
CHAMBERS GLOBAL PRACTICE GUIDES

Alternative Funds 2023

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Germany: Law & Practice
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POELLATH



GERMANY



Law and Practice

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POELLATH (formerly known as P+P Pöllath + Partners) has approximately 180 professionals, around 60 of whom contribute to one of the largest and most experienced fund structuring practices in continental Europe, with locations in Berlin, Frankfurt and Munich. The firm is a market leader in the structuring of private equity funds in Germany and maintains strong relationships with German law firms in jurisdictions abroad. The firm also advises initiators of and investors in private equity funds and worldwide fund participations in the area of alternative investments. The team has extensive expertise

in fund structuring; advice regarding the Alternative Investment Fund Managers Directive (AIFMD), the German Capital Investment Code (“KAGB”) and the Markets in Financial Instruments Directive II (MiFID II); asset management; and secondary transactions. This includes all relevant fund structures in private equity (buy-out, venture capital), private debt, distressed debt, real estate, infrastructure, natural resources, education, hybrid funds, hedge funds, digital assets funds, captive funds, master-feeder structures, separate accounts, annex funds as well as primary and secondary fund of funds.

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1. General

1.1 General Overview of Jurisdiction

Germany is not a typical funds jurisdiction, such as Luxembourg or the Channel Islands. Nevertheless, Germany has a sizeable alternative funds sector with German-based funds and managers in place, for both direct investment funds as well as fund of funds. Besides domestic fund structures, many fund managers offer cross-border fund structures (eg, a German master fund with non-German feeder funds for certain non-German investors). Some German fund managers also use pure non-German fund structures (mostly based in Luxembourg).

As for investors, Germany is a top jurisdiction in Europe with regard to large institutional investors, such as insurance companies, pension funds and pension schemes, banks and credit institutions, as well as family offices and high net worth individuals (HNWIs).

2. Funds

2.1 Types of Alternative Funds

Private equity funds (buyout, venture capital, and growth capital) and real estate funds, as well as fund of funds, are the most commonly established funds in Germany. Renewable energy funds and private debt funds are also noteworthy.

2.2 Fund Structures

A German limited partnership (“GmbH & Co KG”) is typically used for closed-end alternative investment funds. The German limited partnership is structurally comparable to the US, UK or Luxembourg limited partnership. It offers limited liability to its limited partners and has as a corporate type, general partner with unlimited liability

(although the general partner’s liability is limited to its assets, typically EUR25,000, and is thus, effectively, also limited).

The German limited partnership offers the benefits of being tax-transparent and allowing legal flexibility for its governance. It is the market standard for registered fund managers, such as Alternative Investment Fund Managers Directive (AIFMD) sub-threshold fund managers.

Contractual funds with no legal personality (*Sondervermögen*) are typically used for open-end funds. Contractual funds can only be established by alternative investment fund managers (AIFMs) that are fully authorised under the German implementation of the AIFMD (Directive 2011/61/EU). The contractual fund is often established for real estate funds and non-UCITS funds. It is also often used for separate managed accounts as an investment platform for institutional investors.

2.3 Regulatory Regime for Funds

The German regulatory regime for alternative investment funds (AIFs) is based on the AIFMD. Germany implemented the AIFMD into the German Capital Investment Act (*Kapitalanlagegesetzbuch* or KAGB). The KAGB contains the AIFMD manager-related rules and the AIFMD funds marketing-related rules. It further sets out German-specific “product rules” applicable to AIFs. This overlay of product rules for AIFs, however, applies in general only to fund managers that are fully authorised under the AIFMD.

Smaller-Fund Managers

Smaller-fund managers, ie, sub-threshold managers under the AIFMD, are only subject to a registration requirement. The funds of sub-threshold managers are not regulated and no investment restrictions for such funds exist

(except for debt funds). Most German-based fund managers in the alternative assets space are still sub-threshold managers (as opposed to fully authorised fund managers). However, the number of fully regulated managers in Germany is constantly growing, as a result of an increase in assets under management.

Large-Fund Managers

Large-fund managers, ie, fund managers that need to be fully authorised under the AIFMD, are subject to a regulatory regime very much based on the AIFMD. Their funds are also subject to product rules, ie, investment and borrowing limitations.

Investment Limitations

The German Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht* or BaFin) is in charge of overseeing the regulatory regime for fund managers and funds. The applicable product rules for a fund, ie, the investment limitations, depend on the category of the fund and on whether the fund is a retail fund or a non-retail fund. Non-retail funds (so-called *Spezialfonds* or specialised investment funds) are open only to professional and semi-professional investors.

Open-end and closed-end funds

The investment limitations for open-end alternative retail funds are based on the UCITS Directive, but provide for variations and deviations from a UCITS. Deviations are, for instance, broader eligibility of investments in other AIFs or investments in loans or non-listed equity. For open-end real estate funds, the deviations are most profound, ie, real estate funds may only invest in real estate and in vehicles that invest in real estate (in addition to holding liquidity).

