GERMANY

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1. MARKET OVERVIEW

Germany has a well-developed and continuously growing market for investment funds, both undertakings for collective investment in transferable securities (UCITS) and alternative investment funds (AIFs), whether in the form of specialised funds or retail funds.

Nevertheless, a significant portion of the German investor base uses fund vehicles in other jurisdictions or a combination of German and foreign vehicles. Therefore, the German investment fund market is characterised by diverse cross-border constellations, involving onshore jurisdictions such as Luxembourg, UK, and the US, as well as certain offshore jurisdictions such as the Cayman Islands or the Channel Islands.

Whereas collective investment schemes were originally used as instruments of risk diversification for the retail market, they have also become essential for the portfolios of large institutional investors. Many institutional investors previously had a conservative investment approach in the past. The ongoing difficult situation in the traditional financial markets, however, is causing an increasing number of them to participate in more promising investments, including shares in AIFs. About 60% of all specialised fund investors are made up of insurance companies and pension funds. Many of these institutional investors (for example, banks and financial institutions, other investment funds, insurance companies and pension funds) are subject to regulation. Therefore, sponsors of AIFs must often consider not only the regulatory framework that applies to them and the funds they manage, but also the regulatory requirements of potential institutional investors. Investor regulations have often been challenging for sponsors, managers and distributors of AIFs. However, the increasing appetite for alternative investments has also stimulated the regulators to provide rules, under which these types of investments become feasible for these investor groups.

2. ALTERNATIVE INVESTMENT FUNDS

Germany transposed the Alternative Investment Fund Managers Directive (2011/61/EU) (AIFMD) into German Law through the German AIFM Transposition Act providing the introduction of a new German Capital Investment Act (Investment Act) which entered into force in July 2013. The Investment Act applies to basically all collective investment undertakings that pool capital from a number of investors in order to invest it according to a pre-determined investment strategy providing an exclusive catalogue of regulated fund types, each of which is subject to certain product rules. Specialised AIFs are only open to professional and semi-professional (among others, investors who commit to investing at least EUR10 million or commit to investing at least EUR200,000 while being aware of the risks involved and meeting certain personal and other criteria) investors while all other AIFs qualify as retail AIFs. The Investment Act further distinguishes between closed-ended funds and open-ended funds in accordance with Commission Delegated Regulation (EU) No 694/2014 which applies to all kinds of funds within the scope of Investment Act. Where fund interests are redeemable at the request of any of its investors prior to the commencement of its liquidation phase or wind down, directly or indirectly out of the assets of the fund and in accordance with the procedures and frequency set out in the fund documents, the fund is in principle considered to be open-ended. The following analysis only discusses specialised AIFs as defined by the Investment Act in contrast to retail AIFs which are covered in *section 3* below.

2.1 Common structures

The establishment of AIFs in general is restricted to certain legal structures exhaustively listed in the Investment Act, and depending on whether the fund is open-ended or closed-ended.

An open-ended fund can be organised as:

- A contractual fund.
- An investment company with variable capital.
- An open-ended investment limited partnership.

A closed-ended fund can be established as:

- An investment company with fixed capital.
- A closed-ended investment limited partnership.

As for regulated open-ended funds, the most common structure in Germany until now has been the contractual fund. Contractual funds are managed by a management company on the basis of certain terms and conditions that constitute contractual relationships under the law of obligation rather than membership rights and duties. Assets of a contractual fund are either solely owned by the management company, in which the investors are comparable to trustors, or are co-owned by the investors, but such investors do not have the power to dispose of the assets because that power is solely accorded to the management company. In any case, the assets of the fund must be held separately from the investment company's assets. German law also provides a statutory type of open-ended investment funds called investment companies with variable capital established as stock corporations. In general, these corporations issue two types of shares: investor shares and sponsor shares. Investors holding investor shares participate in the fund's assets without being entitled to attend shareholders' meetings or to vote, whereas sponsor shares convey such rights to their holders. The open-ended investment limited partnership is an investment vehicle first introduced by the Investment Act that exclusively addresses certain institutional investors seeking to invest through a regulated open-ended vehicle that is internationally recognised as tax-transparent.

