# *German Hot Topics*

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# *Agenda*

1. German tax environment and tax reporting
2. Will Germany's new treaty shopping rules impact on Channel Islands private equity structure?
3. German Perspective: The onshore versus offshore debate
4. Questions / discussion

# *German Private Equity Fund Unit*

# *German tax environment and tax reporting*

I

# *Agenda*

1. German tax environment – changes in the tax offices approach.
2. German tax reporting – key topics, examples, processes.

# 1. German tax environment - Changes in the tax offices practical approach towards fund compliance

**Political, Legal administrative initiative**

- 2005 Political criticism: Locust/grashopper debate initiated by FranzMüntefering.
- New rules are introduced in the Fiscal Code that increase the German investors obligation to gather sufficient information from offshore investments to ensure proper filing.
- 2008: Higher German Civil Court: Not filing German partnership tax returns can be regarded as minor tax fraud ("Steuergefährdung").
- 2008/2009: Tax authorities built internal expert teams on Financial Services as well as Controlled Foreign Company ("CFC") and Passive Foreign Investment Corporation ("PFIC") rules.
- Tax authorities start to gain better understanding and request more detailed information during tax audits (e.g. classification of entities (e.g. UK LLP), and  hybrid funding instruments (such as CPECs, preferred stock).
- 2011/12: New practice - late filings are automatically forwarded to the German BUSTRA.

**Market reaction**

- US K1 based tax filings
- German partnership tax filing
- Partnership tax filing plus CFC/PFIC filing for lower-tier corporations
- Duly documentation and fully disclosure of uncertain topics
- Timely filing – required

**What's coming up next?**

- Exchange of information& know how between foreign tax offices?

# 2. German tax reporting
# 2.1. Basics

## Background

German provides for three different tax regimes:

- Investment Tax Act
- Partnership Tax Reporting
- CFC or PFIC Reporting

## Who would be affected by the partnership tax reporting?

Foreign closed-ended funds with *at least two* German investors, if the funds classify as partnerships for German tax purposes. (If the fund has just one investor filing a partnership return is not required, however, the German investors might ask the fund to have the numbers calculated according to German tax principles).

## When is the partnership filing due and who bears the costs

12 month after the end of the fund's business year (e.g. 2011 would be due until December 31, 2012). In practice, the costs of the partnership filing are often (but not always) born by the German investors.

## What are the benefits?

- Compliance with the German law.
- Ensure favorable tax treatment (e.g. participation exemption).
- Ensure consistent filings among the investors and e.g. the co.-investors.
- Reduce the risk of adjustments upon inquires/tax audits.

# 2. German tax reporting
## 2.2. Key topics

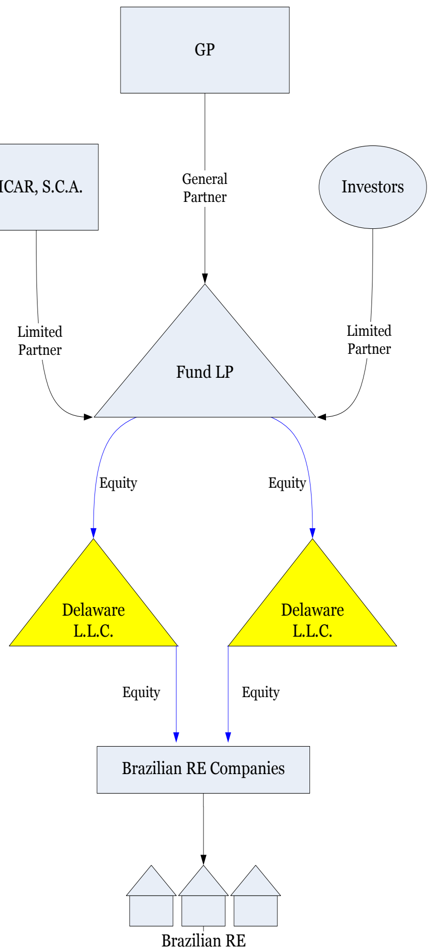
- Determination of the legal structures.
- Classification of entities (corp vs. partnership).
- Classification of type of partnership (trading vs. deemed trading vs. asset management.
- Classification of funding instruments.
- Identification of the timing of repatriation.
- Separate CFC and/or PFIC Reporting

