



Financial Services

# German Flat Tax on Capital Income Overview & Recent Developments

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# Agenda

- **Introduction & Legislative Overview**
- **New Flat Tax on Capital Income (Abgeltungsteuer)**
  - Overview of the Amendments
  - Implications for Direct Investments (Private Investors)
  - Implications for Investment Funds (Private Investors)
  - Grandfathering & Transitory Rules
- **Recent Developments**
  - Focus: Draft Annual Tax Act 2009 (approx. 12/2008)

# General Legislative Overview

- **Business Tax Reform 2008 (08/2007)**
  - Introduction of flat taxation on capital income
- **Annual Tax Act 2008 (12/2007)**
  - Special Application rule for SIF Funds
- **Act Amending the German Investment Act and Other Laws (12/2007)**
  - Amendment of the definition for “Foreign Investment Funds”
- **Draft Annual Tax Act 2009 (approx. 12/2008)**
  - Definition of the “Deemed Distributions”
  - Tax-Optimized Money-Market Funds
  - Implications for Capital Life Insurances
- **Circulars issued by the German Financial Authorities (BMF)**

# New Flat Taxation – Overview (1)

## Intention of German Government: Standardization & Simplification of Taxation of all Capital Income for Private Investors

- As of 01.01.2009: new concept of taxation for private capital income:
- Flat tax of 25% plus solidarity surcharge and church tax (if applicable) on all kinds of capital earnings and capital gains irrespective of a holding period (formerly 1 year)
- Option for tax assessment procedure if personal income tax rate lower than 25%
- Applicable for all current income (interest payments, dividends) as of 01.01.2009
- Grandfathering Rule for capital gains: securities acquired before 01.01.2009 are taxed according to the former taxation rules (Exception: full risk certificates, private label funds)
- Tax deduction directly on the level of the bank / debtor of the capital earnings

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# New Flat Taxation – Overview (2)

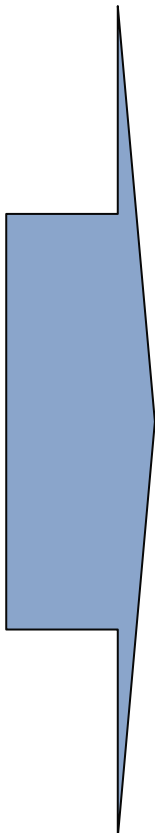
- Flat tax for Private Investors
- Capital Income = Current Earnings + Capital Gains
- Separate taxation concept and tax rate

Flat Tax on **capital earnings**  
(*Kapitalerträge*):  
interest payments,  
dividends, etc.

Flat Tax on **capital gains**  
(*Veräußerungsgewinne*):  
fund units, certificates,  
shares, bonds, irrespective  
of a holding period

# New Flat Taxation – Overview (3)

- **As of 01.01.2009, Flat Tax for Private Investors**
- **Abolition of 1 year holding period**
- **Abolition of half-income-System for dividends and share-gains**
- **Option for tax assessment in exceptional cases (e.g. lower personal income tax rate)**



**Flat tax rate of 25%**  
plus solidarity  
surcharge and church  
tax, if applicable

# New Flat Taxation – Overview (4)

## Applicability of New Taxation Concept:

- **Applicable for all current income (interest payments, dividends) accrued by the investor after 01.01.2009 (§ 52a Abs. 1 EStG)**
- **Capital Gains from the disposal of shares/bonds that have been acquired after 31.12.2008 (§ 52 Abs. 10 EStG)**
- **Disposal of other capital receivables:**
  - Financial innovations: capital gains (interest, accrued interest) accrued by the investor after 31.12.2008 (irrespective of the date of acquisition)
  - Other capital receivables (no FIs): capital gains if acquired after 31.12.2008
  - Full risk certificates: capital gains if acquired after 14.03.2007 and disposed of after 30.06.2009 (§ 52a Abs. 10 sent. 8 EStG)

# New Flat Taxation – Overview (5)

## Implementation / technique:

- **Tax deduction at the source of income by German depositary**
- **In case of foreign deposit: mandatory tax assessment**
- **Loss set off on the bank's level; loss carry forward, if necessary; alternatively: loss certification**
- **Option for tax assessment:**
  - Lower personal income tax rate
  - Setting-off foreign withholding tax
  - Loss set off
  - Saver's flat sum (*Sparerpauschbetrag*)

