Attracting German institutional investors

# How Luxembourg's SIFs fulfil the criteria of a German special investment fund

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**The German special investment fund tax regime, announced in 2018, is still relatively unknown among Luxembourg funds, even as it grows in popularity among German institutional investors. Pension schemes, Germany's Versorgungswerke, and other German tax-exempt investors in particular are calling for more and more investment in such funds. And, the reason is simple—a special fund benefits from transparent status, treating the fund's income as if it were received by an investor. Tax-exempt investors can therefore significantly reduce the tax burden. In addition, specific regulations from the BaFin can restrict the investment of pension schemes into mutual real estate funds, whereas special investment funds are accepted. Luxembourg's specialized investment funds almost entirely fulfil the criteria of a German special investment fund (with some limitations in the investment policy) and therefore, would be a preferred fund vehicle for those investors.**

Here, we analyze some of the legal, tax, and regulatory aspects of Luxembourg SIFs and how they can comply with the German special investment fund rules and how this affects their attractiveness to new investors.

### Legal, Tax & Regulatory aspects

The Luxembourg SIF, regulated in the law of 13 February 2007, can have the form of a *Fonds Commun du Placement* (FCP) a common investment fund that is registered as an open-ended mutual fund; can be organized as an *Société d'investissement à Capital Variable* (SICAV); or as an *Société d'Investissement à Capital Fixe* (SICAF) in the legal form of an S.A., S.C.A., S.à r.l., S.C.S or S.C.Sp.

SIFs are quite flexible and are a lightly regulated investment vehicle in Luxembourg. In principle, there are no restrictions on eligible assets and the only requirement is to comply with certain risk-spreading rules.

The German tax rules for special investment funds are, in certain aspects, much stricter than the SIF rules and a Luxembourg SIF needs to fulfill the following two main criteria:

1. The fund must fall in the scope of the German investment tax act—those funds set up in the legal form of a partnership do not. Therefore, this implies that all SIFs legally formed as an S.C.S., S.C.S(p) automatically cannot reach the qualification of a German special investment fund. The tax regime can only be achieved if the SIF is set up in the legal form of a corporation.

2. In addition to the taxable qualification, there are certain explicit conditions to be considered in the investment policies of the fund which are defined in the German Investment Tax Act. For example, the German special investment fund must be dedicated to non-private investors only with a maximum of 100 investors. The fund (or its management company) must be supervised and has to respect certain investment restrictions such as securities, derivatives, cash, real estate etc.

If the SIF meets all required criteria it can opt for a transparent or non-transparent taxation under the German special investment fund regime. These transparency options significantly affect the tax burden at the investor level and should be selected upon good advice and depending on the type of investor.

### The taxation at investor level with transparent option

When opting for the transparency status, income will be continually withheld at the source—however, also a characteristic acc. to its origin (dividend income, real estate income, foreign income) and allocated directly to the investors of the fund. A tax-exemption at the level of the special investment fund is applicable if the fund withholds 15% of tax i.e. on income derived from real estate, pays it to the competent German tax authority and issues tax certificates to the investors. Taxable investors record this income in their tax return and can offset the tax already withheld against their tax liability.

For business investors, the special investment income is generally subject to income tax (max. 45%) or corporation tax (15% flat rate), plus a solidarity surcharge (5.5%). Additionally, investor can benefit from tax exemptions on special investment income (partial income procedure or box benefits within the context of Section 8b of the German Corporate Income Tax Act and under certain conditions, deduct losses and expenses raised at fund level.

For tax-privileged investors such as those involved in pension schemes, Germany's *Versorgungswerke*, or other tax-exempt investments, the tax (including the solidarity surcharge) will be reimbursed or possibly not even deducted if the corresponding non-assessment certificates are available. However, the respective investor must comply with the special crediting requirements of the German Income Tax Act (Section 36a).

Where foreign investors are invested in the transparent special investment fund, the investor could be subject to a limited income tax liability in Germany if the income is not subject to withholding at source (i.e. income derived from real estate).

### The taxation at investor level with non-transparent option

Without opting for the transparency status, the income is subject to taxation at the level of the special investment fund and no re-characterization of income occurs at the level of the investors. Thus, with respect to persons that are not German tax residents, no limited corporate income tax liability arises.