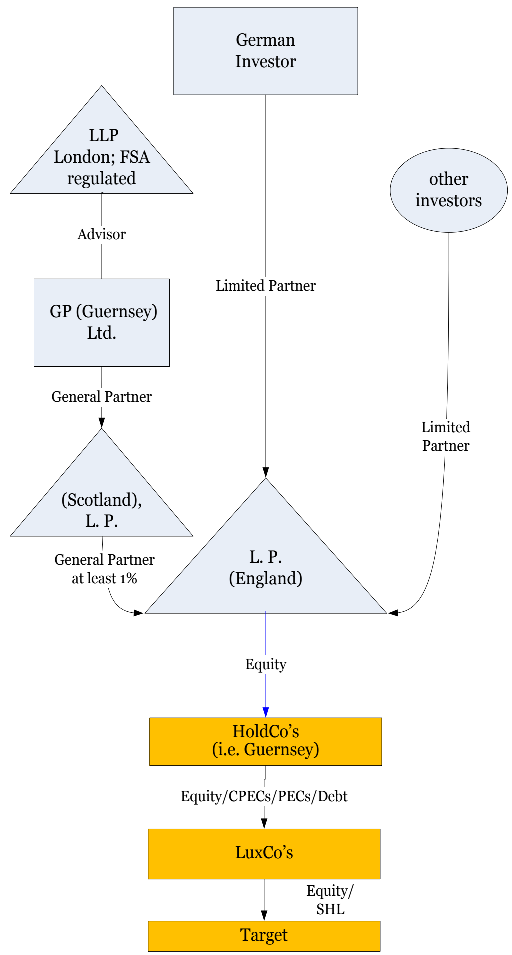
  The fund, on behalf of its German investors, may also be required to prepare, file and report to the investors their share of CFC/PFIC income. CFC/PFIC returns are also due within 12 months of the end of the foreign corporation's business year.

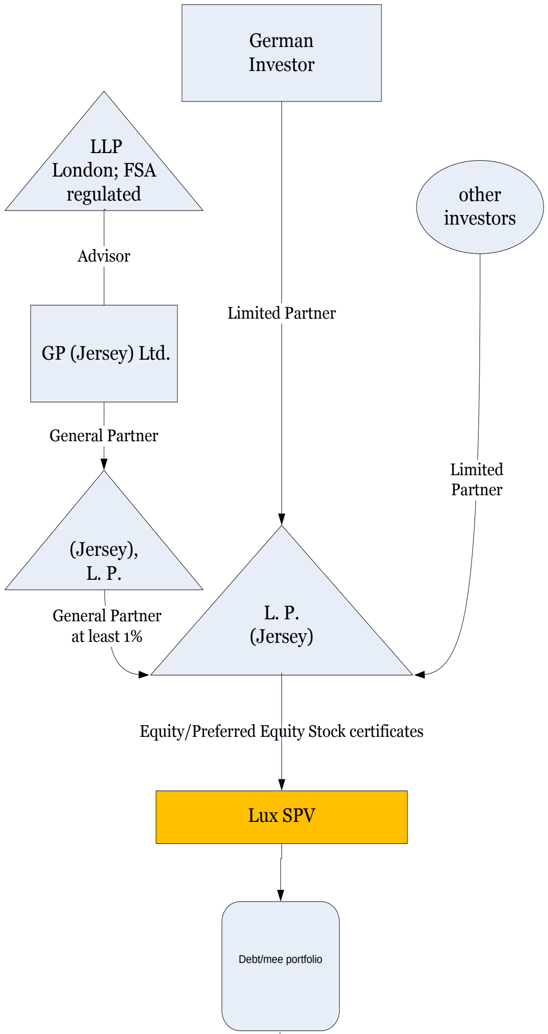
- Separate ROC Reporting

  Special reporting for EU corporations related to returns of capital and other transactions at the target level. The deadline for other reporting may be as little as one month from the transaction date.