The vehicle most commonly used in Germany for closed-ended AIFs continues to be the German limited partnership where the general partner is typically a company with limited liability. Investors can participate as limited partners holding limited partnership interests. Limited partnerships offer a cost-efficient and tax-neutral approach to structuring private funds. Limited partners can be admitted comparably easily. Carried interest can be structured to be tax-efficient, that is, in such a way that 40% of the carried interest can be exempt from tax. Under the German Commercial Code, a partnership does not have legal personality, but is vested with legal capacity and can therefore be subject to rights and obligations. Limited partners are only liable for partnership debts up to the amount of their capital contribution registered with the commercial registry. The general partner is liable for the partnership debts without limitation. In cases in which the general partner is a corporation, the shareholders of the corporation are not liable for the general partner's liabilities. Under the Investment Act, these funds can be set up under in accordance with the regime that applies to closed-ended investment limited partnerships. The German market has also seen closed-ended funds established on the basis of corporate vehicles. The rules concerning investment companies with fixed capital provide the regulatory format for this option.

2.2 Regulatory framework

The Investment Act provides a comprehensive regulatory framework for practically all investment funds, including AIFs and their managers. An AIF's terms must be filed with the Federal Financial Supervisory Authority (BaFin), and basically all AIFs are subject to supervision by BaFin.

Any manager of an AIF will generally be required to be licensed as a capital investment management company (CIMC) unless they qualify for an exemption, in which case a registration with BaFin will suffice.

Managers who do not exceed certain thresholds will be eligible for the registration process as an exemption from the general authorisation requirement. In particular, managers who exclusively manage specialised AIFs and have assets under management of no more than EUR100 million (including assets acquired through the use of leverage) or of no more than EUR500 million (if no leverage is used and investors are not entitled to redeem their interests in the first five years after the first investment) (sub-threshold AIF managers) will fall within such category. In the registration process, corporate documents of both the manager and the managed AIF will have to be submitted. Sub-threshold AIF managers will only be subject to reporting obligations and to general supervision by BaFin. In addition, managers who exclusively manage closed-ended AIFs (while not being limited to specialised AIFs) and have assets under management of no more than EUR100 million (including assets acquired through the use of leverage) are also exempted from the authorisation requirement, but are subject to certain other requirements of a fully licensed AIF manager (such as depository, governance, and marketing requirements, among others).

All managers who do not qualify for a registration must apply for a licence as a fully authorised AIF manager. Furthermore, managers eligible for the registration process might opt to apply for a full licence to benefit from the marketing passport (see *section 2.4* below) or to market to retail investors as well.

During the licensing process, BaFin will check if the manager meets certain requirements (for example, whether the manager has sufficient capital means to pursue its business, the reliability and qualifications of its directors, structural requirements) before authorising the manager as a CIMC. Suitable verifications of such facts, a business plan, and other documents must be submitted to BaFin in the application.

Any manager fully authorised as an AIF manager by BaFin will be subject to all the regulatory requirements set out in the Investment Act. These include reporting and marketing requirements, the appointment of a depository for each AIF under management, as well as certain governance rules (for example, risk and liquidity management).

Investment advisers are not regulated by the Investment Act itself. However, investment advisers providing advice on the acquisition of financial instruments (including interests in investment funds) must possess a licence under the German Banking Act which implements the Markets in Financial Instruments Directive (2004/39/EC) (MiFID) into German Law.

Grandfathering rules apply, for example, to managers of funds that do not make any additional investments after the implementation of the Investment Act on 22 July 2013 as well as to managers of closed-ended funds where the subscription period expired before 21 July 2011 and where the terms expire by 21 July 2016 at the latest.

2.3 Operational requirements

Different types of specialised AIFs are subject to different requirements and restrictions with regard to the investment activities of their managers.

