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Flash News

Modification of the flat rate tax ("Abgeltungsteuer")

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As announced on 12 September 2007, the financial committee of the German Federal Council has recommended in its meeting on 6 September 2007 a revision of the provisions concerning the flat rate tax ("Abgeltungsteuer") that were voted on in July 2007. This affects – like flat rate tax itself – only private investors. The main objective of the proposed modification is limiting the exemptions from the flat rate tax applicable to specific investment funds and is especially aimed at Luxembourg Specialized Investment Funds.

The German Federal Council, does not intend to question the present exemption from the flat rate tax for assets acquired prior to 1 January 2009 in general, i.e. for publicly distributed investment funds. The financial committee states: "For wealthy private investors, the possibilities to launch an own investment fund have been, especially in Luxembourg, substantially improved. Therefore, there is the risk that the taxation of capital gains will, following the flat rate tax introduction, be permanently avoided by such structuring." The reasons explicitly refer to Luxembourg Specialized Investment Funds: "Luxembourg changed its investment regulations by the law of 13 February 2007 in such a way that individuals can already with investments of 1.25 million Euro or more be the sole investor of a Specialized Investment Fund. Such investment funds are in default of a public distribution in Germany and not subject to the strict German regulatory supervisions as under the Investment Act."

Following these arguments, the financial committee proposed a regulation limited to investment funds with up to 30 investors according to which accumulated capital gains are deemed to be distributed upon the redemption of fund units and thus are – in contrast to a public accumulating fund - subject to the flat rate tax. For reasons of protection of confidence / grandfathering, such a provision should apply only to fund units that have been acquired after a specific date that has not yet been defined.

Background

The provisions related to the flat rate tax will most likely result in an additional tax burden for a material number of investors. Indeed, capital income will be subject to a lower flat rate tax of 28.735 % (including solidarity charge and church tax) if compared with the individual tax rate; however, the tax base will be substantially broadened: Irrespective from any holding period, all capital gains, e.g. from the sale of shares or derivatives, will be subject to the flat rate tax. The present tax exemption for capital gains after a one year holding period will be abolished.

Under the current provisions of the flat rate tax, capital assets acquired before 1 January 2009 will not be in scope of the flat rate tax for an indefinite period. Capital gains thus remain tax exempt even if the sale takes place after 31 December 2008.

This regulation applies accordingly to investment fund units. In case of an accumulating fund, it is not relevant at which date the fund acquired its assets. It is only important that the investor has purchased the fund units before 1 January 2009 to obtain grandfathering and relief of the flat rate tax. Distributed capital gains are, however, subject to the flat rate tax as far as the fund has purchased the assets after 31 December 2008.

Example:

Direct investment:
Shares that were acquired on 27 June 2008 are sold on 5 July 2009 with a capital gain of 100 Euro. A second equity position purchased on 2 January 2009 is sold on 5 July 2010, realizing a capital gain of 150 Euro. The capital gain deriving from the first transaction remains tax exempt, the capital gain realized in the second transaction is subject to the flat rate tax.

Investment via an investment fund/:
On 26 July 2008, a private investor acquires units of a investment fund that makes the above-mentioned transactions. If the investment fund accumulates the capital gains deriving from those transactions, the capital gain realized by the investor at redemption of the fund units would remain tax exempt (250 Euro). In case of a distribution, however, only the capital gain resulting from the first transaction (100 Euro) would be tax free, the capital gain deriving from the second transaction (150 Euro) would be subject to the flat rate tax.

Consequently, a fund investment will be preferred to a direct investment in certain cases. This applies to domestic as well as foreign funds, equally. The German Federal Council has now focused on this possibility of tax planning.

Currently it cannot be assessed if and in which form the proposed revision will be implemented. However, it can be expected that the German Federal Ministry of Finance will welcome the recommendation. The recommendation of the financial committee of the German Federal Council has been made in the context of the hearings of the Tax Amendment Act 2008. This will be discussed in the Lower House of German Parliament on 20 September 2007; the passing of the law by the German Federal Council is currently planned for the 30 November 2007. Therefore, a respective draft bill is to be expected soon.

More details on recent developments will be presented during an event dedicated to the flat rate tax hosted by PricewaterhouseCoopers on 24 September 2007.

Before structuring new investment vehicles, a detailed analysis of the current legal development is strongly recommended

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