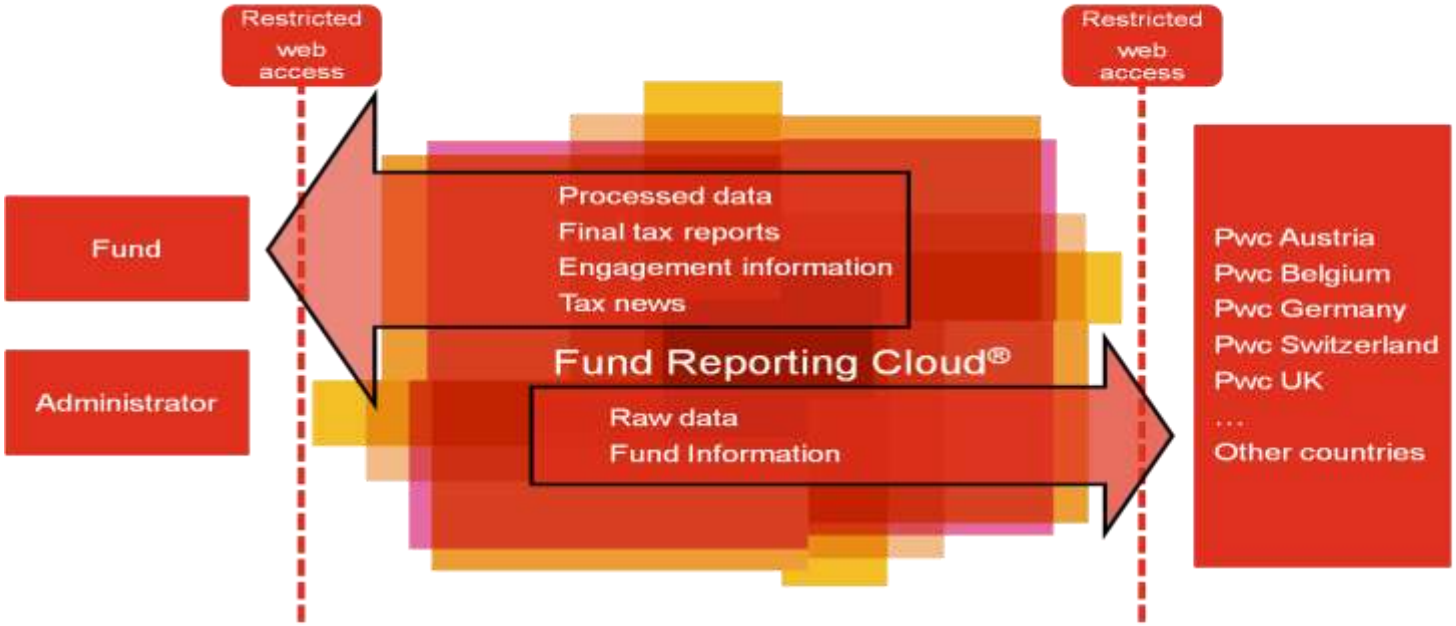
# 2. German tax reporting
# 2.3. Some examples



# 2. German tax reporting
# 2.4. Fund Reporting Cloud could enhance communication




**Value added**

- Reduction of the back office administrative burden; no need to handle requests from different jurisdictions.
- The quality and consistency of the returns should increase and provide more comfort for tax audits.

