KMLZ

VAT'S UP

VAT NEWSLETTER

Future Financing Act: VAT exempt management of all Alternative Investment Funds

46 I 2023

1 Background

Sec. 4 no. 8 lit. h German VAT Act exempts the management of certain investment funds from VAT. Until 30 June 2021, the regulation extended to Undertakings for Collective Investments in Transferable Securities (UCITS, sec. 1 para. 2 German Investment Code) and Alternative Investment Funds (AIF, sec. 1 para. 3 German Investment Code) comparable to UCITS. As regards the comparability, the ECJ has defined various characteristics and essentially requires AIF to be in competition with UCITS. Therefore, closed-end special AIF were, in particular, previously not exempt from VAT. As of 1 July 2021, the legislator added certain venture capital funds (*Wagniskapitalfonds*) to the list of eligible investment funds. As a result, certain AIF investing in growth companies (in particular EuVECA funds) could fall under the VAT exemption without fulfilling all of the requirements for comparability with UCITS. At the time, the legislator decided against extending the VAT exemption to all investment funds, as the Federal Ministry of Finance raised concerns regarding its conformity with Union law. Thus, the German VAT exemption has to date lagged behind countries like Luxembourg, France and the UK.

2 Legal situation as of 1 January 2024

With the Future Financing Act (*Zukunftsfinanzierungsgesetz*), the legislator extends the VAT exemption to all investment funds within the meaning of the German Investment Code. This is being done in order to align with the legal situation in other EU member states. In addition to UCITS, all AIF will fall under the VAT exemption from 1 January 2024. Comparability with UCITS is no longer necessary. Qualification as a venture capital fund will also no longer be relevant, which is why these will be removed from the list of eligible funds. The VAT exemption will now apply to the management of all AIF, including private equity, venture capital, real estate, infrastructure and crypto funds. Only the management of investments that do not

Laura Klein
Certified Tax Consultant
Master of Science (M.Sc.)

+49 (0) 89 21759 1296
laura.klein@kmlz.de

qualify as AIF (in particular investment clubs and single investor funds) will continue to be subject to VAT. With regard to any concerns under EU law, the government has asked the Federal Ministry of Finance to discuss these with the EU Commission and to work towards a standardised approach within the EU.

As before, the VAT exemption is limited to the "management" of the fund. The principles defined by case law and the tax authorities – as well as the existing difficulties resulting from them - remain unchanged. For various administrative services, the question often arises as to whether these constitute a VAT exempt management service or at least fall under the VAT exemption as an ancillary service to the management services provided. In practice, the concept of fund management is also often discussed in cases in which only individual management tasks are performed. In principle, the VAT exemption can also apply if fund managers outsource individual administrative tasks to a third party. However, viewed broadly, the outsourced tasks must form a distinct whole and be specific to, and essential for, the management of the investment funds. This must always be examined on a case-by-case basis.

3 Relevant consequences of the VAT exemption

The revised sec. 4 no. 8 lit. h of the German VAT Act will be effective as of 1 January 2024. The VAT exemption is mandatory for all fund management services provided after 31 December 2023. No transitional regulation is provided for funds already in operation. Nor can the VAT exemption be waived in accordance with sec. 9 of the German VAT Act. Fund managers must therefore promptly review the extent to which their activities are to be regarded as fund "management" in accordance with the existing principles. They must then invoice their management services – and the remuneration charged for them, such as the management fee – without VAT and refer to the VAT exemption in the invoice. If fund managers show VAT for VAT exempt services in their invoice, they will generally be held liable to pay this VAT according to sec. 14c of the German VAT Act. The recipient, however, is not entitled to deduct input VAT from such invoices.

Insofar as fund managers do, in future, render VAT exempt supplies by managing the funds, they will no longer be entitled to deduct input VAT. On the one hand, this concerns services directly attributable to the fund management, such as consultancy services. If fund managers outsource (individual) management tasks, not only the supplier but also the outsourcing fund manager should check on the VAT treatment of these tasks: Will they continue to be subject to VAT – and thus lead to a final VAT burden – or will they also be VAT exempt in future and, if so, are they invoiced accordingly? On the other hand, the VAT exempt management services will affect the input VAT deduction from general costs. In this respect too, input VAT deduction will often be completely excluded in the absence of further supplies which are subject to VAT. For input VAT deducted in the past, it is also necessary to determine to what extent the changed qualification of the management services triggers a (pro rata) input VAT adjustment according to sec. 15a of the German VAT Act.

If fund managers have rented premises, they should immediately check their lease agreements for information obligations, compensation obligations or rent increases. This could apply in cases in which the landlord has waived the VAT exemption for the lease, and the fund manager, as tenant, has undertaken to use the premises only for supplies which entitle to input VAT deduction. Due to the now VAT exempt services provided by the fund manager, the landlord loses his right to waive the VAT exemption for the lease and thus his right to deduct input VAT. Depending on the agreement, the fund manager may be obliged to compensate the landlord for his input VAT loss or a rent increase may apply to compensate for the loss. This is a question of the lease agreement provisions in the individual case.

KMLZ Rechtsanwaltsgesellschaft mbH | www.kmlz.de | office@kmlz.de
D-80331 München | Unterer Anger 3 | Tel.: +49 89 217501220 | Fax: +49 89 217501299
D-40221 Düsseldorf | Speditionstraße 21 | Tel.: +49 211 54095320 | Fax: +49 211 54095399