AIF, its management, its investment, strategy, the risks associated with an investment and the expected tax consequences of the investment. This disclosure is recom-

mendable in order to avoid liability of the sponsor or managers under general prospectus liability rules.

An extensive disclosure document (prospectus) is required if an AIF is marketed to retail investors.

For UCITS, Germany follows the disclosures rules of the UCITS Directive, but requires an additional German-specific 'country addendum' for non-German UCITS.

### 1.9 Legal Forms

The typical legal forms of investment funds used in Germany are a limited partnership (which may take the form of a so-called investment limited partnership), an investment stock corporation and a contractual fund with no legal personality of their own. The most frequently used legal form for private funds is the limited partnership, whereas retail funds and UCITS funds are rather structured as contractual funds. The key difference is that a limited partnership is transparent for German tax purposes, whereas the rules of the German Investment Tax Act apply in respect of corporate fund structures and contractual funds.

### 1.10 Regulatory Status

Regulation of funds in Germany is primarily exercised through regulation of the respective manager within the framework of the KAGB. For funds managed by fully regulated managers, the KAGB may contain certain investment restrictions to be implemented into the fund documentation.

### 1.11 Legal, Regulatory or Tax Legislative Changes

Regarding the issue of VAT on management fees in Germany, as of 1 January 2018, a new provision under the German VAT Act became effective with the purpose of implementing the ECJ's jurisprudence (in particular, the *Fiscale Eenheid* case (No C-595/13 of December 2015) by selectively extending this scope of application of the relevant VAT exemption. According to the revised Section 4, Sub-section 8(h) of the German VAT Act, the management of UCITS and certain AIFs that are comparable to UCITS are exempt from German VAT. The German legislator has not explicitly stipulated which types of AIFs are comparable to UCITS. The German tax authorities have established the criteria that must be fulfilled in order to benefit from the VAT exemption. It is still unclear where the typical closed-ended venture capital, private equity and other alternative investment funds will benefit from the respective VAT exemption. There are, however, first indications from the German tax authorities that this VAT exemption will be applied to typical private equity funds.

The coalition agreement dated 7 February 2018, of the current German federal government stipulates that the existing flat income tax regime on interest income will be abolished. This relatively brief statement in the coalition agreement raises many questions that will have to be clarified. In the

case of an investment in an investment fund, it remains to be seen how the taxation of interest income with the personal tax rate will be ensured. This is unclear as an obligation of investment funds to publish their tax base no longer exists. Currently, all fund income of a private investor is taxed on the basis of the flat income tax regime. If the flat income tax regime on interest income would indeed be abolished, a split between interest income and other income would have to be made. In general, the tax environment is complex and also in Germany subject to constant change.

## 2. Fund Investment

### 2.1 Types of Investors

German investors typically investing in investment funds include retail investors as well as diverse types of institutional investors, high net worth individuals (HNWIs) and family offices. A significant portion of the institutional investors are professional pension funds (*berufsständische Versorgungswerke*) and insurance companies, but also tax-exempt or taxable corporate pension funds (*Pensionskassen*, *Pensionsfonds*) and banks.

### 2.2 Legal, Regulatory and Investment Structures

German investors' preferences for certain structures depend on a number of factors. Unregulated investors such as HNWIs and family offices usually do not have specific requirements regarding the structures, except characteristics targeting the tax neutrality of a fund investment. The legal structure for private funds in which most types of investors are usually prepared to invest is the limited partnership.

Certain tax-exempt investors, in particular pension funds (*Pensionskassen*) and open-ended investment funds for institutional investors with the tax status of a *Spezial-Investmentfonds* cannot invest in business-type partnerships and therefore, due to difficulties in ruling out that a partnership qualifies as a business-type partnership, rather invest in corporate-type funds, investment funds of the contractual type (*Sondervermögen*) or securitisation vehicles, each of which is usually accepted as a feeder vehicle into a master fund which is structured as a limited partnership.

### 2.3 Legal, Regulatory or Tax Themes/Issues

German pension funds which are subject to German domestic insurance regulation (Solvency I investors) usually prefer regulated investment funds managed by a regulated manager. Requirements regarding provenience and regulatory status of the fund depend on the classification of the fund. For private equity funds, fund vehicles and managers having their seats within an EU/EEA country or Organisation for Economic Co-operation and Development (OECD) member state and a manager regulation which is at least comparable to the regulation of a sub-threshold AIFM is sufficient. For all other types of funds, only EU/EEA vehicles

with full-scope AIFMs with an EU/EEA seat are required. For a fund to qualify as a private equity fund, it needs to be closed-ended and may only invest in equity and equity-like instruments (excluding senior debt financing).