# 2. German tax reporting
# 2.5. Utilization of globally standardised request lists can further reduce your administrative burden

| | Consolidated request list | Germany | UK | US |
|---|---|---|---|---|
| **A.** | **Details of investors in the Fund entity** | | | |
| A.1 | Name, address, tax payer identification number etc of investors resident in the jurisdiction | X | X | X |
| A.2 | Type of investor (corporate, bank, insurer etc.) | X | X | X |
| A.3 | Capital statement for the investors resident in the jurisdiction | X | X | X |
| A.4 | Distribution notices to investors resident in the jurisdiction | X | X | |
| A.5 | Investor level expenses related to the investment | X | | |
| A.6 | List of investors who have requested US tax forms | | | X |
| **B.** | **Transfer of a partnership interest** | | | |
| B.1 | Details of any changes | X | X | X |
| **C.** | **Information of the individual Fund LP** | | | |
| C.1 | LPA - If the LPA has been revised during the fiscal year, please provide a copy of the revised LPA | X | X | X |
| C.2 | Financial accounts for the Fund | X | X | X |
| C.3 | Financial statment for the Fund LP | X | X | X |
| C.4 | Trial Balance | X | X | X |
| **D.** | **Restructuring/exit of investments** | | | |
| D.1 | Date for the transaction (sales agreement or shareholders resolution) | X | X | X |
| D.2 | Currency in the transaction | X | X | X |
| D.3 | Structure memo | X | X | X |
| D.4 | Allocation of gains/losses to funding instruments (Shares, PECs, CPEC etc) | X | X | X |
| D.5 | Repatriation of capital gain | X | X | X |
| D.6 | Any reinvestment of proceeds? | X | X | X |
| D.7 | Acquisition date and book cost basis for each exited investment | | | X |

## Value added

- Supports the overall standardisation of the compliance procedures.
- Helps to meet increasing transparency and compliance requirements.

# 2. German tax reporting
# 2.6. Entity and asset classification tools can help in FoF scenarios

| No. | Funding instrument's title according to financial statements | Translation into German/ description based on the title | Fixed assets (FA)/ Current assets (CA) | Tax privilege based on the funding instrument's title |
|---|---|---|---|---|
| 1. | 2nd lien term loan | Nachrang-Darlehen | FA | Not privileged |
| 2. | ADR<br>(American Depository Receipts) | Zertifikat, ausgestellt von US-Banken, über die bei ihr hinterlegten ausländischen Aktien | FA | Privileged |
| 3. | Amended and restated secured promissory note | Gesichertes Schuldscheindarlehen | FA | Not privileged |
| 4. | Bain I units | Anteile | FA | As far as shares of a corporation - privileged, otherwise not privileged |
| 5. | Bridge financing | Überbrückungsfinanzierung | CA | Not privileged |
| 6. | Bridge loan | Überbrückungskredit | CA | Not privileged |
| 8. | Class A common shares | Stammaktie | FA | Privileged |
| 9. | Class A common stock | Stammaktie | FA | Privileged |
| 10. | Class A common units | Stammanteile | FA | As far as shares of a corporation - privileged, otherwise not privileged |
| 11. | Class A interests | Stammanteile | FA | As far as shares of a corporation - privileged, otherwise not privileged |
| 12. | Class A limited partnership units | Anteile an Personengesellschaft (Transparenzgrundsatz; principle of transparency) | FA | As far as shares of a corporation - privileged, otherwise not privileged |

**Value added**

- Harmonised and standardised entity and asset classification tools; which can be shared with the relevant tax authorities.
- Demonstrate that market standards are adopted in the compliance procedures.
- Based on our experience this would support discussions arising during tax audits.