The Investment Act distinguishes between the following types of specialised AIFs:

- General open-ended specialised AIF are unrestricted with regard to the assets in which they may invest as long as they follow the principle of risk diversification, and the market value of the assets can be determined. Furthermore, the portfolio structure must not interfere with the AIF's qualification as open-ended, that is, redemption of the units has to remain possible.
- For the purposes of the Investment Act, any general open-ended specialised AIF that additionally makes use of either leverage to a substantial degree or short selling, is considered to be a hedge fund.
- Open-ended specialised AIFs with fixed investment terms are widely used by institutional investors such as insurance companies and pension funds. They are in general subject to most of the regulations that also apply to UCITS and open-ended retail AIFs. However, with the consent of the investors and by complying with a catalogue of certain eligible assets, such restrictions can be lifted with the result that the funds can be used as a more flexible vehicle. In any case, investment limits apply to the acquisition of interests that are not listed on a stock exchange or organised market. Furthermore, borrowings are limited in amount and are only allowed on a short-term basis.
- Closed-ended specialised AIFs are permitted to invest in all assets the market value of which can be determined and are therefore the most flexible of all specialised AIFs.

Any of the specialised AIFs discussed above that acquire control in a portfolio company will be subject to transparency requirements as well as certain restrictions to prevent or delay asset stripping.

Furthermore, the AIF manager itself is subject to certain general restrictions regarding its conduct, such as proper risk and liquidity management as well as obligations with respect to potential conflicts of interest.

In addition to regulation by the Investment Act, certain institutional investors are subject to further regulatory regimes with regard to their investments in UCITS or AIFs. For instance, professional pension funds continue to have to comply with certain restrictions and quotas under to the German Investment Ordinance in connection with their investment activities. Insurance companies have to comply with the German Insurance Supervisory Act which as of 1 January 2016 includes requirements under the Solvency II Directive (2009/138/EC) applying to most investment company investors. Even though Solvency II replaces the German Investment Ordinance for the majority of insurance company investors, pillar 2 of Solvency II provides a number of qualitative requirements under the so-called prudent person principle.

2.4 Marketing the fund

Fund marketing is regulated by the Investment Act with regard to all funds that fall within its scope. The term "marketing" in this context, is defined as any direct or indirect offering or placement of units or shares in an investment fund. If an AIF is to be marketed to professional and/or semi-professional investors only (a specialised

AIF), then the term "marketing" only includes offerings or placements initiated by or made on behalf of the CIMC and directed to investors within the EU. Therefore, if such activities are carried out by unsolicited third parties, the Investment Act marketing provisions on specialised AIFs are not applicable.

Any domestic manager (authorised as a CIMC) intending to market domestic specialised AIFs or any EU AIF to professional and/or semi-professional investors must notify BaFin beforehand and provide information and documents about the AIF to be marketed.

The AIFMD provides a marketing passport regime for EU AIF managers wishing to distribute AIFs within the EU facilitating marketing on the basis of a filing with one regulator rather than the regulators of each country in which AIFs are to be distributed. Any EU AIF manager holding a marketing passport under the AIFMD is allowed to market specialised AIFs as well as EU AIFs to professional and semi-professional investors in Germany.

No passport regime was available as of the end of 2015 to non-EU managers who intend to market to German professional and/or semi-professional investors. The European Securities and Markets Authority (ESMA) provided advice including an assessment of the eligibility of certain non-EU jurisdictions for the passport regime in July 2015, and on that basis a delegated act will have to be adopted by the European Commission. Until a passport regime is in place, non-EU managers and managers of non-EU-AIFs are subject to filing requirements under German domestic law in connection with marketing within Germany.