German insurance companies (Solvency II investors) have certain transparency requirements due to the prudent person principle under Solvency II. Investors usually require look-through information on the basis of the tripartite reporting template.

Interests in closed-ended funds held by Solvency I investors or Solvency II investors (VAG investors) need to be transferable without the general partner's or manager's or any other investor's prior consent, as long as the interests are transferred to another institutional (or other creditworthy) investor. At the same time, the fund documents might need to contain specific language clarifying that an interest can only be transferred upon the prior written consent of a trustee appointed by the investor to safeguard the investor's assets, dedicated to cover a client's claims against the insurer.

## 2.4 Restrictions on Investors

There are no general restrictions for investors investing in investment funds. However, certain restrictions apply to specific types of investors. For example, Solvency I investors may not invest in investment funds which invest in working capital or consumer credits.

## 2.5 Marketing Restrictions

Except for the marketing by German sub-threshold managers, the marketing of investment funds requires an authorisation by BaFin or at least a European marketing passport under the AIFM Directive or, in the case of UCITS, under the UCITS Directive. In the case of AIFs marketed to retail investors, the marketing approval process is rather extensive.

## 3. Regulatory Environment

### 3.1 Regulatory Regime

#### Management of Investment Funds

BaFin is responsible for regulating funds and fund managers.

Management of investment funds is regulated in Germany by the KAGB. The KAGB implements the EU UCITS Directive (2009/65/EC) and the AIFM Directive.

The law requires that the manager is either fully licensed or registered with BaFin under the KAGB. If a fund is internally managed, then the fund itself needs a licence or registration.

#### *Registered managers ('sub-threshold managers')*

The registration regime is only available to certain small or medium-sized managers. The most important category of

these small to medium-sized managers is known as 'sub-threshold managers' under the AIFM Directive/KAGB.

Sub-threshold managers under the KAGB are managers with assets under management of not more than EUR100 million (in the case of leverage) or not more than EUR500 million (no leverage) and who only manage special alternative investment funds (Special AIFs). Special AIFs are AIFs whose interests or shares may only be acquired according to the fund documents by professional investors within the meaning of the AIFM Directive or by semi-professional investors.

The registration procedure for a sub-threshold manager is comparatively simple and takes about one month. It requires the submission of an informal registration request together with certain 'corporate' documents on the manager and the managed funds (such as the fund's LPA and the manager's articles of association).

An advantage of the registration is that only a light-touch regulatory regime applies to a 'registered-only' manager, in particular a registration requirement as well as some ongoing reporting requirements. Fund-specific requirements do not apply to 'registered-only' managers and their funds. In particular, the depositary requirements and marketing requirements of the KAGB for fully licensed managers do not apply.

On the downside, the registration restricts the manager to the type of funds and investors for which the registration was obtained (ie, only special AIFs and professional or semi-professional investors). Furthermore, a registered manager does not benefit from the European marketing passport under the AIFM Directive; however, a registered manager might opt for the EuVECA-regime in order to benefit from the EuVECA marketing passport.

#### *Fully licensed manager*

A full fund management licence opens the door for a manager to market funds to retail investors as well as to the marketing passport under the AIFM Directive or UCITS Directive. Retail investors are investors who are neither professional nor semi-professional investors.

The licensing procedure is a fully fledged authorisation process. The requirements are equivalent to the requirements for granting permission under Article 8 of the AIFM Directive or Article 6 of the UCITS Directive. Timing of the licensing procedure varies between six to twelve months. The licensing procedure checks numerous requirements, such as sufficient initial capital or own funds, sufficiently good repute of the directors and shareholders, and organisational structure of the manager.

The licensing of the manager results in the manager being subject to the entirety of the KAGB. This means, in particular, compliance with implemented manager-related requirements of the AIFM Directive or, as applicable, of the UCITS Directive.

The main difficulties in practice typically arise in the context of getting the internal organisational rules properly documented and implemented. Also, getting the business plan and the financials right often poses quite a challenge to clients.

### Advising Investment Funds

Advising investment funds or their managers on the fund's investments is MiFID investment advice if the advice is a personal recommendation to buy or sell investments. The responsible regulator is BaFin.

The main requirements for a simple MiFID licence for investment advice are the following:

- initial capital of EUR50,000;
- sufficient good repute, sufficient knowledge, skills and experience as well as availability of the managing director;
- sufficient suitability of shareholders holding 10% or more in the firm;
- a head office in Germany; and
- a sufficient business plan providing information on the intended organisational structure, compliance measures and projected business development.

The main difficulties in practice typically arise in the context of the shareholder control procedure. Also, getting the business plan and the financials right often poses quite a challenge to clients.