The investment limitations for closed-end alternative retail funds are not based on the UCITS Directive. Accordingly, they are more in line with alternative asset classes. The reason for this is that closed-end funds have traditionally been used for alternative investments. Therefore, closed-end funds can invest in real assets, such as real estate, ships, aeroplanes and infrastructure, or in non-listed equities.

With regard to open-end and closed-end special funds, the only investment limitation is that the assets must have a market value (in addition to the fund being risk-diversified). However, the KAGB also provides for a so-called “special fund with fixed investment guidelines”. The special fund with fixed investment guidelines is popular with institutional investors as an investment platform, as it offers the possibility of being tax transparent and being exempted from group consolidation under German accounting rules. Closed-end special funds can grant loans to non-consumer borrowers within strict limits (see **2.6 Loan Origination**).

The EuVECA, EuSEF and EU-ELTIF regimes

In addition to the above regimes, the European Venture Capital Funds (“EuVECA”) regime and the European Social Entrepreneurship Funds (“EuSEF”) regime are directly applicable in Germany, as well as the European Long-Term Investment Funds (ELTIF) regime. The ELTIF regime was only recently amended by EU legislature (ELTIF 2.0) with the goal to opening the private capital market to retail investors.

Timing with regard to regulatory approval in Germany

As mentioned above, regulatory approval in Germany needs to be obtained by the manager of the fund and not by the fund itself. Depending on the type of licence, BaFin must make its

decision for approval within certain statutory deadlines. The deadlines begin from the date of receipt of the complete documents required for the approval of the respective licence. Such deadlines are:

- two weeks for a sub-threshold manager;
- two months for a EuVECA/EuSEF manager; and
- six months for a fully licensed manager.

However, it remains at the sole discretion of BaFin, when the required documents for approving the respective licence are complete. That said, in practice the usual time indication for receiving the respective approval is (i) two to four weeks for a sub-threshold manager; (ii) three to six months for a EuVECA/EuSEF manager; and (iii) 12 to 18 months for a fully licensed manager.

2.4 Disclosure/Reporting Requirements Prospectus

In respect of special funds, ie, non-retail funds, Article 23 AIFMD disclosures must be provided if the fund is marketed in Germany or in the EU. In any case, a private placement memorandum (PPM) is commonly produced for all special funds, to protect fund sponsors from civil litigation liability.

Key Information Document

If the fund is marketed to semi-professional investors, a key information document must be produced.

Annual Reporting

There are annual reporting requirements for both managers of retail funds and managers of non-retail funds. In addition, there are semi-annual reporting requirements for contractual funds and investment stock corporations (*Aktiengesells-*

chaft or AG) with variable capital. The reports must be published.

Federal Bank Reporting

Investment funds (ie, in particular AIFs) must submit (monthly) reports to the German Federal Bank for statistical purposes. The reports must contain, among other things, information on the amount and composition of the fund assets.

Partnership Structures

With regard to a German partnership, its limited partners need to be registered with the local commercial register. The records maintained at the commercial registry are publicly available via the internet. This includes the identity of the investors as limited partners and their liability amounts (typically expressed as a small percentage of the capital commitment). Such disclosure can be avoided by interposing a nominee as direct limited partner, to hold and manage the limited partner interest for and on behalf of the investors as beneficiaries.

Filing of the partnership agreement is not required, thus the fund terms remain confidential. However, if the fund is set up as a corporate fund (GmbH or AG), the governing rules (the statute) of the fund needs to be filed with the respective commercial register, after which, the fund terms are publicly available (unless included in a separate document, eg, shareholder agreement).

AML Transparency Register

In 2018, Germany introduced the transparency register under the EU anti-money laundering (AML) law. The transparency register must include all beneficial owners. The law was then revised, effective from 1 August 2021, by the Transparency Register and Financial Information Act. As a result, almost all legal entities in Germany are required to notify the transparency

register of all beneficial owners, regardless of the information already contained in other registers.

Sustainable Finance Disclosures Regulation/ ESG Reporting

Furthermore, Regulation (EU) 2019/2088 – the Sustainable Finance Disclosures Regulation (SFDR) on sustainability-related disclosures in the financial services sector – and Regulation (EU) 2020/852 – on the establishment of a framework to facilitate sustainable investments (the “Taxonomy Regulation”) – both require disclosure of information regarding the ESG status of a fund. The goal of the regulations is to allow investors to properly assess how sustainability risks are integrated in the investment decision process, to prevent greenwashing activities on the part of financial institutions and to monitor ESG activities. The level of disclosure under the SFDR depends on the relevant level of impact the fund intends to pursue. In general, funds are required to disclose pre-contractual information about the fund in the annex of the offering memorandum and on the website of the fund manager, as well as ongoing disclosures of information about the fund as an annex to the annual report. Additionally, the fund manager is required to disclose information about itself on its website. Many details of these disclosures are still subject to additional rule-making and ongoing changes.