Registered domestic small managers of specialised AIFs are exempt from marketing provisions under the Investment Act (see also *section 2.2* above). A simplified marketing notification regime applies to EU managers who are, along with registered small managers of specialised AIFs in Germany, exempted from AIF manager authorisation in their member state. These managers must be registered in their home member states and that member state must also permit German registered small managers of specialised AIFs to market them without stricter requirements than those set out by the Investment Act (the principle of reciprocity). If a manager qualifies for the simplified regime, BaFin has taken the position that filing one AIF to be distributed in Germany by an EU manager is sufficient even if the manager intends to distribute further AIFs within Germany.

Certain information about the AIF (such as its investment strategy, the assets to be acquired and techniques to be used, investment limitations and use of leverage) and certain reports must also be disclosed to any potential investors in the marketing process.

When forming AIFs for the German market, managers should also consider other regulatory restrictions that might apply to institutional investors (such as insurance regulatory requirements, see *section 2.3* above).

Since the regulations on European Venture Capital Funds (EVCFs) and on European Social Entrepreneurship Funds (ESEFs) became directly applicable in 22 July 2013 in all EU member states, managers of these new fund categories benefit from the EU marketing passport. With this passport, they can manage and market these funds within the EU with the specific EVCF and ESEF labels. In general, these regulations only apply to managers of AIFs who only manage assets up to EUR500 million, that are established within the EU and are subject to registration with the competent authorities of their home member state. To qualify as one of the funds, at least 70% of the managed assets must be "qualifying investments". In both cases, these include equity or quasi-equity instruments issued by a qualifying portfolio undertaking. (In the context of an EVCF this is an undertaking that employs fewer than 250 persons and that has an annual turnover not exceeding EUR50 million at the time of the investment.) A qualifying portfolio undertaking in the context of an ESEF must have the primary objective of achieving measurable, positive social impacts. Additionally, its profits must be used primarily to achieve this objective and the undertaking must be managed in an accountable and transparent way. Either way, the particular qualifying investment undertaking must not be admitted to trading on a regulated market and must be established within the territory of a member state.

2.5 Taxation

The general rules on the taxation of investment funds are contained in the German Investment Tax Act which generally applies to all funds that are also regulated by the Investment Act (all UCITS and all AIFs, both retail and specialised). However, the Investment Tax Act establishes different tax regimes depending on the nature and structuring of the fund in question. Any such determination under the Investment Tax Act is tax-specific and does not affect the regulatory classification of the funds.

Funds that meet certain requirements (so-called "product regulation requirements") are treated as privileged qualifying funds, whereas all other funds are classified according to their respective legal form.

Qualifying funds

Funds that meet the specific product regulation requirements and are treated as privileged qualifying funds will be treated as corporate income tax subjects while also benefitting from a personal tax exemption (semi-transparent tax regime). To qualify for such treatment, a fund must provide its investors with the right to redeem their units at least annually, so excluding any closed-ended funds. Furthermore, active participation in the management of portfolio companies must be excluded, limiting the fund to asset management activities. Risk diversification must be in place, and certain limitations regarding investments in companies not listed on an organised market and in corporations, as well as the extent of borrowings by the fund, must be observed. Lastly, any fund intending to qualify for such regime is only allowed to invest in certain eligible assets exhaustively listed in the Investment Tax Act.

Investors in a qualifying fund are subject to German income tax on certain distributions as well as retained income of the fund and capital gains upon disposal of units in the fund.

Investment companies

Funds that do not comply with such product regulation requirements, such as all closed-ended funds or funds that, for instance, invest in ineligible assets, are classified as so-called investment companies. The tax treatment of such non-qualifying investment companies depends on their legal format, that is, whether they have been established as partnerships or corporations.