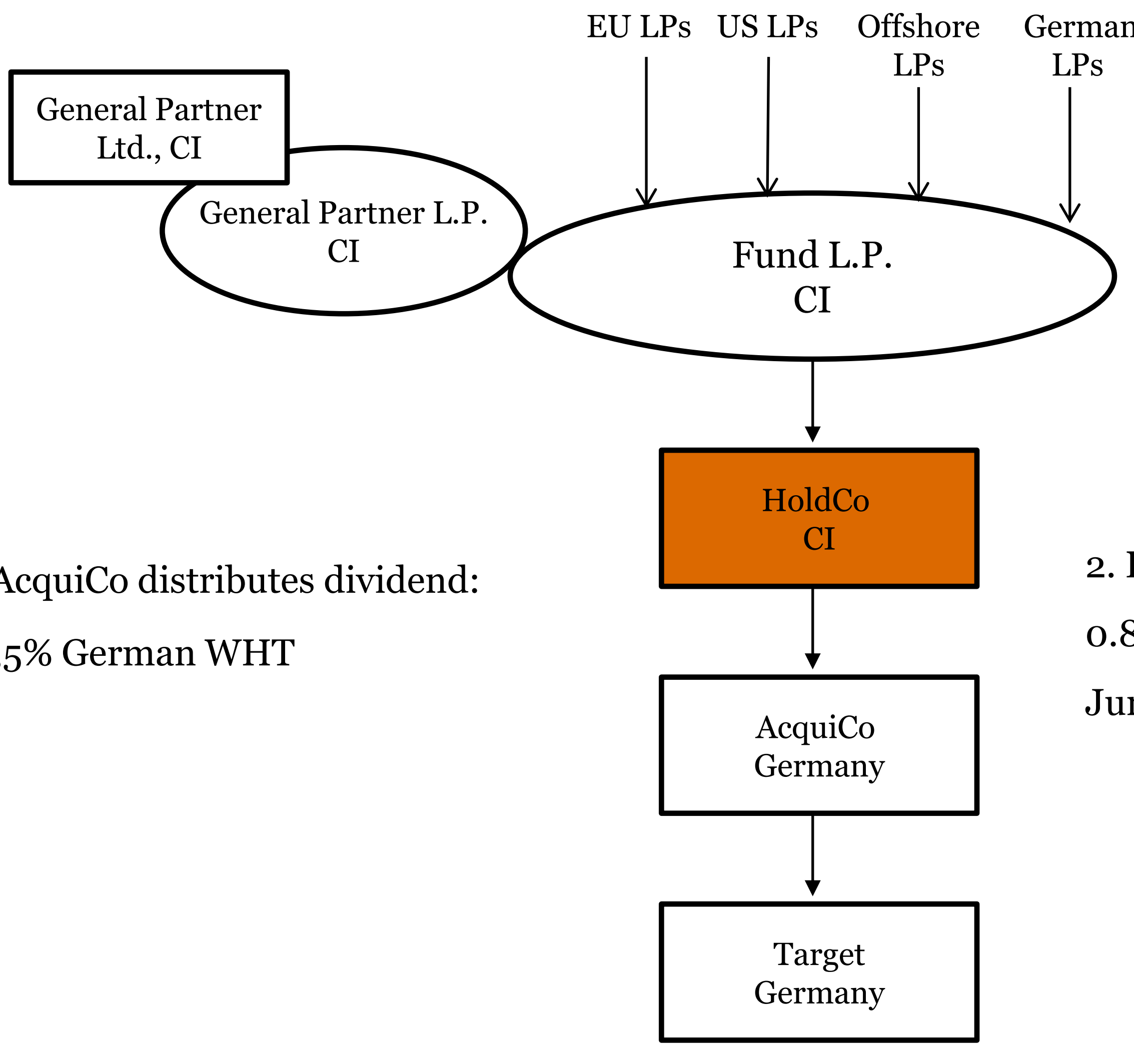
# *Will Germany's new treaty shopping rules impact on Channel Islands private equity structure?*

II

# *Agenda*

1. Acquisition Structure: Channel Islands Holding
2. Acquisitions Structure: Benelux Holding
3. Look-through approach of new German treaty shopping rule
4. First Escape Clause: Listing or Investment Fund
5. Second Escape Clause: Active Management Holding
6. Third Escape Clause: Good business reasons and substantial place of management
7. Other aspects
8. Conclusion