Timing of the licensing procedure varies between six and twelve months.

### 3.2 Territorial Reach of Regulators

EU fund managers regulated under the AIFM Directive or the UCITS Directive can provide fund management services under the passport regimes of the AIFM Directive or the UCITS Directive.

Non-EU fund managers can currently not manage funds in Germany, neither cross-border nor via a German branch. However, a non-EU fund manager may assume from a German fund manager the discretionary portfolio management of a German-based fund as a delegation. The discretionary portfolio management would be a MiFID activity, whereby Germany does not regulate the activity under MiFID if the non-EU fund manager provides the portfolio management on a reverse solicitation basis.

### 3.3 Regulatory Approval

Except for the marketing by German sub-threshold managers, the marketing of investment funds requires an approval or a comparable process by BaFin or a marketing passport under the AIFM Directive or UCITS Directive.

### 3.4 Authorisation of Marketing Activities

Germany understands marketing activities as any direct or indirect offering or placement of units or shares in an investment fund. Reverse solicitation is not marketing.

Marketing must relate to units or shares in an investment fund. BaFin concludes from this that marketing in particular takes place with regard to a fund if the fund has been established (ie, first closing with investors), or terms of the fund are ready to be sent for acceptance to investors.

Consequently, there is no marketing if the fund has not yet had a closing with investors and only incomplete fund terms are distributed. This means that in practice marketing might start rather early in the investor relationship process.

However, in this firm's view, marketing can only occur if the investor has a legal basis for a subscription or for making an offer to subscribe. In the absence of this legal basis, there can neither be an 'offering' nor a 'placement'. An activity should therefore still be pre-marketing if (i) the investor has no access to the final documents (PPM, LPA and subscription documents) and (ii) it is made clear that the fund manager is not currently seeking subscriptions and that offers to subscribe will only be possible after BaFin marketing approval on the basis of the final documents (eg, in a disclaimer in the documents).

### 3.5 Investor-Protection Rules

As explained in 3.1 Regulatory Regime, Germany is aware of the concept of Special AIFs. These are AIFs whose interests or shares may only be acquired according to the fund documents by professional investors within the meaning of the AIFM Directive or by semi-professional investors. Special AIFs themselves are either subject to a lighter regulatory regime than retail funds (in the case of fully licensed managers) or they are not subject to a regulatory regime at all (in the case of a German sub-threshold manager).

### 3.6 Approach of the Regulator

The German regulator BaFin is, in this firm's experience, generally co-operative and open to discussions. Expected timeframes can sometimes be an issue, in particular if BaFin is requested to answer questions on new issues. BaFin regularly takes enforcement actions. BaFin enforcement is usually a proportionate step-by-step approach. Often, BaFin just issues a request for explanations as a warning and only takes further action if the answers are not satisfactory.

## 4. Fund Finance

### 4.1 Access to Fund Finance

Funds that are eligible for non-business treatment (see also **5.1 Tax Framework**) are generally not permitted to raise debt on a fund level or to provide guarantees or other forms of collateral for indebtedness of portfolio companies. As an exception, tax authorities have accepted that funds can enter into a capital call facility and the number of funds making use of this concession as well as the number of financial institutions offering capital call facilities to German funds increase. Leverage is not permitted for tax reasons and is restricted for regulatory reasons.

### 4.2 Borrowing Restrictions/Requirements

The criteria for non-business treatment includes a general prohibition of borrowings. As an exception, short-term borrowings to bridge capital calls are accepted by tax authorities. While short-term has not been defined, the maximum number of days for which borrowings can remain outstanding shall not exceed 270 calendar days. Fund managers first need to issue the capital call and can thereafter draw down the amount under the capital call facility. The amount borrowed is then repaid out of the capital contributions.

### 4.3 Securing Finance

Under German law, the investors' commitment to the capital of a fund is not an asset that can be pledged in favour of the capital call facility provider. As a consequence, capital call facility agreements entered into by German funds normally provide that payments of capital contributions shall be made to a bank account maintained with the facility provider which is pledged in its favour. In addition, the facility provider reserves the right to claim directly from investors payment of capital contributions when due and to enforce the fund's rights under the fund agreement in the event of default. Assets and investments held by the fund are normally not pledged as collateral.

### 4.4 Common Issues in Relation to Fund Finance

Common issues include the following: (i) financial covenants regarding excused investors in respect of an investment by reference to the number of excused investors and the total amount, and (ii) default situations pending at the time of a drawdown under the facility agreement by reference to the number of defaulting investors and the total amount.