# New Flat Taxation – Overview (6)

- **New Flat Tax may only be imposed within Germany**
  - German bank (paying agent) is obliged to deduct flat tax...
  - ...as well as German investment company if investment units are held in „investment deposits“ and are directly redeemed by the investment company
- **Flat tax collected by the means of tax assessment if capital income is not accrued by the investor through a German bank (§ 32d (3) EStG-E)**
  - Taxation according to the flat tax rate
  - Information and reporting requirements for foreign banks remain mostly unchanged
  - **Only capital income that has not been taxed according to the flat tax will be subject to tax assessment**

# New Flat Taxation – Overview (7)

## Example: Certificates

### Former Taxation

#### Full / partly guaranteed Certificates

- ◆ So called financial innovations: full taxation of distributions and realized capital gains
- ◆ Capital gains are subject to tax irrespective of holding period; tax assessment applies

#### Full Risk Certificates

- ◆ capital gains tax-exempt if disposed of after > 1 year after acquisition
- ◆ If disposed of < 12 months, exemption limit of €511,99
- ◆ Distributions are subject to withholding tax (ZaSt) and are taxed according to the personal income tax rate; tax assessment applies.

### Taxation as of 01.01.2009

#### Full risk certificates

- ◆ Acquired before **15.03.2007**: capital gains tax-exempt if disposed of after > 1 year after acquisition
- ◆ If acquired after **14.03.2007** and disposed of before **30.06.2009**: capital gains tax-exempt if disposed of after > 1 year after acquisition
- ◆ In all other cases the disposal / redemption will trigger a taxable event in case of a disposal after 01.01.2009 (flat tax)

#### Guarantee Certificates

- ◆ Limited transitory rule is not applicable; any disposal after 01.01.2009 is subject to the new flat tax (even if acquired before 2009)

# New Flat Taxation – Overview (6)

**Recommended (Short-term) actions (especially if personal tax rate > 25%):**

- **Interest payments should be accrued after 31.12.2008**
  - Acquisition of Bonds with no interest payments in 2007/ 2008, but higher interests in 2009
- **Investments acquired in 2008 to be held for long term (no financial innovations)**
- **If necessary, change from direct to indirect fees**

**Acquisition until end of 2008:**

- **Flexible investment fund units to be held for long term (strategy funds)**
- **Fund of Funds, Funds (also) investing in Certificates**
- **Investment funds with grandfathered capital gains from securities / shares / derivatives**
- **Accumulating funds with mainly gains from securities / shares / derivatives**



# New Flat Taxation – Investment Funds (1)

- **The New Flat Tax has not yet been fully implemented in the German Investment Tax Act**
- **Distributed Earnings**
  - Deduction of new flat tax at the level of the German paying agent or by the means of tax assessment in case of foreign deposits
    - On distributions of German and foreign investment funds
    - Not applicable for distributed capital gains from grandfathered shares acquired before 01.01.2009 (tax exempt)
- **Accumulated Earnings / Deemed Distributions:**
  - German accumulating investment funds:
    - Deduction on the level of the German Investment company
  - ...also for German and foreign dividends
- **Flat tax cannot be deducted and collected on the level of foreign accumulating funds:**
  - Mandatory tax assessment for capital income not yet taxed

# New Flat Taxation – Investment Funds (2)

- **The fund distributes income or gains...**
  - Either tax deduction at the German bank's level (paying agent) or tax assessment process
  - Distributed realized gains on “old” shares/ derivatives (purchased or entered into before 1. January 2009) will stay non-taxable
- **The fund retains income (deemed distribution)...**
  - Either direct payment of flat-tax by the German investment company or tax assessment process for all non-German investment funds

# New Flat Taxation – Investment Funds (3)

- **Flat tax on capital gains from the disposal of the investment unit itself**
  - ...if the unit has been acquired after 31.12.2008
    - The accumulated earnings included in the capital gains have to be deducted since they have already been taxed!
  - Application of the „*Immobilien*gewinn“ (Real Estate Gain) for Private Investors generating capital gains from real estate that are tax exempt according to a DTT
  - (tax-exempt) distributed capital gains from grandfathered shares (acquired before 01.01.2009) have to be added again to the profits
- **Taxation of *Unrealized Profits (Zwischengewinn)* will remain**
- **Flat tax to be deducted by the German bank**

# New Flat Taxation – Investment Funds (4)

## Distributed capital gains (§ 18 InvStG):

- **Application of flat tax on all capital earnings; also applies for capital gains from shares / derivatives if the shares / derivatives have been acquired after 31.12.2008**
- **If acquired before 01.01.2009: Distributed capital gains from shares / derivatives remain tax exempt if investor has acquired fund units before 01.01.2009 and holding period > 12 months**
- **If acquisition of fund units after 01.01.2009: distributed capital gains from grandfathered shares / derivatives (before 31.12.2008) remain temporarily tax exempt; the capital gains will later be added to the taxable gain in case of redemption / disposal of the fund unit itself**