# 1. Acquisition Structure: Channel Islands HoldCo




1.AcquiCo distributes dividend:

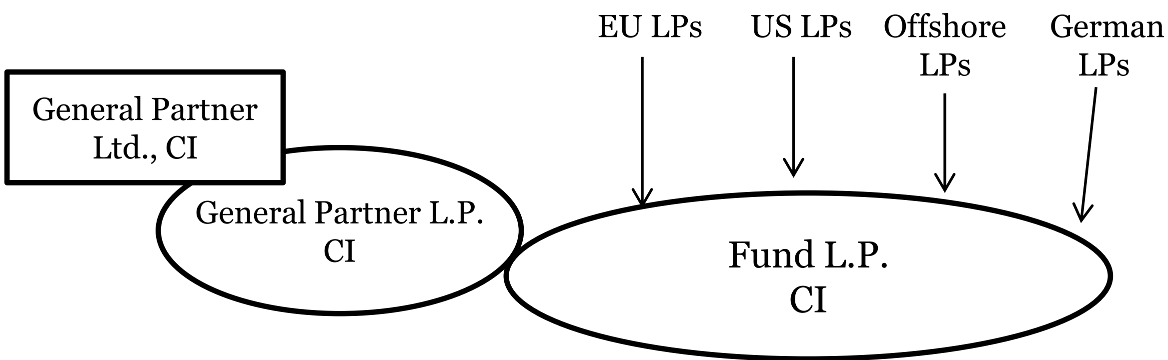
26,5% German WHT

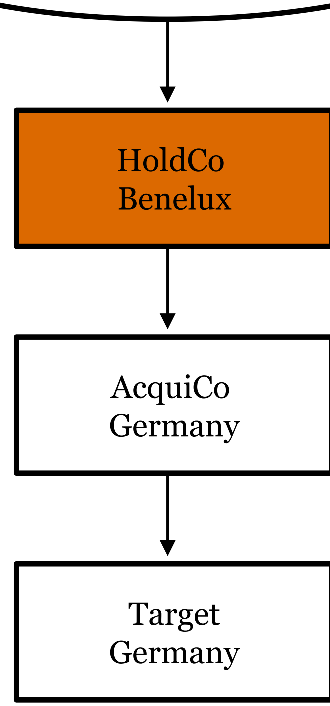
2. Holding sells AcquiCo:

0.8% German CT

June 2012 proposal: 16% German CT, if <10% shareholding

# 2. Acquisition Structure: Benelux HoldCo




1.AcquiCo distributes dividend:

- 0% German WHT (uncertainties under old law, EU, burden of prove)
- New German Treaty Shopping Rules (2012 Guidance Letter)
    - Risk of look-through approach:
    - 0% WHT EU LPs
    - 15% WHT US LPs
    - 26.5% WHT Offshore LPs
    - 26.5% WHT German LPs

2. HoldCo sells AcquiCo:

- 0% German CT
- New TS Rule does not apply for capital gains
- However, general anti abuse provision may apply?

# *3. Look-through approach of new German treaty shopping rule*

- Old rule (2007) was against EU law (too general, 10% rule, burden of proof was unclear).
- New rule addresses most of EU concerns (more specific, three escape clauses, clear burden of proof).
- Applicable as of 2012, and in older meaningful open cases.
- January 2012: Quite restrictive tax guidance letter published.
- Remaining concerns (EU compliant).
- New Rule looks through Benelux HoldCo and the fund.
- New Rule does not look through Offshore LPs!
  - For example, no WHT reduction/exemption, if Offshore LP were held by EU residents!

# *4. First Escape Clause: Listing or Investment Fund*

- HoldCo is listed at a reputable stock exchange and significant stocks are traded regularly.
- HoldCo qualifies as an investment fund under German investment law.

