Comprehensive VAT exemption for management of alternative investment funds (AIFs) planned in Germany

THE DRAFT BILL OF THE GERMAN FUTURE FINANCING ACT WAS PUBLISHED ON 12 APRIL 2023. WHEREAS THE MANAGEMENT OF ONLY CERTAIN INVESTMENT FUNDS WAS PREVIOUSLY EXEMPT FROM VAT, THIS AMENDMENT WOULD EXTEND THE VAT EXEMPTION TO INCLUDE ALL ALTERNATIVE INVESTMENT FUNDS (AIFS).

Executive Summary

- The planned amendment to Section 4 no. 8 lit. h) of the German Value Added Tax Act (*"**GVATA**"*) would exempt the management of all AIFs from VAT.
- The amendment aims to put Germany on a level playing field with other European Member States, such as Luxembourg, by broadening the scope of application of the German value added tax ("**VAT**") exemption.
- The expanded VAT exemption is currently scheduled to come into force as of 1st January 2024. According to the current draft bill this change in the law will not have any retroactive effect.

Background

The recently published draft of the German Future Financing Act (*Zukunftsfinanzierungsgesetz*) sets out sweeping changes to the Germany's tax law, financial market law and corporate law. The aim of the new act is to create business conditions more suitable for start-ups and growth companies and to facilitate much-needed future investments in digitalisation and the green transformation of the economy. One change that is likely to be particularly important for the funds industry is the broadening of the VAT exemption for the management of AIFs, which we would like to highlight and examine in more detail below.

The tax exemption for the management of special investment funds under Section 4 no. 8 lit h) GVATA is based on Article 135 para. 1 lit. g) of the EU's Directive on the common system of VAT. According to this, Member States shall exempt the management of special investment funds from VAT as defined by Member States.

Under current legislation in Germany, the scope of the VAT exemption essentially covers the management of undertakings for collective investment in transferable securities (UCITS) within the meaning of Section 1 para. 2 of the German Investment Code (*Kapitalanlagegesetzbuch,* "**KAGB**"), the management of alternative investment funds (AIFs) comparable to UCITS within the meaning of Section 1 para. 3 KAGB and the management of specific venture capital funds.

Currently, whether an AIF is comparable to a UCITS has to be examined on a case-by-case basis using the criteria provided in the German VAT Application Decree (*Umsatzsteuer-Anwendungserlass*), which in some cases can entail legal uncertainties. Depending on their structure, closed-ended AIFs may not benefit from the VAT exemption, for example, if PE/VC funds, real estate funds, film funds or ship funds are only invested in a single asset, e. g. a company or a property, and thus, do not diversify their risk.

Whether a fund can be classified as a venture capital fund (*Wagniskapitalfond)* must also be assessed on a case-by-case basis using the criteria set out in the German VAT Application Decree. European venture capital funds as defined by the European Venture Capital Fund Regulation (EuVECA) and other PE/VC funds that meet the relevant criteria qualify as venture capital funds.

Planned new regulation

The draft bill prepared by the German Federal Ministry of Finance and the German Federal Ministry of Justice would exempt the management of all alternative investment funds within the meaning of Section 1 para. 3 KAGB from VAT in the future. The exemption shall apply irrespective of the AIF's investment strategy or whether the AIF is structured as an open-ended or closed-ended AIF exclusively for semi-professional and professional investors or also for private investors.

Checking whether a fund meets the tax authorities' criteria for a venture capital fund or an AIF comparable to a UCITS would no longer be necessary. Asset management companies of closed-ended funds that did not previously qualify for the VAT exemption, such as PE/VC funds, infrastructure funds, real estate and project development funds, crypto funds and credit funds, would benefit most from the planned regulation.

Preliminary conclusion

Following the expansion of the VAT exemption to include the management of venture capital funds in 2021, making all AIFs VAT exempt through this new planned amendment is a welcome next step towards ensuring greater legal certainty and creating a level playing field for Germany as an attractive location for financial services and investment funds. From an economic point of view, one positive aspect of the planned amendment is that statutory VAT will no longer be due if the recipient of the previously taxable service is not entitled to deduct input tax. However, as AIF managers would no longer be entitled to deduct input tax from their input services, the economic burden of VAT cannot be neutralised in this sense by an input tax deduction.

We will be happy to keep you updated as the legislative process progresses. As lawyers and tax advisers, we are also available to answer all your questions on the subject of investment funds and taxes.

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