A non-qualifying partnership (in particular, a German KG and GmbH & Co. KG as well as a limited partnership) will be treated under the regular German tax regime for partnerships. This means that, where a fund is structured as a partnership that is not engaged in trade or business but is classified as only engaged in asset management, the fund vehicle itself is fully tax transparent (so not subject to German income tax or local trade tax and the relevant share of the partnership's income is taxed at the level of the investors). Whether or not a partnership is engaged in trade or business is a factual matter. According to an administrative pronouncement on the taxation of venture capital and private equity funds issued by the German Federal Ministry of Finance in 2003, the following criteria generally indicate that a private equity fund is not engaged in business activities from a German tax perspective:

- Investments are generally financed with equity rather than debt. However, funds using government subsidies structured as a loan, as well as short-term loans against outstanding capital calls used to bridge the notice period for capital contributions, are permitted.
- In general, funds must not provide collateral (such as guarantees) for indebtedness of portfolio companies. As an exception, providing collateral is permitted if the portfolio company's indebtedness is connected with the unpaid balance of the investors' capital commitments to the fund.
- The partnership cannot "trade" with investments. Proceeds realised by a fund upon the sale or other disposition of investments must not be reinvested, but distributed. As exceptions to this general concept, proceeds up to the amount of which management fees and other expenses have been funded out of capital contributions can be reinvested in investments, and proceeds up to an amount of 20% of the total committed capital of a fund can be reinvested in portfolio companies in which the partnership already holds an investment (follow-on investments).
- Investments should be held "long-term", that is, for a weighted average holding period of three to five years.
- A fund and its agents or representatives should not engage in the day-to-day management of the portfolio companies. This does not affect the possibility of monitoring the investments through the exercise of shareholder rights, including the right to appoint members of the board of directors of the portfolio companies as non-executive directors. As a rule, the definition of a catalogue of management actions requiring board approval is permitted, unless the catalogue has the effect that the management board of the portfolio company does not retain an actual scope to exercise entrepreneurial discretion.

A partnership that is not engaged in trade or business can still be classified as such under the deemed business concept. Under this concept, a limited partnership is deemed to be in business regardless of the nature of its activities, but rather solely due to its legal structure. In particular, a partnership will be deemed a business if its general partner is a corporation and only the corporate general partner or persons who are not partners are authorised to manage the affairs of the limited partnership. A limited partnership, however, is not deemed to be in business if at least one of its general partners is not a corporation or management authority has been vested under the partnership agreement in a limited partner acting in that capacity. In order to avoid a deemed business designation of a limited partnership, it is therefore usually necessary to also vest management rights in a limited partner. Finally, under German law, a limited partnership is classified as a business type partnership, regardless of the nature of its activities or its legal structure, if it receives income from a participation in other business type partnerships.

A non-qualifying fund that is a corporation (including all funds that do not qualify as a partnership, for example, German AG or GmbH, Luxembourg S.C.A, S.A. and S.à r.l.) is subject to a special tax regime. Funds of the contractual type (such as German *Sondervermögen* or Luxembourg *fonds commun de placement*) are deemed to be of corporate nature. Domestic corporate funds are subject to German corporate income tax as well as German local trade tax under this regime, whereas the tax treatment of foreign corporate vehicles is dependent on whether German source income is generated by the fund.

Taxation of investors

Investors in non-qualifying AIFs are, in principle, taxed in accordance with the fund vehicle's legal structure. Investors resident in Germany are taxed on their worldwide income, including income from AIFs, whereas non-resident investors are only taxable in Germany with regard to their German source income as determined in accordance with German domestic law and further qualified by applicable treaty law. Investors in non-qualifying AIFs treated as corporations do not qualify for the so-called partial income tax and/or the tax exemption for dividends and capital gains, unless the income from the AIF is subject to tax (in sufficient degree) at the AIF level.

Taxation of managers

Compensation paid to managers and advisers of AIFs (such as management/advisory fees and performance fees) are generally subject to German income tax and German trade tax, as the case may be. Under certain conditions, 40% of carried interest paid by a fund that qualifies solely as an asset management vehicle rather than a business entity, is tax-free.