2.5 Tax Regime for Funds

Overview

The applicable tax regime depends on the legal form of the fund in question. For funds structured as partnerships (eg, the German KG), the German general tax rules apply. This is typically the case for closed-end AIFs. For funds structured in other legal forms (corporations or contractual-type funds), special tax regimes are applicable under the German Investment Tax

Act (*Investmentsteuergesetz* or InvStG). This is mostly applicable to open-end UCITS, certain open-end AIFs, as well as closed-end AIFs (if structured as corporations or contractual-type funds).

Funds as Partnerships

According to German general tax rules, partnerships are not subject to German income tax, ie, they are tax-transparent. However, funds structured as partnerships may be subject to German trade tax. If the fund is structured as a partnership, the main issue under the German general tax rules is whether the fund is conserved to be engaged in trade or business, or whether such activity is considered investment activity (also called private asset management status). If the fund is considered to be engaged in investment activities only, it is not subject to German trade tax (ie, it is fully “transparent” for tax purposes).

Any income derived by a partnership is immediately allocated to its partners and taxed at the level of the partners, in accordance with the rules of the tax regime applicable to the respective partners. On the other hand, if the fund vehicle qualifies as being engaged in a trade or business, the fund itself is not subject to German income tax, but it is subject to German trade tax.

There are no withholding tax implications at the level of a partnership itself. However, withholding tax implications can arise from the underlying investments made by the fund.

Funds as Corporations or Contractual-Type Funds (Investment Funds)

The German Investment Tax Act applies to all funds other than partnerships. Thus, it covers so-called “investment funds”, ie, funds that are structured as corporations or contractual-type funds (*Sondervermögen*). The Act gener-

ally applies to UCITS and AIFs (both retail AIFs and special AIFs). Also covered are certain other entities that do not qualify as “investment funds” under the KAGB (in particular, single-investor funds).

Prior to the 2018 revision of the Act, the German Investment Tax Act provided for a tax regime known as the “restricted transparency” regime. This has been replaced by two different concepts, the “opaque regime”, which is the general regime under the revised Act, as well as the “restricted transparency option” regime, to which only specialised investment funds pursuant to the German Investment Tax Act may opt in.

Under the opaque tax regime, there are two levels of taxation: the fund and the investors. This tax regime is applicable to all retail funds. Furthermore, it also applies to all other investment funds (including non-retail funds) that do not satisfy the specific criteria for specialised investment funds, or specialised investment funds that do not use the transparency option.

Opaque regime

Under the opaque regime, the fund itself is subject to taxation. However, the fund is only subject to taxation with respect to certain types of income: certain domestic German income (in particular, dividends and real estate income, but not capital gains from the sale of securities unrelated to real estate and unrelated to a permanent establishment in Germany). In respect to such income, a 15% tax rate (ie, German corporate tax rate) applies to the fund. The exemption for dividends (Section 8b of the German Corporation Tax Act) is not applicable at fund level even if the relevant threshold (ie, 10%) is exceeded.

In addition, German trade tax may apply at fund level if the fund itself is engaged in trade or business in Germany (subject to a potential exemption if the fund does not engage in “active entrepreneurial management” in relation to its assets). Investment funds are required to withhold tax for the taxable income of their (domestic) investors, but not for the income from the sale of fund units.

In general, there are no tax exemptions at the level of the fund. In return, at the level of the investor, proceeds received from the fund are subject to partial exemptions depending on the respective fund type (equity fund, mixed fund or real estate fund).

At the investor level, there is lump-sum taxation (designed for the needs of retail funds with a large number of investors, but applicable to all funds covered). In particular, distributions from the fund, predetermined tax bases and capital gains realised upon sale or redemption of the fund interests are covered. The objective of the predetermined tax base is to subject the retained income of the investment fund to tax.

Different investor types

For individual investors, the actual rate of investor-level taxation depends on whether the investor holds the fund interests as part of their “non-business” or “business” assets. If individuals hold their investment fund interests as part of their non-business assets, such items are subject to flat income tax. If individuals hold their investment fund interests as part of their business assets, generally, the full amount of such items is subject to income tax at their personal rate.

For corporate investors, the full amount of such items is subject to corporation tax. In addition,

German trade tax may be triggered at the corporate investor level. The partial income taxation and the exemption pursuant to Section 8b of the German Corporation Tax Act do not apply. In return, investment fund proceeds (ie, distributions, predetermined tax bases and capital gains from dispositions or redemptions) are now subject to partial exemptions depending on the respective fund type.