To avoid double taxation at the investor level, the business investor can use partial exemptions (20%, 60%, or 100%). However, the full tax exemption is only granted if the special investment fund is subject to the full corporate income tax rate of 15%. This may not be the case if the SIF is entitled to an exemption below this rate based on a double taxation agreement. It is irrelevant whether the foreign special investment fund asserts this claim.

In summation, German real estate income of a special investment fund that has not opted for transparent taxation is generally subject to tax of 15.825% at the level of the special investment fund, whereas a full tax exemption might be applicable at the level of the German investor.

### Tax comparison and tax burden in case of dividend and real estate income

Tables 1 and 2 provides a tax comparison in case of dividend income (Table 1) and real estate income (Table 2) at the fund level for both Luxembourg SIFs that fulfill the criteria of a German special investment fund and those that do not. It shows that the German tax-exempt investors benefit from an investment into a special investment fund with transparent option. However, other investors (e.g. fully taxed insurance companies) would benefit from the non-transparent status of real estate income, and would more likely prefer the opaque fund vehicle with the tax exemption rates in case of dividend income.

### Conclusion

Despite the relative rarity of German special investment fund regime in Luxembourg, it could be a new fund vehicle to attract new investors. Luxembourg SIFs almost fulfil the very restrictive criteria of the special investment fund regime in Germany and any adjustments that need to be done would be limited, especially regarding a concrete limitation of investors and investments. Depending on the type of investors and the fund investment policy, the total tax burden for investors of special investment funds can be optimized. Tax-exempt investors in special investment funds prefer the transparency option especially in the case of German-sourced income, whereas the non-transparent option or even the normal opaque investment fund, would be more beneficial for fully-taxed investors. To this end, certain new requirements must be observed when designing funds, and specialized tax experts must be consulted for legal and tax advice or structuring.

**Table 1: Tax comparison in case of dividend income (Lux' SIF as German special investment fund vs. normal fund)**

| Dividend income | Income and tax burden | Lux SIF as German special investment fund (without tranparent option) | Lux SIF as German special investment fund (with tranparent option) | Lux SIF as opaque investment fund | Lux SIF as opaque investment fund (mixed) | Lux SIF as opaque investment fund (equity) |
|---|---|---|---|---|---|---|
| Fund level | German dividend | 100,00 | 100,00 | 100,00 | 100,00 | 100,00 |
| | German CIT 15% | 15,00 | 0,00 | 15,00 | 15,00 | 15,00 |
| | Foreign dividend | 100,00 | 100,00 | 100,00 | 100,00 | 100,00 |
| | WHT (DTT) 15% | 15,00 | 15,00 | 15,00 | 15,00 | 15,00 |
| | Expenses | 50,00 | 50,00 | 50,00 | 50,00 | 50,00 |
| Business investor | Taxable basis for investor | 140,00 | 120,00 | 120,00 | 84,00 | 48,00 |
| | Income Tax (42%) | 43,80 | 41,40 | 50,40 | 35,28 | 20,16 |
| | MBT (14%) fully creditable | 19,60 | 16,80 | 16,80 | 11,76 | 6,72 |
| | Tax to be paid by investor | 43,80 | 41,40 | 50,40 | 35,28 | 20,16 |
| | **Tax paid in total** | **73,80** | **56,40** | **80,40** | **65,28** | **50,16** |
| Corporate investor | Taxable basis for investor | 100,00 | 200,00 | 120,00 | 72,00 | 24,00 |
| | CIT (15%) | 0,00 | 15,00 | 18,00 | 10,80 | 3,60 |
| | MBT (14%) | 14,00 | 28,00 | 16,80 | 10,08 | 3,36 |
| | Tax to be paid by investor | 14,00 | 43,00 | 34,80 | 20,88 | 6,96 |
| | **Tax paid in total** | **44,00** | **58,00** | **64,80** | **50,88** | **36,96** |
| Insurance and health companies | Taxable basis for investor | 100,00 | 200,00 | 120,00 | 102,00 | 84,00 |
| | CIT (15%) | 0,00 | 15,00 | 18,00 | 15,30 | 12,60 |
| | MBT (14%) | 14,00 | 28,00 | 16,80 | 14,28 | 11,76 |
| | Tax to be paid by investor | 14,00 | 43,00 | 34,80 | 29,58 | 24,36 |
| | **Tax paid in total** | **44,00** | **58,00** | **64,80** | **59,58** | **54,36** |
| Tax-exempt investor | Taxable basis for investor | 0,00 | 200,00 | 120,00 | 72,00 | 24,00 |
| | CIT (%) | 0,00 | 0,00 | 0,00 | 0,00 | 0,00 |
| | MBT (%) | 0,00 | 0,00 | 0,00 | 0,00 | 0,00 |
| | Tax to be paid by investor | 0,00 | 0,00 | 0,00 | 0,00 | 0,00 |
| | **Tax paid in total (can be reclaimed)** | **30,00** | **15,00** | **30,00** | **30,00** | **30,00** |