Investors typically object to the requirement to provide financial information, unless publicly accessible. Because of the general prohibition to provide guarantees and other forms of collateral for indebtedness of portfolio companies, equity commitment letters are very often used as an alternative. They should fall outside the scope of application of the general prohibition if structured as an agreement between the fund and its portfolio company, where the fund undertakes to provide additional capital in the event the portfolio

company is in payment default or in breach of financial covenants. This undertaking, however, should not be pledged by the portfolio company in favour of its creditors in order to avoid a disguised guarantee of the fund. The portfolio company can undertake in the agreement with its creditors not to change, amend or waive the fund's equity commitment letter unless with the consent of its creditors.

## 5. Tax Environment

### 5.1 Tax Framework

The tax framework applicable to fund structures depends on whether a fund is organised as a corporate entity or a partnership.

Taxation of corporate-type funds (including contractual funds) and their investors is governed by the German Investment Tax Act. A corporate-type fund is a taxpayer as and of itself. Regardless of whether its centre of management is located in Germany or outside of Germany, its tax bases only include certain German source income, ie, capital investment income if subject to German withholding tax, income derived from German real estate and business income effectively connected with a German permanent establishment, but exclude income derived from capital investments. Distributions by corporate-type German funds to non-resident investors are not taxable in Germany and, subject to the fulfilment of certain procedural requirements, not subject to German withholding tax.

The tax framework applicable to funds organised as partnerships is the following.

#### Fund Structures

Consistent with international standards, German funds are normally structured as partnerships that are eligible for non-business treatment and avoid that their investment activities constitute a trade or business that is effectively connected with a permanent establishment. The non-business requirements for private equity and venture capital funds are set out in an administrative pronouncement and include the following.

- No borrowings and guarantees on fund level (see **4 Fund Finance**).
- No reinvestment of proceeds subject to the following two exceptions: (i) proceeds up to an amount previously drawn down to fund management fees and fund expenses can be reinvested to achieve that an amount representing 100% of the total capital commitments can be invested; and (ii) an additional amount not exceeding 20% of the total capital commitments can be reinvested to fund follow-on investments.
- Weighted average holding period of investments of at least 36 months.

- No involvement in the operating management of portfolio companies; representation on the supervisory or advisory board of portfolio companies in a non-executive, monitoring capacity is permitted.

While the administrative pronouncement has been recently questioned by the courts, it is still applied by the fiscal authorities.

Management of private equity and venture capital funds by German managers is subject to VAT in Germany which cannot be recovered.

### **Allocations and Distributions to Investors**

In the case of funds structured as a partnership, taxation follows allocations and not distributions. Non-resident investors of funds that are eligible for a non-business treatment are not exposed to a German tax filing obligation in respect of their allocable share of the fund's taxable profit. The fund files a partnership return setting out separately and uniformly the investors' allocable share of the fund's taxable profits. Non-German investors are included in the partnership return only for information purposes. They are subject to tax in their country of residence in accordance with their personal tax status.

Distributions by the fund to investors are not subject to German withholding tax. Dividends received by the fund from German portfolio companies, as well as payments by portfolio companies on certain hybrid instruments (including silent partnership interests, *jouissance* rights, profit sharing loans), are subject to withholding tax at the rate of 26.375% (including solidarity surcharge) at source on the level of the portfolio company. Generally, portfolio companies are not permitted to apply a reduced rate in respect of the allocable share of investors that are eligible for a reduced rate; for example, under an applicable tax treaty. These investors have to file a refund application with the German federal tax office which is awarded subject to the fulfillment of certain procedural requirements.

### **Carried Interest Participants**

The German fiscal authorities recharacterise carried interest payments as a compensation for professional services and carried interest payments are not taxed in accordance with the rules applicable to the source from which these payments are derived. Carried interest payments by private equity funds and venture capital funds that are eligible for non-business treatment are eligible for a partial tax exemption of 40% and the remaining 60% is subject to tax at the marginal income tax rate of the carried interest participant. Carried interest payments are not subject to VAT.

### **5.2 Tax Treaty Network**

Germany's tax treaty network is extensive and covers, among others, all member states of the EU and the OECD. German

tax treaties generally follow the OECD Model Convention. German corporate-type funds should be eligible for protection by German tax treaties, regardless of the fact that its tax bases only include certain items of German source income. Because distributions by German corporate-type funds to non-resident investors are not taxable in Germany under German domestic tax law, corporate-type funds are not impacted by Germany's tax treaty network regarding their investors.

Funds organised as partnerships are transparent for income tax purposes. German investors benefit from Germany's tax treaty network because the geographic focus of funds typically relates to tax treaty countries. Funds investing in Germany benefit from Germany's tax treaty network because their fund-raising very often relates to tax treaty countries.

