

Asset & Wealth Management Tax & Legal Newsflash



Stock lending – a potential show stopper

The new German Investment Tax Act (GITA) has not yet kicked in and the rules are already becoming more and more complex.

Among other topics, the German Ministry of Finance (BMF) has, in a recent circular dated 21st December 2017, clarified that a fund's activities in lending or repo transactions over stock may jeopardize certain tax benefits under the partial tax exemption regime for its German investors. The circular deals with the question whether stocks which are part of stock lending or repo transactions qualify as equity participation and thus form part of the fund's equity participation ratio (EPR).

Depending on the EPR the tax exemption available for the German fund investors varies between 0% and 80%!

Details of the BMF circular

The BMF has confirmed that for the purpose of the determination of an investment fund's EPR only those equity participations should be considered where the fund qualifies as **the legal and beneficial owner**. If the fund has transferred the legal ownership (e.g. by means of stock lending and repos) the respective equity participation is generally not considered in terms of the EPR even if there is a right to claim a retransfer.

If - vice versa - equity participations are transferred to a fund in terms of a stock lending or repo agreement these have to be considered for the EPR if the beneficial ownership is transferred with the legal title.

The BMF emphasizes that regarding the beneficial ownership a **case-by-case analysis** is required. Subsequently, no blanket statement can be made on the consideration of stock lending and repo transactions in terms of the EPR.

Impact

Investment funds engaged as lenders or sellers in terms of stock lending and repo transactions are at risk of falling under the relevant EPR threshold for equity funds (51%) or mixed funds (25%) or at least coming up with a significantly lower EPR than originally presented to the German marketplace.

In this case, German investors may not benefit from the partial tax exemption regime. In addition, the investment terms may not reflect the treatment of stock lending and repo activities in accordance with the BMF and therefore overstate the EPR. Subsequently, investment funds may be incorrectly categorized at WM Daten and funds of funds may refer to overstated EPRs leading to wrong tax assessments at investor level. In the case of

a wrong EPR, investment funds will be obliged to report corrected tax data for their German investors with the consequence that the settlements will have to be corrected.

Therefore, the wording in the investment terms regarding the intended EPR may need to be adjusted. However, it should be sufficient based on the transition rule stipulated in the circular of the BMF dated 14th June 2017 to update the wording **by 31st December 2018** and to use a "self-declaration" for 2018.

It remains open whether the tax technical view of the BMF is in line with the legislative goals of the GITA. However, applying a deviating view for products distributed in Germany should require an immediate disclosure to the competent German tax authorities and triggers the risk that a multitude of tax assessments at investor level will be challenged.

To-Dos

- Identification of impacted products (i.e. products engaged in securities lending or repo transactions with German investors)
- Impact assessment based on portfolio data as well as underlying stock lending and repo agreements. In particular: analysis of transfer of legal and beneficial ownership and reverse-consideration of stock-collateral!
- If necessary: amendment of the tax status classification / self-declaration for the respective investment funds
- If necessary: amendment of the minimum EPR for fund of funds investors

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