**Table 2: Tax comparison in case of real estate income (Lux SIF as German Special Investment fund vs. normal fund)**

| Real estate income | Income and tax burden | Lux SIF as German special investment fund (without tranparent option) | Lux SIF as German special investment fund (with tranparent option) | Lux SIF as opaque investment fund | Lux SIF as opaque investment fund (>50% foreign real estate) | Lux SIF as opaque investment fund (>50% German real estate) |
|---|---|---|---|---|---|---|
| Fund level | German real estate | 100,00 | 100,00 | 100,00 | 100,00 | 100,00 |
| | German CIT 15% | 15,00 | 0,00 | 15,00 | 15,00 | 15,00 |
| | Foreign real estate | 100,00 | 100,00 | 100,00 | 100,00 | 100,00 |
| | WHT (DTT) 25% | 25,00 | 25,00 | 25,00 | 25,00 | 25,00 |
| | Expenses | 50,00 | 50,00 | 50,00 | 50,00 | 50,00 |
| Business investor | Taxable basis for investor | 80,00 | 75,00 | 110,00 | 22,00 | 44,00 |
| | Income Tax (42%) | 33,60 | 31,50 | 46,20 | 9,24 | 18,48 |
| | MBT (14%) fully creditable | 11,20 | 10,50 | 15,40 | 3,08 | 6,16 |
| | Tax to be paid by investor | 33,60 | 31,50 | 46,20 | 9,24 | 18,48 |
| | **Tax paid in total** | **73,60** | **56,50** | **86,20** | **49,24** | **58,48** |
| Corporate investor | Taxable basis for investor | 0,00 | 75,00 | 110,00 | 22,00 | 44,00 |
| | CIT (15%) | 0,00 | 11,25 | 16,50 | 3,30 | 6,60 |
| | MBT (14%) | 0,00 | 10,50 | 15,40 | 3,08 | 6,16 |
| | Tax to be paid by investor | 0,00 | 21,75 | 31,90 | 6,38 | 12,76 |
| | **Tax paid in total** | **40,00** | **46,75** | **71,90** | **46,38** | **52,76** |
| Insurance and health companies | Taxable basis for investor | 0,00 | 75,00 | 110,00 | 22,00 | 44,00 |
| | CIT (15%) | 0,00 | 11,25 | 16,50 | 3,30 | 6,60 |
| | MBT (14%) | 0,00 | 10,50 | 15,40 | 3,08 | 6,16 |
| | Tax to be paid by investor | 0,00 | 21,75 | 31,90 | 6,38 | 12,76 |
| | **Tax paid in total** | **40,00** | **46,75** | **71,90** | **46,38** | **52,76** |
| Tax-exempt investor | Taxable basis for investor | 0,00 | 75,00 | 110,00 | 22,00 | 44,00 |
| | CIT (%) | 0,00 | 0,00 | 0,00 | 0,00 | 0,00 |
| | MBT (%) | 0,00 | 0,00 | 0,00 | 0,00 | 0,00 |
| | Tax to be paid by investor | 0,00 | 0,00 | 0,00 | 0,00 | 0,00 |
| | **Tax paid in total (can be reclaimed)** | **40,00** | **25,00** | **40,00** | **40,00** | **40,00** |