2.6 Customary or common terms

The terms of AIFs primarily depend on the investment strategy pursued by each fund. For example, AIFs in developed fund jurisdictions use similar fund terms, for example, most commonly ten years with one or more possible one-year extensions for private equity funds or between 20 and 30 years for infrastructure funds. Usually, the fund term is divided into an investment and a divestment period. During the investment period (which usually ends either when half of the fund term has elapsed or the committed capital has been invested) the fund is allowed to draw capital from investors and acquire portfolio assets in accordance with its investment strategy. After the investment period, investments are mainly limited to follow-on investments (that is, investments in portfolio companies in which the fund already holds a share). In order to align the sponsors' and the investors' interests, it is customary to provide for an obligatory management team capital commitment to the fund of between 1 and 2% of the aggregate capital commitments.

Remuneration arrangements normally include fixed compensation (often referred to as a management fee) and variable compensation (carried interest). During the investment period, the fixed compensation is normally calculated as a percentage of the aggregate capital commitments of the fund. At the end of the investment period, it is reduced either by applying the same percentage on the amount of invested capital or by reducing the applicable percentage. Whereas this compensation drop-down is an internationally recognised standard in the private equity world, terms used in German funds can exhibit specific features due to German value added tax (VAT) issues. German tax authorities generally impose VAT on fees for services rendered by a management company to an AIF as long as such management fees are paid irrespective of the fund's gain or loss. This is due to a strict interpretation of a provision of German tax law implementing the AIFMD. While the VAT Directive provides a VAT exemption for fund management services without excluding certain types of funds, Germany has so far only acknowledged such exemption for qualifying funds (see *section 2.5* above). The European Court of Justice has held in a case submitted from the Netherlands (*Fiscale Eenheid X*, Case C-595/13) that the management of real estate funds that are subject to specific state supervision will be free of VAT. It is the responsibility of the German legislator to implement the decision accordingly. AIF managers and AIFs regulated in accordance with AIFMD should be tax exempt according to the new decision. There are good arguments that the same applies to sub-threshold special AIF managers and mini retail AIF managers. Until new legislation has been enacted, German fund terms should, to be on the safe side, either contain provisions whereby the management fee is structured as a genuine part of the fund's gain (which is only owed if the fund generates sufficient gain and therefore is not subject to VAT) or which determine whether the fund or the management company has to bear the VAT burden.

3. RETAIL FUNDS

3.1 Common structures

Open-ended retail funds can, in general, be organised as contractual funds or as investment companies with variable capital, whereas open-ended investment limited partnerships cannot be used for retail funds. Closed-ended retail funds can be organised as investment companies with fixed capital or closed-ended investment limited partnerships. Whereas investors in specialised AIFs established as closed-ended investment limited partnerships must become limited partners, investors in a retail closed-ended investment limited partnership can also participate as trustors with a trustee limited partner actually holding a limited partner interest.

3.2 Regulatory framework

As for specialised funds, the main source of regulatory legislation that applies to retail funds is the Investment Act. As a general rule, the terms of retail funds need to be approved by BaFin and managers of retail funds must obtain a licence from BaFin. Managers of retail funds may be exempt from the licence requirement if the assets under management do not exceed EUR100 million (see also *section 2.2* above).

3.3 Operational requirements

Under the Investment Act, only certain types of investment funds subject to restrictions regarding their investment policy can be established, managed and distributed in Germany if the shares in the funds are to be acquired by retail investors (all investors that do not qualify as professional investors or semi-professional investors).

Types of open-ended retail funds include UCITS, the rules for which have been harmonised within the European Union since 1985, as well as the following types of retail AIFs:

- Mixed investment funds.
- Other investment funds.
- Funds of hedge funds.
- Open-ended real estate funds.

Participations that do not qualify as securities are not eligible for "other investment funds". This is crucial since other investment funds have, prior to the Investment Act coming into force, been one of the broadly available types of open-ended investment funds that can allocate at least a small portion of their portfolio to shares of closed-ended funds. However, from a regulatory point of view, it should be possible for "other investment funds" to invest in closed-ended AIFs, the shares of which qualify as securities.

