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KMLZ VAT NEWSLETTER

VAT exemption for the management of investment funds

1. Legal position until 31.12.2017

According to the previous version of sec 4 no 8 lit. h of the German VAT Act, the management of investment funds, within the meaning of the Investment Tax Act (InvStG), was VAT exempt. Therefore, the management of investment funds in terms of the UCITS Directive and investment funds fulfilling the strict investment limits of sec. 1 para 1b InvStG (old version) was covered by the VAT exemption. Based on European law, the management of funds, with comparable characteristics to those governed by the UCITS Directive, had to be VAT exempt. The ECJ defined different characteristics as regards this comparability. Accordingly, the scope of the VAT exemption for the management of other AIFs (Alternative Investment Funds) than those covered within the meaning of the InvStG (old version) was unclear. The management of closed-end funds was, at least in the opinion of the German tax authorities, not VAT exempt.

2. Change to the legal position as from 01.01.2018

The management of undertakings for the collective investment in transferable securities (UCITS), which comply with the UCITS Directive, remain VAT exempt. Further, since

Broadening of the VAT exemption

As from 01.01.2018, the new version of sec 4 no 8 lit. h of the German VAT Act applies to the VAT exemption for the management of investment funds. According to this new legal position, the scope of the VAT exemption is broader than it has previously been. In particular, the management of AIFs could be subject to changes. The precise limits are, however, currently unclear. Investment fund managers should keep an eye on the implications of the broader VAT exemption on their input VAT deduction.

01.01.2018 the management of comparable AIFs, in terms of sec 1 para 3 of the Investment Code (KAGB), is VAT exempt. In its letter of 13.12.2017, the Federal Ministry of Finance points out the following seven cumulative criteria. If they are fulfilled, an AIF is comparable to a UCITS:

- 1) The AIF is subject to a comparable special State supervision (e.g. regulation in accordance with the Investment Code or the AIFM Directive),
- 2) the AIF addresses the same group of investors (small investors),
- 3) the AIF is subject to the same conditions of competition (comparable obligations and controls),
- 4) the AIF has issued shares to various investors,
- 5) the profit from the shares is dependent on the result of the investment,
- 6) the shareholders participate in the profit and risk as regards the management of the assets
and
- 7) the investment of the assets takes place in accordance with the principle of risk spreading.



Contact: Dr. Michael Rust
Lawyer
Phone: +49 89 217501274
michael.rust@kmlz.de

Now, the management of closed-end investment funds can be expressly VAT exempt, where the investment fund meets the above mentioned requirements. The precise limits are, however, unclear. Open-end domestic special AIFs with fixed investment rules, within the meaning of sec. 284, para. 1 Investment Code, are not obliged to fulfil criteria 2 – 4 mentioned above.

There are no major amendments as regards the opinion of the tax authorities on the characteristic “manage”. Further, the German VAT Circular provides for a catalogue of administrative work. Where this work is taken over by an outside third party, this service supply must, viewed broadly, form a distinct whole. Further, the supply must have the specific and essential character of a management service for investment funds. This additional condition is basically not required where an investment management company, or similar, is the manager of an investment fund allocated to it in accordance with the Investment Code.

3. Impact on practice

The criteria set out by the Federal Ministry of Finance on the comparability of AIFs with UCITS reflect ECJ case law. They are therefore not totally new. Due to the currently applicable reference to the InvStG, they previously only applied to a limited extent in Germany. It is therefore recommended that investment fund managers check if they have rendered their services exempt from VAT since 01.01.2018. Then, they must cease issuing invoices showing VAT. If they continue invoicing VAT, they will be held liable for the payment of the VAT amount stated. The difficult part of the examination is that the criteria issued by the Ministry of Finance leave room for interpretation and (to date) there is no case law in this

respect. E.g. it remains open to question to what extent the management of funds, where small investors are excluded from participating (“special AIF”), can be VAT exempt.

A manager himself is not entitled to deduct input VAT from his purchases if he renders VAT exempt supplies of administrative services. The same usually also applies if he renders his services to a fund, which is based abroad. The place of supply of the administrative service is abroad. The recipient is liable for the payment of the VAT if the administrative service is not VAT exempt on the basis of the legal situation in that country. A manager based in Germany would, nevertheless, not be entitled to deduct input VAT if the supply was VAT exempt in Germany.

The Federal Ministry of Finance's letter provides for a transitional system. Managers can already apply the principles set out in the letter to supplies carried out prior to 01.01.2018. This is particularly useful where the fiscal authorities deny a VAT exemption, which has been previously claimed. In cases where the recipient of the hitherto taxable supply of administrative services (such as a closed-end fund) has not deducted input VAT, the retroactive application of the Federal Ministry of Finance's letter can also be beneficial (if the requirements for VAT exemption are now met). The manager can correct the invoices and repay the VAT to the fund. In this case, the tax office will, in accordance with the wording of the letter of the Federal Ministry of Finance, refund the VAT to him. It is recommended that the manager make a prior agreement with the fund as to how the overall financial advantage is to be split between them. The fund manager should bear in mind that its input VAT deduction must be reduced due to his now VAT exempt supply.