



Private Equity Funds German Tax Compliance

**German Investors in Private Equity Funds
need German Tax Reporting**



KPMG offers private equity funds access to the German market with high quality managed tax reporting services based on an efficient technology.

Background

For a private equity fund structured as a partnership, an annual partnership tax return must be filed in Germany if two or more German tax resident partners are directly invested. The partnership tax return does not result in any income taxes to be paid by the partnership (provided there is no taxable presence in Germany). Instead the partnership tax return serves the sole purpose of calculating the income and capital gains according to German tax principles and allocating the derived income to the German limited partners. Although each German investor is obliged to do this, they often do not have all the information needed at hand. This is why they rely on the private equity fund to provide tax reporting services and typically ensure this reporting obligation in a side letter.

Partnership tax returns have to be filed by an external tax provider by the end of February of the second subsequent year to the tax year (e.g. for 2018 the filing deadline is 29 February 2020). Starting tax year 2018 late filing penalties are compulsory if the partnership tax return is filed after that date. Typically, investors seek to be provided with the tax reporting earlier. If partnership tax returns have not been filed in the past, they still need to be filed retroactively for the period in which at least two German tax resident partners were invested in the partnership in order to comply with German tax rules, even if the German limited partners declared their income derived from the private equity fund in their tax returns. The German tax offices are entitled at their sole discretion to impose late filing fees in such a case.

If only one German partner is invested in a partnership, a partnership tax return does not have to be filed for that year. However, the investor needs pro forma tax reporting to incorporate the income derived from the private equity fund into his corporate (income) tax return.

The calculation of income and capital gains at the level of the private equity fund must be carried out in accordance with German tax law, i.e. with specific tax adjustments. Depending on the type of partnership (i.e. trading or non-trading), different profit determination methods apply. If the partnership is engaged in a trading activity, the accrual method is used. If the partnership is engaged in a non-trading activity, the cash method generally applies. However, if corporates are invested in a non-trading partnership, their allocated income needs to be calculated based on the accrual method. In such a case the income needs to be calculated twice by using both profit determination methods.

From a German tax perspective, there are three scenarios that result in a trading partnership: (i) the partnership engages in a genuine trading activity or, (ii) the partnership is deemed trading based on the structure or, (iii) the partnership is "tainted" trading based on the trading activity of a portfolio partnership.

Depending on the private equity fund's structure, CFC tax returns may be required to be filed especially in the case of certain lower tier blocker corporations.

Further, return of capital by non-German corporations is only recognized for German tax purposes, if it also was return of capital under German tax rules. Otherwise the repayment would need to be recognized as a dividend. In order to qualify as a return of capital a formal application with the German Central Tax Office is necessary and it needs to be demonstrated that the repayment does not stem from income.

However, the rule only allows EU corporations to file this application. The German Federal Fiscal Court concluded that non-EU corporations are also eligible to return tax neutral capital - without such a formal assessment - provided they can demonstrate that the repayment does not stem from earnings or retained earnings. Nevertheless, the German tax authorities still hold the view that a tax neutral return of capital is per se not possible for non-EU corporations.

German investors need to keep in mind that the acquisition of interest in a non-German partnership triggers reporting requirements in accordance with the German Fiscal Code.

Our services – Your value

The professionals at KPMG are well experienced with German tax reporting for private equity funds and are experts in this field. They are up to date with the latest developments in tax law and tax court decisions.

We typically provide the following services for private equity funds:

- Fund structuring advice
- Side letter negotiations with future investors
- Carried interest tax structuring
- Memo on the structure of the private equity fund from a German tax perspective to assess which profit determination method is applicable
- Memo on the applicability of CFC rules
- Registration of private equity funds with the German tax office
- Preparation and filing of the annual partnership tax returns
- Preparation of pro forma tax reporting if there is only one German investor
- Additional individual tax reporting for each German investor
- Review of the tax assessment notices
- Support in tax field audits of private equity funds
- Preparation and filing of CFC tax returns
- Tax opinions on unclear issues
- Representation of private equity funds or investors before the Fiscal Tax Court

KPMG deploys an internally developed, tailor made, efficient PE tax reporting tool. This tool ensures consistent high quality and seamless communication with private equity funds and investors.

Happy to discuss

We would be happy to advise you on the tax reporting requirements for the German market and together with you develop an optimized strategy to remove any tax obstacles affecting your future German investors.

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