As for closed-ended funds, the Investment Act provides a uniform set of rules for all retail funds. This type of fund can acquire certain types of assets including:

- Real assets (as further specified by the Investment Act, including real estate, ships, planes, renewable energy facilities, railway vehicles, electric vehicles, containers and infrastructure for the aforementioned assets).
- Participations in certain public-private partnership infrastructure projects.
- Certain participations (including those in non-listed businesses).
- Units in other retail AIFs or specialised closed-ended AIFs.

Closed-ended retail AIFs must invest in accordance with the principle of risk diversification, except where all retail investors in the fund invest at least EUR20,000 (in addition to further requirements). However, this exception does not apply to private equity funds.

3.4 Marketing the fund

The marketing passport regime under AIFMD only applies to AIFs marketed to professional investors and so excludes any retail AIFs. Managers who intend to market retail AIFs in Germany are therefore subject to the domestic marketing regime for retail AIFs provided in the Investment Act. Such marketing must be notified to BaFin and involves disclosing the retail AIF's prospectus and key investor documents. Retail funds that are UCITS, however, can be marketed with a passport under the UCITS Directive.

With its regulation on European long-term investment funds (ELTIF), the EU introduced a new type of collective investment framework, aimed at investment fund managers who want to offer long-term investment opportunities to professional or retail investors across Europe. The marketing of such a fund only requires notification to the competent authority in the home member state. As managers of ELTIFs benefit from an EU marketing passport, additional authorisation in the host state will not be necessary. Nevertheless, the regulation prescribes special requirements concerning the distribution of ELTIFs to retail investors, for example providing appropriate investment advice and performing a suitability test. To qualify as an ELTIF, the fund can only invest in certain types of assets. These include equity or quasi-equity instruments that are issued by a qualifying portfolio undertaking, for example an unlisted company requiring long-term capital, such as infrastructure, notably in network industries. ELTIFs can also invest in other European funds such as other ELTIFs, EVCFs or ESEFs. In accordance with the principle of risk diversification, at least 70% of assets under management must be invested in eligible assets. Furthermore, an ELTIF must be offered by a manager who is authorised under the AIFMD and must run for a specified period of time during which the investors do not have the right to redeem their shares.

3.5 Taxation

The AIF managers Tax Adaption Act provides uniform rules for all UCITS and AIFs, both specialised and retail AIFs. Whereas the rules described above for (specialised) AIFs also apply to retail funds, it seems to be an accurate expectation that the portion of open-ended retail funds falling within the tax regime for "qualifying funds" under the Investment Act will be larger than for specialised AIFs. Closed-ended funds, however, will always be treated as non-qualifying funds, their tax treatment solely depending on each fund vehicle's legal format (see *section 2.5*).

3.6 Customary or common terms

There is a large spectrum of possible terms for retail funds, depending on the type of investments pursued by the fund and the legal and regulatory form of the fund. The Investment Act provides minimum requirements applicable to all fund types and more specific rules for each fund type.

4. PROPOSED CHANGES AND DEVELOPMENTS

In July 2015, the Federal Ministry of Finance released a discussion draft for a proposed German Investment Tax Reform Act to come into force in January 2018. With regard to investment tax, the discussion draft provides for systematic changes with two tax systems functioning independently of one another. For retail funds, an opaque tax regime is envisioned. This would entail two major features. Firstly, an investment fund's income from domestic sources will be subject to German corporate income tax. Secondly, an investor's allocable share of income derived from an investment fund will be subject to tax regardless of the sources of the relevant proceeds. For specialised funds, the principle of semi-tax-transparency will largely be limited to capital gains tax. Going forward, private investors will not be permitted to invest in specialised investment funds either directly or indirectly through partnerships.

Furthermore, implementation of the UCITS V Directive (2014/91/EU) is underway which will, among other things, ease restrictions on debt funds. Until May 2015, the German regulator took the view that loan origination was not a permitted activity for an AIF. In accordance with ESMA's view, BaFin revised this approach and in principle accepted loan origination by AIFs. The draft UCITS V Implementation Act contains more detailed rules with regard to loan origination activities by AIFs.