# IPOs : soyez vigilant avant d'investir dans les nouveaux entrants sur le marché boursier

**Un grand nombre d'entreprises sont introduites en bourse en ce moment, mais cette frénésie inonde également le marché d'une abondance d'entreprises de qualité très variable. Alexander Dominicus, gestionnaire de portefeuille des fonds MainFirst Top European Ideas Fund et MainFirst Germany Fund, décrit les aspects auxquels les stock pickers doivent prêter attention pour identifier les bons modèles d'entreprise.**

Les introductions en bourse (IPO) sont réputées pour les opportunités d'investissement intéressantes qu'elles offrent aux acteurs du marché. Les entreprises se présentent souvent pour la première fois à de nouveaux investisseurs potentiels dans le cadre d'une introduction en bourse. «Ces entreprises sont encore peu connus à ce moment-là et leurs opportunités et risques pas suffisamment explorés» explique Alexander Dominicus. «C'est pourquoi il est important de ne pas se précipiter aveuglément sur les entreprises dites à la mode.» Des sujets tels que la technologie, l'e-mobilité ou les énergies renouvelables font l'objet d'une telle demande que les modèles d'entreprise médiocres sont parfois ignorés et que les valorisations bondissent de record en record. Il est possible que nombre d'entreprises arrivent sur le marché boursier alors qu'elles sont déjà très valorisées, mais opèrent sur une base à faible marge et non rentable.

«Les valorisations sont souvent fondées uniquement sur les ventes.» indique Alexander Dominicus. «Dans ce cas, une prudence particulière est de mise et l'on peut se demander à quel moment les investisseurs récupéreront leur capital investi sous forme de flux de trésorerie et de dividendes.»

### Les investisseurs doivent faire leurs devoirs

Les investisseurs devraient examiner de plus près les IPO : «Il est important de regarder au-delà d'une présentation marketing bien ficelée», souligne Alexandre Dominicus. Des argumentaires d'investissement portant principalement sur les mégatendances et le potentiel du marché peuvent être une indication d'un modèle d'entreprise médiocre. Selon lui «Un potentiel de marché ne devient intéressant que si l'entreprise peut démontrer de manière convaincante sa capacité à convertir la taille du marché en bénéfices durables.»

Il s'agit notamment d'offrir des solutions qu'un concurrent ne peut pas fournir ou un avantage client qui apporte une valeur ajoutée par rapport aux produits précédents. Alexander Dominicus précise : «Les entreprises qui réussissent proposent à leurs clients des solutions optimales à leurs problèmes, ces dernières se démarquent par leur qualité et leur prix.». Ce sont généralement les acteurs de niche qui présentent les meilleurs modèles d'entreprise et génèrent des rendements supérieurs à long terme pour les investisseurs.

### Les modèles d'entreprise solides sont décisifs

Dans l'ensemble, il est crucial pour les investisseurs d'identifier les bons modèles d'entreprise, car de nombreuses sociétés présentant un potentiel de croissance ont également fait leur entrée sur le marché ces derniers mois : «Si les sociétés opèrent sur un marché où les critères d'entrée sont élevés, qu'elles sont très rentables et en forte croissance, il peut s'avérer judicieux pour un investisseur d'accepter des multiples de valorisation plus élevés.»

D'après Dominicus, de tels investissements peuvent sans aucun doute offrir un potentiel d'alpha. «En tant qu'investisseur, vous avez la possibilité de trouver de bonnes entreprises au cours de cette phase, avant que d'autres ne les découvrent et vous pouvez donc profiter d'entreprises qui se forgent une bonne réputation et un potentiel de croissance au fil du temps sur le marché boursier.»

Alexander Dominicus tire également profit de cela dans les fonds qu'il gère lorsque des opportunités se présentent. «Nous examinons en détail et avec un œil critique les hypothèses des entreprises. Nous dressons ensuite un portrait neutre et individualisé pour chacune d'entre elles. À long terme, cela s'est toujours avéré être la meilleure recette d'un succès durable. Par conséquent, nous avons déjà bénéficié de nombreuses introductions en bourse particulièrement réussies par le passé et nous continuerons de chercher à profiter de ce type de profils risque/rendement à l'avenir.»