Investment Tax Reform 2018: Questions and Answers

Why was the investment tax law changed?

With the new law, the legislator achieves the tax equality of domestic and foreign investment funds required by European law: another objective is to simplify the taxation of mutual funds at investor level.

- **When does the new investment tax law apply?**

The provisions set out in the amended Investmentsteuergesetz (InvStG – German Investment Tax Act) are applicable as of 1 January 2018. Taxation of investment units in the period up to 31 December 2017 is subject to the law in force prior to the amendment.

- **What changes will occur at the end of 2017?**

All investment funds with a financial year that is not the calendar year must recognise a short tax year as of 31 December 2017, the date on which the **tax system changed**. This construct ensures that all funds can transition to the new law in a uniform manner. The fund units are then notionally redeemed and repurchased, and the notional net disposal gain is calculated as of 31 December 2017. The tax payable on any notional disposal gain is then deferred without interest by the tax authorities until the units are actually sold/redeemed by the investor or, in the present case, until the fund is liquidated. In the same way, any notional loss on disposal is included in the calculation of the disposal gains when the units are actually sold/when the fund is actually liquidated.

As from 1 January 2018, the key tax figures for mutual funds (such as the gains from real estate and shares, and the interim profits) no longer have to be published every day. Special funds continue to calculate their gains from shares, the gains subject to a double taxation agreement and, where applicable in the case of investments in target funds, the gain subject to partial exemption on each valuation date.

- **What are the main changes to the Investment Tax Reform 2018?**

  - At **Fund level**, corporation tax of 15% is levied on domestic income from properties, domestic capital gains on the disposal of properties and domestic dividends (plus the solidarity surcharge in the case of income from properties)
  - At **investor level**, partial exemptions in varying amounts apply, depending on the type of fund involved
  - Special funds continue to be taxed transparently. A transparency option is also available in the case of income that will be taxed in future at fund level
  - Introduction of a minimum taxation mechanism in the form of a Vorabpauschale (advance lump sum)
  - Special rules apply to funds in liquidation for a period of five years
  - Grandfathering cap for existing shareholders – but a new tax-free allowance of EUR 100,000 per person
  - Abolition of requirement to publish key tax figures such as interim profits, gains from real estate, etc. in the case of mutual funds

- **How will taxation at fund level change for mutual funds?**

A non-transparent tax regime is being introduced for **mutual investment funds**. With effect from 1 January 2018, these will be subject to **corporation tax** on the following domestic income:

1. Domestic income from equity investments (including dividends, section 6(3) of the InvStG, as amended)

2. Domestic current rental income and capital gains on the disposal of real estate, regardless of the holding period – in particular the ten-year period for private disposals in accordance with section 23(1) sentence 1 no. 1 of the Einkommensteuergesetz (EStG – German Income Tax Act) does not apply – (section 6(4) of the InvStG, as amended)
3. Other domestic income within the meaning of section 49(1) of the EStG

Other income such as domestic and foreign interest income, foreign dividends or foreign income from properties will continue in future not to be taxed at fund level, but at the investor level.

In the case of **domestic income from equity investments**, investment income tax of 15% (including the solidarity surcharge) will generally be retained by the distributing company. This retention definitively settles the tax liability for this income.

As a matter of principle, all of the above-mentioned types of **domestic income** are taxable at fund level, and the mutual investment fund must be assessed for these (i.e. a corporation tax return must be submitted).

The treatment of foreign rental income will not change, as it is still generally taxed in the country in which the property is located.

- **What does the partial exemption mean for real estate funds?**

To offset taxation at fund level, the following partial exemption rates are applied to dividends at the investor level, provided that this has been agreed in the Fund Rules:

	If the Fund invests is at least 51% invested in properties or real estate companies	
	Focus on Germany	Focus abroad
Partial exemption rates	60 %	80 %

- **Do the partial exemptions also apply to funds in liquidation?**

No. Although the Funds were designed as real estate funds, the Fund Rules do not explicitly require it to be more than 51% invested in properties and real estate companies.

- **How are distributions from funds in liquidation treated for tax purposes?**

Section 17 of the InvStG 2018 addresses the situation of funds in liquidation by introducing a special provision that effectively exempts return of capital distributions from taxation for a period of approximately five years as from the point in time at which the funds are transferred to the Custodian Bank.

The special provision set out in section 17 of the InvStG 2018 applies until:

SEB ImmoInvest	31.12.2022
SEB ImmoPortfolio Target Return Fund	31.12.2022
SEB Global Property Fund	31.12. 2021

The regulation of Section 17 I InvStG 2018 does not apply to the SEB Konzept Stiftungsfonds, as the management mandate has not been transferred to the custodian bank and is therefore not in liquidation from a tax perspective.

- **Is business tax payable at fund level?**

From 2018, the investment fund will in principle be subject to business tax on domestic income, for which an exemption from business tax is possible if active entrepreneurial management remains within certain limits.

- **How will distributions of funds in liquidation be treated for tax purposes in the next approx. 5 years?**

Since the partial exemptions do not apply, 25% investment income tax plus the solidarity surcharge is initially retained by the custodian institution when the distribution is made. In a second step, the amount retained must be reimbursed after the end of the year in question to the extent that the distributions relate to capital repayments. The paying agent (generally the unitholder's custodian institution) is responsible for making the repayment.

Distributions are only classified as income to the extent that they include the increase in value for a calendar year. The increase in value is calculated by aggregating the distributions for a calendar year and adding them to the last redemption price determined in the calendar year. If the resulting total exceeds the first redemption price determined in the calendar year, the difference represents the increase in value.

- **Will there continue to be exemptions from tax deductions from 2018?**

With effect from 2018, sections 8(1) and 8(2) of the InvStG 2018 theoretically provide a mechanism for tax-favoured investors (e.g. charitable foundations, religious institutions or professional pension schemes) to be refunded the corporation tax paid on fund receipts in the case of domestic income from properties (for tax-favoured investors in accordance with section 8(2) of the InvStG 2018) and domestic dividends (for tax-favoured investors in accordance with section 8(1) of the InvStG 2018) on application at the level of the investment company.

Since all (SEB ImmoPortfolio Target Return Fund, SEB Global Property Fund and SEB Konzept Stiftungsfonds) or nearly all (SEB ImmoInvest) of the properties have been sold and the Funds are therefore expected to only receive extremely small amounts of domestic income from 2018 onwards, they cannot make use of this application procedure.

- **How will the interim dividends in the second half of 2017 be treated for tax purposes?**

The interim distributions for the funds SEB ImmoInvest, SEB Global Property Fund, SEB ImmoPortfolio Target Return Fund and SEB Konzept Stiftungsfonds are subject to the law in force prior to the amendment. The distributions all included a high tax-free portion.

Note: Please contact your tax advisor for tax issues at investor level.