Partial exemptions in respect of certain types of funds

With respect to “equity funds”, the partial exemption is:

- 30% of such proceeds for individuals who hold their investment fund interests as part of their non-business assets;
- 60% for individuals who hold their investment fund interests as part of their business assets; and
- 80% for corporate investors.

With respect to mixed funds, half of the partial exemption rate applicable to equity funds is available to investors. With respect to real estate funds, the partial exemption is 60% or 80% of the proceeds, depending on whether the fund invests at least 51% of its value in German or non-German real estate and real estate companies. In return, income-related expenses and operating expenses may not be deducted to the extent of the available partial exemption percentage. With regard to trade tax at investor level, half of the applicable partial exemption rate applies.

Non-resident investors

Domestic and foreign investors in investment funds are treated equally on a formal basis. However, the partial exemption rates provided in the German Investment Tax Act only benefit

German investors, because foreign investors are generally not subject to any tax obligation in Germany at the level of investment fund investor.

In the case of non-resident investors of a German investment fund subject to the German Investment Tax Act, the distributions to such non-resident investor will not be taxable in Germany and will not be subject to withholding tax. As a result, non-resident investors who make German investments via (domestic or foreign) investment funds only have to bear a German tax burden, as far as there is taxation at fund level (fund input side). The German non-taxation of distributions to non-resident investors (fund output side) is completely independent of which assets the fund holds, in which country the investor is domiciled and whether a double-taxation agreement is applicable.

Specialised investment funds: “restricted transparency” regime (optional)

If the investment fund qualifies as a specialised investment fund, the fund may opt to be treated transparently for tax purposes. As a result, the fund itself will not be subject to taxation, ie, it will effectively be transparent (although not as fully transparent as a partnership). This “restricted transparency option” regime is similar to the tax regime for investment funds under the German Investment Tax Act which was in force before 2018, but with certain amendments.

Specialised investment funds may only have a maximum of 100 investors. Unlike the prior law (in force before 2018), there is a look-through approach with respect to partnerships as investors (ie, each partner of such partnership is counted as one investor of the fund). However, individuals may now invest directly in a specialised investment fund, provided that they hold such fund interests as part of their business

assets (previously, only the indirect participation of investors was possible).

To qualify as a specialised investment fund, a fund must satisfy certain criteria with respect to regulation, redemption rights, eligible assets and investment restrictions. These are substantially similar to the criteria under the law in place before 2018 (although certain changes with respect to the definition of “securities” apply).

If the specialised investment fund opts to apply the restricted transparency regime, at fund level, there is no taxation for domestic participation income and domestic real estate income. At the investor level, “special investment income” is subject to tax (ie, distributed income, deemed distributed income and capital gains realised upon the disposition or redemption of fund interests). The flat income tax rate is not applicable, even if an individual holds its investment fund interests as part of its non-business assets. Foreign withholding tax is still creditable.

2.6 Loan Origination

Closed-end special funds can originate loans in Germany. This applies to both German funds as well as EU funds with an EU-AIFM. German funds may, however, grant loans only to corporate, non-consumer, non-retail borrowers, leverage of the fund itself is restricted and certain diversification rules apply. Also, detailed rules on risk management apply (“KAMaRisk rules”). EU funds with an EU-AIFM may grant loans to German corporate, non-consumer, non-retail borrowers based on the rules of such AIFM’s home jurisdiction.

Non-EU funds may grant loans to corporate, non-consumer, non-retail borrowers in general only if the loan is granted on a reverse solicitation basis or if the loans are subordinated to

almost-equity level in the case of insolvency or financial difficulties on the part of the borrower.

Additionally, a fund (with respect to German borrowers) is able to purchase a fully drawn term loan, revolving or unfunded portions of a term loan facility (becoming the lender of record), or enter into a sub-participation of a loan, without a banking licence (loan participation). However, a later restructuring of the loan terms may be regarded as a (new) loan origination and may require a banking licence (unless other exemptions apply).

2.7 Non-traditional Assets

Cryptocurrencies

Funds managed by sub-threshold managers may invest in cryptocurrencies and non-traditional assets.

With regard to fully authorised managers, a special fund can in theory also invest in cryptocurrencies and non-traditional assets. The practical problem is that the mandatory depositaries for such funds oppose the holding of such assets. That said, new regulatory rules for acting as a depositary for cryptocurrencies and other digital assets were implemented in 2020, although those rules will still face the test of time. As a result, it is expected that specialist depositaries will develop and that traditional depositaries will delegate their activities with regard to digital assets to these new “fintech” service providers. At the time of writing, only a limited number of depositaries for cryptocurrencies have been licensed by BaFin.

Special funds (ie, non-retail funds) can invest in cryptocurrencies without any limitation. But special funds managed by fully authorised managers have to appoint a depositary for their crypto-investments.