# *5. Second Escape Clause: 'Active Management Holding'*

- HoldCo generates gross revenue from active business
- Acitve production business accepted (not relevant here)
- More relevant: new rule also accepts business of 'Management Holding' to be active:
  - HoldCo should hold at least two (meaningful) portfolio companies (MasterLuxCos).
  - HoldCo should actively guide/instruct the management of the portfolio companies (mere administration/execution is not sufficient!).
  - Delegation of activities to other companies via management agreements not accepted(!).
  - Dividends from actively managed portfolio companies qualify as active.

# *6. Third Escape Clause*

- Third Escape is twofold:
  - Interposition of Passive Holding has to be based on ‘good business reasons’ :
    - Accepted: plan to build up Active Holding.
    - Accepted: legal, political, relegious reasons.
  - *And,* Passive Holding has ‘substantial place of management’ which ‘participates in the common business life’:
    - Personnel (directors plus staff) with suitable qualification.
    - Own office with technical equipment.
    - Activities not only internal vis-a-vis fund and portfolio companies but also vis-a-vis third parties.

# *7. Other aspects*

- Escape Clauses can apply in parallel and/or pro rata
- Burden of proof lies with HoldCo!

# *8. Conclusion*

- Areas where new German Treaty Shopping will impact CI private equity structure:
  - New Rule will increase awareness of German tax administration to dig into Benelux and CI acquisition/holding structures for German portfolio companies.
  - Benelux HoldCos require more substance.
  - Increased awareness may increase the risk for CI HoldCos with regard to capital gains under German general anti abuse rules.
  - MasterHoldCos as Active Management Holdings to be considered for Jersey/Guernsey Holdings.
  - Private Equity industry of Jersey/Guernsey would benefit from further negotiations of tax treaties with EU member states.
- German CFC-Rules.

# *German Perspective: The onshore versus offshore debate*

III

# *Agenda*

1. Background
2. German perspective; the onshore versus offshore debate
3. Conclusion

# *1. Background*

- Trend of German PE fund managers to look for non-German locations for their new generation funds.
- Three reasons against German limited partnerships:
  - German VAT on management fee / PPS.
  - German Federal Court Decision increases risk of fund being qualified as trading partnership. Consequences:
    - Permanent establishment for non-German investors.
    - Taxation risk 0.8-1.6% for capital gains (up to 32% if exemption were abolished).
    - German tax filing required.
  - AIFMD requires European managers to appoint a custodian in the country where the fund is resident (Germany does not yet have custodians who are familiar with PE industry).

# 2. German Perspective to Compare CI versus Benelux as Fund Location

| Aspects | Jersey/Guernsey fund | Example: Luxembourg fund |
|---|---|---|
| Synergies | Closer to London PE network (investors, placement agents, banks) | Closer to acquisition structures |
| Flexible limited partnership law | Yes, longstanding | Not yet (but plans to improve LP law) |
| Tax transparency of fund vehicle | Yes, limited partnership (Jersey/ Guernsey LP, migration of English/Scottish LP) | Yes, if status as SICAR or SIF |
| VAT on management fee | No | Exempt (remaining risk?) |
| Carried interest taxation | Beneficial as no tax on capital gains | Luxembourg has not yet introduced beneficial carry taxation for Lux residents |
| Regulation | Light regulation, even under AIFMD | Stricter regulation, in particular under AIFMD; German institutional investors may to prefer stricter regulation; marketing, labelling |
| Service Provider familiar with private equity | Yes, longstanding | Yes, for several years when SICAR was introduced |
| Place of management of the fund under German tax law | Yes, if sufficient substance in CI GP or UK Management Company | Yes, if sufficient substance in Lux GP or Lux Management Company |

# *3. Conclusion*

- No one answer.
- Evaluation depends on specific requirements at all four levels:
  - Investors
  - Management team
  - Portfolio companies
  - Acquisition structures

# *3. Questions?*

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