### **5.3 FATCA and CRS Regimes**

Germany has entered into an intergovernmental agreement with the USA and has incorporated the reporting and disclosure requirements under FATCA into German domestic law and German fund managers have to submit the FATCA reporting and disclosure to the German federal tax office, which forwards this information to the USA. As a consequence, German fund managers do not have an obligation towards the USA regarding FATCA reporting and disclosure.

Germany also incorporated the CRS into German domestic law and German fund managers have an obligation under German domestic law to submit to the German federal tax office the information under the CRS.

### **5.4 Tax Structuring Preferences of Investors**

The following description is limited to funds organised as a partnership.

#### **Domestic Funds Eligible for Non-Business Treatment**

Taxation follows allocations and each investor's allocable share of the fund's taxable profits will be determined separately and uniformly by the fund's tax authority. Income tax is then levied on the investor level in accordance with its tax status. A distribution by the fund is a non-taxable event.

#### ***Resident corporate investors***

95% of a resident corporate investor's allocable share of equity capital gains is exempt from tax and the remaining 5%, as well as all other items of income (interest, dividends), is subject to German corporate income tax and trade tax.

#### ***Resident individual investors***

A resident individual investor's allocable share of interest, dividends and equity capital gains of shareholdings representing an indirect interest of less than 1% are subject to income tax at the flat rate of 25% (plus solidarity surcharge). Equity capital gains of shareholdings representing an indi-

rect interest of 1% or more are subject to income tax levied at the marginal tax rate, but 40% is exempt from income tax.

### ***Non-resident corporate investors***

A non-resident corporate investor's allocable share of German equity capital gains is effectively exempt from German tax. German dividends received from portfolio companies and payments on certain German hybrid debt instruments bringing along a profit share are subject to withholding tax at the domestic rate. Tax treaty-protected investors may claim a refund under the relevant tax treaty upon application with the German federal tax office. Income derived from non-German portfolio companies is not taxable in Germany.

### **Non-German Funds**

Regardless of the qualification of its investment activities, non-German funds are normally deemed to be in business from a German tax perspective due to their legal structure.

### ***Non-resident corporate investors***

The deemed business status of a non-German fund does not affect their taxation in Germany. Their allocable share of German equity capital gains is effectively exempt from German tax. They are only subject to tax in Germany in respect of income derived from German sources that are subject to German withholding tax; ie, German dividends and payments on certain German hybrid debt instruments bringing along a profit share. Tax treaty-protected investors may claim a refund under the relevant tax treaty upon application with the German federal tax office.

### ***Resident corporate investors***

Their allocable share of a non-German fund's total taxable profits is subject to German tax. 95% of equity capital gains is exempt from corporate income tax and 100% is exempt from trade tax. The full amount of interest and dividends is subject to corporate income tax, but trade tax is levied only on interest and not on dividends.

### ***Resident individual investors***

Due to the deemed business status of a normal non-German fund, their allocable share of the non-German fund's total taxable profits is subject to German tax as follows. 60% of equity capital gains and dividends and the full amount of

interest is subject to German income tax at the individual investor's marginal tax rate.

The above description of the tax impact on allocations confirms also from a German perspective a structuring preference of investors for equity capital gains. However, German tax law does not allow allocations of specific income items to separate investors.

## **6. Miscellaneous**

### **6.1 Asset Management Industry Bodies**

Key asset management industry bodies in Germany are the BVI (Bundesverband Investment und Asset Management eV), the BVK (Bundesverband Deutscher Kapitalbeteiligungsgesellschaften, or the German Private Equity and Venture Capital Association eV) and the BAI (Bundesverband Alternative Investments eV).

The BAI has a focus on the alternative investment segment of fund management, whereas the BVI has the goal to represent the fund industry as a whole. BVK has a focus on the private equity and venture capital segment of the market.

### **6.2 Preference for Courts or Arbitration**

Arbitration clauses occasionally exist in fund documents. More typically, however, are clauses that assign disputes to the courts.

### **6.3 Level of Litigation/Arbitration**

Litigation or arbitration activities do practically not exist in the area of institutional investors. With regard to retail or other non-institutional investors, court disputes are common and are often based on misrepresentations or omissions of material facts in marketing materials.

### **6.4 Periodic Reporting Requirements**

An annual fund report is always necessary. Semi-annual reports are required in the retail area for contractual funds and investment stock corporations with variable capital. The reports need to be published.

### **6.5 Powers of Attorney**

Investors typically give a power of attorney to fund managers for commercial register purposes, as well as for default measures. Limitations are of general nature; ie, the duty of the manager to act in good faith.