Consumer Credit and Loan Portfolios

In general, German investment funds cannot originate consumer credit loans. However, special funds can originate loans to corporate, non-consumer, non-retail borrowers in Germany. German closed-end special funds are allowed to originate loans of up to 30% of the already paid-in capital minus the fees and costs borne by the investors. Additionally, German closed-end special funds can only lend 20% of the already paid-in capital minus the fees and costs borne by the investors, to a single borrower in order to minimise the credit default risk.

Furthermore, these funds can borrow up to 50% as shareholder loans of the already paid-in net capital to portfolio companies that the fund holds directly.

German open-end special funds can originate loans of up to 50% of their invested capital.

The AIFMs which manage loan-originating AIFs are required to have adequate liquidity and risk management systems in place.

Lastly, the AIFs are also allowed to restructure existing loans.

Litigation Funding

Funds which are allowed to grant loans are also mostly allowed to fund litigation. However, there is a limitation with regard to the funding of litigation. AIFs which are managed by fully authorised AIFMs are only allowed to invest in assets which can be valued at any time. This is challenging with respect to financing of litigation, as the risk of the loan depends on the legal risk of the respective financed lawsuit, which is difficult to assess independently. Therefore, significant practical challenges remain when setting up

litigation funding AIFs under the German fund regime.

Cannabis and Cannabis-Related Investments

Funds can invest in cannabis or cannabis-related portfolio companies, as long as the portfolio company's activity is legal or it has the necessary licence to do so. In other words, German funds are not allowed to invest in an activity which is illegal. Other than that, there are no restrictions with regard to cannabis or cannabis-related investments.

2.8 Use of Subsidiaries for Investment Purposes

The use of subsidiaries is common, in particular, with regard to private equity funds and real estate funds. The advantages are often structural reasons, such as creating different tiers of structural subordination (not just contractual subordination) of lenders or making use of leverage (in this case, private equity funds). From a tax and regulatory perspective, the use of subsidiaries is also relevant, as leverage should ideally be used at the subsidiary level, since leverage at the fund level (however, only regarding private equity and venture capital) may trigger both qualification of the fund as being engaged in a trade or business for German tax purposes, as well as triggering the lower EUR100 million assets-under-management threshold requiring full authorisation for the fund manager under the AIFMD. In addition, real estate funds tend to use subsidiaries to better handle real estate transfer tax issues and make shareholder loans tax-deductible at the subsidiary level (to a certain extent).

2.9 Requirement for Local Investment Managers

Germany requires either a German-based fund manager or a fund manager with an AIFMD passport.

The fund manager can, however, outsource portfolio management to an investment manager abroad. Such outsourcing is, for instance, quite common with regard to special funds established as a separate managed account for a specific German institutional investor.

2.10 Other Local Requirements

The fund manager (AIFM) needs to have sufficient substance in Germany, both from a regulatory and tax perspective. This basically translates into having sufficient physical presence in terms of senior management and staff in Germany. On the regulatory side, BaFin follows the European Securities and Markets Authority (ESMA) Brexit guidelines with regard to substance requirements (ESMA34-45-344).

Directors of a corporate fund may not need to be German residents. However, foreign directors must make sure that corporate decisions are made in Germany (this can happen on a well-documented fly-in basis).

A local general partner is required for German partnership funds. Germany follows the “seat theory” with regard to the applicable law in the case of partnerships.

Funds are not expected to maintain business premises or hire local employees in Germany.

2.11 Rules Concerning Other Service Providers

Fund Depository

A fund depository is necessary if the fund is managed by a fully authorised manager – based on the AIFMD. For German-based funds, the depository must be German-based as well.

Money-Laundering Officer

A money-laundering officer must be German-speaking and German-resident. BaFin does not accept a money-laundering officer on a fly-in basis. It is usually sufficient, however, for the money-laundering officer to be employed by the fund manager and not by the fund.

Compliance Officer

A compliance officer and other internal control functions usually require a local presence as well. It is also usually sufficient for the compliance officer to be employed by the fund manager and not by the fund.

Fund Administrators

Fund administrators can provide their services from outside Germany. This is useful for offshore fund administrators who would like to access the German market, but for whom it does not make business sense to have a local presence.

2.12 Anticipated Changes German Act to Modernise the Law on Partnerships (“MoPeG”)

After a transition period of around two years six months, comprehensive reform of the German Law of Partnerships will essentially come into force on 1 January 2024. The reform adapts German partnership law to the requirements of a modern, diverse economic life, and codifies certain legal developments of the past decades that have already been carried out in case law, science and practice. Among other important innovations (eg, a special new register for a standard German partnership), the law has certain implications for German limited partnerships as well (eg, the rules governing legal challenges to partnership resolutions).

3. Fund Managers

3.1 Origin of Promoters/Sponsors of Alternative Funds

Promoters/sponsors of German alternative funds are typically established in Germany.