# Focus: Annual Tax Act 2009 (DRAFT) (1)

- **Government's Draft Annual Tax Act 2009 issued on 8.8.2008**
  - Extension of the definition of the deemed distribution to avoid tax deferrals for certain certificates and notes
  - Solely gains from shares and derivatives will not be affected
  - Complex rules for the determination of the taxable income (extension of the accruing principle for interest)
- **Comments of the German Bundesrat issued on 19.9.2008**
  - Modification of the governments proposal: All realized gains from bonds, certificates and notes should be taxed as deemed distribution (no longer differentiation between bonds and certificates)
  - Anti-avoidance rules for tax optimized money market investment funds affecting gains from shares and derivatives in certain combinations

# Focus: Annual Tax Act 2009 (DRAFT) (2)

- **Amendment Proposal by the CSU/CDU and SPD parliamentary group dated 17.10.2008:**
  - Certain capital receivables in terms of § 20 (2) sent. 1 no. 7 EStG shall be excluded from the deemed distributions: capital receivables with an emission yield, notes and non-securitized receivables with a fixed coupon, down-rating notes, floater and reverse-floater, full-risk certificates reflecting the price of one or more shares 1:1 (not discount certificates), exchangeable notes, convertible notes, reverse convertible notes, flat traded obligations and debt-like jouissance rights, bond with warrant (cum)
  - All other risk certificates shall be included in the future definition of deemed distributions
  - **tax optimized money market funds**

# Focus: Annual Tax Act 2009 (DRAFT) (3)

- **Proposed anti-avoidance rules for tax optimized money market investment funds (purchased before 2009)**
  - Examples:
    - Purchase and immediate forward sale of securities (the forward price of an asset is the current price plus market yield)
    - Low-interest non EURO-bonds and swaps (Yen performance plus swap leading to EURO money market performance)
  - Current tax treatment
    - The fund realizes capital gains or derivative gains instead of interest
    - Retained gains are not taxable and the private investor can realize the increased value of the unit tax exempt after a holding period of at least 1 year
  - Proposed tax treatment (applicable from September 2008?)
    - Further to realized gains from bonds also that from shares and derivatives shall be included in the deemed distributions if a combination of them is intended to generate a money market yield

# Funds vs. Certificates

- **Guarantee Funds / Guarantee Certificates: Change of Customers' interests?**
  - Guarantee Funds (established before 01.01.2009)
  - LUX accumulating guarantee funds (taxation via tax assessment process)
  - German guarantee funds have to deduct flat tax; as long as no deemed distributions are generated, the taxation of guarantee funds and guarantee certificates are equal
  - Bifurcation: Zero Bonds plus Call...
- **Index Certificate plus Option**
- **Discount Certificate plus Option**
- **OTC Fully Funded Swap**
- **ETF plus Option**
- **Hedge-Fund Certificate / jouissance right...**

# Proposed Taxation of Capital Life Insurances

- **Current beneficial treatment of capital life insurances acc. to Sec. 20 para 1 no. 6 Income Tax Act**
  - Avoidance for individually managed portfolios wrapped in a capital life insurance contract
- **Proposed measures:**
  - Draft Circular of the BMF (as of 22 August 2008) and draft Annual Tax Act 2009 (as of 19 September 2008)
  - Minimum risk coverage is supposed to be required
  - The investor must not have any influence on the portfolio management
  - Consequences of non fulfillment: Direct attribution of the assets and profits to the investor, no beneficial tax treatment for insurance contracts

# New BMF Circular for Private Label Funds

- **New BMF-Circular dated 22.10.2008 concerning so called “millionaires’ funds”**
- **Existing transitory rules for Sepcial Funds and Private Label Funds acc. to § 18 (2a) InvStG**
  - Fund Units acquired before / after 09.11.2007
- **BMF establishes assumption (fiction) for applicability of special transitory rules**
  - Up to 10 shareholders
  - Contribution > 100.000 €

**Implications for Private Investors until 01.01.2009?**

# Qualification as Foreign Investment Fund

- **The German investment Tax Act is only applicable on non German funds if the funds fulfils the requirements of the investment fund definition**
  - There have been uncertainties about the former material investment fund definition (despite the 2005 BMF circular)
  - Additional formal criteria's are required from 2008 on: An open end regime is required or the fund has to be subject to a qualified investment supervision
- **The German Federal Financial Supervisory Authority (BaFin) issued a draft interpretation letter to clarify the scope of the Investment Act in May 2008**
  - We expect the Tax Authorities to adopt those interpretations
  - Consequences: Application of CFC rules if the fund is out of scope

# Thank you for your attention!

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