3.2 Legal Structures Used by Managers

Managers almost always use a corporate entity for the managing entity (GmbH or AG). In the case of internal management of the fund, the management is carried out by the fund's own management bodies (managing directors or board members).

3.3 Regulatory Regime for Managers

The German regulatory regime for AIFs is based on the AIFMD. Germany implemented the AIFMD into the German Capital Investment Act (*Kapitalanlagegesetzbuch* or KAGB). See 2.3 Regulatory Regime for Funds for details.

3.4 Tax Regime for Managers

Overview

With respect to the tax regime applicable to income received from the fund by fund managers, several income streams need to be distinguished. Fund managers typically invest their own money (usually through a separate team commitment vehicle organised as a German limited partnership considered to be engaged in private asset management). With respect to income in relation to such capital commitment, the fund managers are treated like normal investors in that no special rules apply. In addition, fund managers may receive, according to the so-called distribution waterfall in fund agreements, additional income which does not correspond to their capital commitment – ie, which is capital disproportionate – so-called “carried interest”. In Germany, special tax rules apply – with certain requirements and qualifications –

to carried interest received by fund managers (see 3.6 Taxation of Carried Interest). The third type of income stream that fund managers may receive from the fund is the management fee, which is typically accrued by the management company itself. As (external) management entities are generally structured as corporations, the management fee is typically subject to corporate income tax and trade tax at the management company level. That said, from an income tax perspective, all management fee income is taxable as income received for services provided, that is, no special tax exemption is applicable.

In practice, the greatest issue in relation to management fees arises in relation to the value added tax (VAT) treatment.

Management Fee and VAT

German VAT Act

The issue of VAT treatment in relation to management fees in Germany has changed over the years, but is still a hot topic. Until the end of 2017, the management fee payable to the fund manager of an AIF was subject to German VAT (unlike the management fee on UCITS funds, where there has been a specific exemption for many years). With the revision of the German VAT Act in early 2018, the fund managers of UCITS and of certain AIFs that are comparable to UCITS, are exempt from VAT. The law does not provide guidance on which types of AIFs are comparable to UCITS but the German tax authorities have issued guidance on this point. Accordingly, certain criteria must be fulfilled in order to benefit from the VAT exemption (in particular, the AIF has to offer shares to the same group of investors and be subject to similar obligations and controls as UCITS). In practice, the German tax authorities try to argue that AIFs which target professional investors (and semi-professional investors) are not comparable to

UCITS, thus denying the VAT exemption. The situation has not been settled and certain German local tax authorities have confirmed the application of the VAT exemption in individual cases, or, if disputed, have agreed to a compromise (partial exemption, eg, up to 90% in some cases).

Funds-Jurisdiction Strengthening Act

Effective since 1 July 2021, the Funds-Jurisdiction Strengthening Act extended the VAT exemption on management fees for certain types of AIFs (venture capital funds). Although a positive development, the legislative wording is rather narrow and potentially excludes a number of AIF categories (eg, buyout funds, infrastructure funds, private debt funds, real estate funds, etc) from the benefits of VAT exemption and creates potential issues under European state aid rules. This point remains an issue that is seen as a potential negative factor when comparing German funds with funds in other European jurisdictions.

Supplement to the German VAT Regulations

In June 2022, the Federal Ministry of Finance published a final version of the long-awaited supplement to the German VAT Regulations and clarified the conditions under which a fund qualifies as a venture capital fund within the meaning of the Act. The definition's linchpin is a minimum capital contribution of at least 50% of the fund's aggregated investments in young, innovative growth companies based in the EU or EEA (target companies) that meet certain requirements (eg, the company must have been established less than 12 years ago). Furthermore, the fund must demonstrate that it is subject to comparable conditions to those of a UCITS as well as to special government supervision. The decree has therefore brought more legal certainty for VC funds in the area of VAT.

Act on Financing of the Future

In April 2023, the German Federal Ministry of Finance and the German Federal Ministry of Justice and Consumer Protection announced a draft bill for an Act on Financing of the Future. The draft bill intends, among other things, to extend the VAT exemption to the management of all AIFs (eg, also buyout funds, infrastructure funds, private debt funds, real estate funds, etc). See 3.10 Anticipated Changes.

3.5 Rules Concerning Permanent Establishments

Germany does not have an exemption ensuring that alternative funds with a German manager do not have a "permanent establishment" or other taxable presence in Germany. This is due to the fact that for funds structured as limited partnerships, the German general tax rules apply. The German Investment Tax Act, that is, the special tax regime applicable to funds structured other than as partnerships (ie, funds in the form of a corporation or a contractual-type fund), does provide certain special rules that deviate from the general German tax rules, but, in effect, it does not provide special rules to substantially limit the permanent establishment risk of foreign investors.

3.6 Taxation of Carried Interest

Overview

The tax treatment of carried interest for fund managers will depend on the legal form and tax status of the fund. The tax treatment of funds structured as partnerships that are not engaged in a trade or business, that is, that are considered to be engaged in private asset management activities, is well established. These rules apply to the majority of German funds. The rules applicable to other types of funds, in particular, funds structured as partnerships that are engaged in a trade or business, or structured as

a corporation or contractual-type fund are less settled, although certain recent developments are encouraging.

Carried Interest Taxation

Funds structured as partnerships engaged in private asset management

Most German funds, in particular direct investing funds, are set up as partnerships and carefully structured to qualify as private asset management activities. Often, fund managers will apply for an advance tax ruling with the German tax authorities to confirm this point prior to the first closing of the fund. Funds that are partnerships engaged in private asset management activities are fully tax transparent, that is, the fund itself is not subject to German trade tax. In addition, a special German tax regime applies to carried interest income received by fund managers, subject to certain technical qualifications (Section 18 paragraph 1 number 4 German Investment Tax Act). As a result, a certain tax exemption (ie, 40% income tax exemption) applies, which results in an effective rate of income tax of around 28.5% at the level of the individual tax managers (as opposed to the highest personal income tax bracket of 45% otherwise applicable). One of the technical requirements is that the carried interest must be paid only after the investors have received all their invested capital back from the fund. If the specific requirements and qualifications of the special carried interest tax regime are not met, the fund managers' income in relation to carried interest received could potentially be fully taxable at the respective German personal income tax rate (up to 45%).

Funds structured as partnerships engaged in a trade or business

Some funds are structured as partnerships that are engaged in a trade or business. This might be the case because some institutional inves-

tors prefer that the fund is engaged in a trade or business, or because the respective fund strategy is seen to be more active than a typical private equity fund (eg, turnaround funds or venture capital funds acting as incubators). In such cases, the German tax authorities have taken the position that the carried interest received by fund managers is subject to the respective German personal income tax rate (up to 45%), that is, that the special tax exemption for funds qualifying as private asset management is not applicable. This is due to the fact that the tax authorities consider the carried interest to be a "hidden payment" for services provided by fund managers to the fund rather than a capital-disproportionate participation in the distribution waterfall among partners of the fund.

However, the German highest tax court issued a ruling in a recent case from late 2018, which disagrees with this tax treatment. According to the court, the waterfall distribution rules in fund agreements that set out the distribution of profits received by the fund among all partners of the fund have to be respected. In other words, the court considers that carried interest received should not be characterised as a "hidden payment" for services provided by fund managers to the fund. Rather, the court ruling qualifies such payment received by fund managers as a (capital-disproportionate) share of the profits. Therefore, the so-called partial income rule, which exempts 40% of the income and makes only 60% of the income received subject to the normal individual tax rate, will also be applied by the court in cases where the fund qualifies as being engaged in a trade or business. This results in a tax rate of around 28.5% at the level of the individual tax managers. This ruling greatly reduces the risk for fund managers that a changing assessment by the tax authorities of the fund activities (trade or business versus private asset

management) would negatively affect their tax position with respect to carried interest. However, the long-term implications of the ruling will have to be closely monitored, as the German tax authorities have not yet indicated whether they will accept this ruling or whether they will try to amend the tax laws to implement their position in the law.

3.7 Outsourcing of Investment Functions/Business Operations

Outsourcing by fund managers is possible and commonly used. If portfolio management or risk management is outsourced, the delegate must have a licence (as required by the AIFMD). Outsourcing agreements are often based on a sample agreement published by a German investment lobby group called BVI. Outsourcing agreements must ensure specific control and supervisory rights by BaFin and by the fund manager's internal control functions.

3.8 Local Substance Requirements

See 2.9 Requirement for Local Investment Managers and 2.10 Other Local Requirements.

3.9 Change of Control Fully Authorised Managers

Fully authorised managers must notify BaFin – to the extent they become aware of the impending change – of the following:

- a significant shareholding of the manager is acquired or relinquished;
- the participation thresholds of 20%, 30% or 50% of the voting rights or of the capital have been exceeded or have dropped, or the manager becomes or ceases to be a subsidiary of another company; or
- the manager intends to merge with another AIFM.

The notification enables BaFin to examine whether there might be a reason to prohibit such transaction due to the lack of reliability of the holder of the significant participation, or whether to subsequently revoke the licence of the manager. It also provides clarity about the origin of the manager's capital, not least, to prevent money-laundering activities. Violations of these obligations are subject to fines.

EuVECA Managers

As with the national provisions for fully authorised managers and pursuant to the EuVECA Regulation, the BaFin must be informed of subsequent material changes to the registration before they are implemented. This also refers to intended or decided changes of control that have not yet been implemented. BaFin must respond to such submissions within one month. This deadline might be extended by one month at the sole discretion of BaFin.

Sub-threshold Managers

Sub-threshold managers are subject to a reduced regulatory regime that requires them to notify BaFin about changes to their registered office, address, corporate purpose and contact details, but does not require them to notify about a change of control.

Investor Approval

In line with clauses containing key-person provisions, German fund agreements often contain change-of-control clauses. As investors have a strong interest in controlling the different cash streams in the fund structure to ensure a proper alignment of interest, such clauses regularly cover changes of control at the manager level and at the level of the carry and team vehicles. If a change-of-control event occurs, the investment activities of the fund are typically suspended and the fund agreement ties the continuation of such

investment activities to approval of the change of control on the part of a super-majority of the total capital commitments. If the investors do not approve the change of control, a liquidation of the fund is often triggered.

3.10 Anticipated Changes

Tax

Draft legislation: VAT exemption for all German AIFs

A draft bill for an Act on Financing of the Future was introduced in April 2023. The draft intends, among other things, to extend the VAT exemption for the payment of management fees (currently only provided to UCITS, AIFs comparable to UCITS, and certain venture capital funds) to all AIFs. The proposed legislation would provide legal clarity, as management fee payments of all AIFs would be exempt from VAT in the future (ie, expanding the existing exemption of certain venture capital funds to also encompass all venture funds, buyout funds, debt funds, real estate funds, infrastructure funds, project development funds, crypto funds, litigation funds, funds of funds, etc). The level of regulation of the AIF or its AIFM would no longer be relevant, nor would the qualification of the investors. This would harmonise the German VAT treatment of management fees with the legal situation in most other EU member states, such as Luxembourg, thus eliminating competitive disadvantages for Germany as a fund jurisdiction. The proposed new provision is scheduled to become effective as of 1 January 2024 without retroactive effect, if adopted.

Corporate Income Tax Modernisation Act

The Modernisation of the Corporate Income Tax Act took effect as of 1 January 2022. It offers a “check the box” regime with an irrevocable option for partnerships to be treated as corporates for tax purposes. This should effec-

tively result in a third form of tax treatment for AIFs under German tax laws. In addition to the options mentioned previously (AIFs in the form of a partnership treated according to the general rules of German taxation for partnerships or AIFs formed as corporations treated as investment funds or specialised investment funds under the Investment Tax Act), there is now the option to treat an AIF formed as a partnership-like taxable corporation without falling into the scope of the German Investment Tax Act. This might help prevent foreign investors from having tax declaration obligations in Germany, and to retain the possible application of the taxation privilege for capital gains under Section 8b of the German Corporation Tax Act (*Körperschaftsteuergesetz* or *KStG*) for German corporate investors, as well as the fund entity itself. This should limit the tax leakage at the fund level. However, certain withholding tax issues make this option less attractive. In addition, certain additional guidance by the tax authorities would be welcomed by the fund industry.

Anti-tax Avoidance Directives

The latest ATAD (Anti-tax Avoidance Directive) implementation law came into force on 1 July 2021. This covers both the ATAD I Directive (EU) 2016/1164 of 12 July 2016 concerning, in particular, interest barriers, rules on exit taxation, general abuse avoidance rules and CFC Rules, and the ATAD II Directive (EU) 2017/952 of 29 May 2017 concerning hybrid arrangements, both resulting in several restrictions for companies operating cross-border. A positive clarification for AIFs in a corporate form is that the specialised CFC rules do not apply to income received in respect of a foreign intermediate company that falls within the scope of the Investment Tax Act. The new law provides for a limitation of the taxation privilege on capital gains in certain cross-border cases (Section 8b of the German

Corporation Tax Act). Currently, ATAD III relating to shell companies is being discussed at European level but it will not be implemented by EU member states before 2024. Recent publications of the EC seem to suggest that it has been difficult to reach a political agreement on ATAD III and the initially proposed draft might be split into separate legislative initiatives.

Regulatory

Regulatory key trends are currently the sustainable finance initiative of the EU, the introduction of electronic securities and investment fund units, the handling of cryptocurrency funds, as well as certain additional compliance rules.

New structuring options for domestic investment funds

The German Fund Jurisdiction Act (*Fondsstandortgesetz*, or FoStoG) came into force in August 2021. It expanded the options available to fund managers with respect to the permissible structuring options. The new range of permitted products includes, for example, a master-feeder structure for closed-end funds and the introduction of an open-end infrastructure fund.

Whistle-blower Protection

The German Whistleblower Protection Act (*Hinweisgeberschutzgesetz*) obliges managers as of 2 July 2023 to establish and operate an internal reporting office for so-called “whistle-blower activities” of internal whistle-blowers. This applies to all management companies regardless of their size. Whistle-blowing by employees is intended to lead to the detection, prosecution and suppression of malpractice of the fund manager. Individuals, groups of people within the management company or third parties (eg, service providers) can act as internal whistle-blowers.

4. Investors

4.1 Types of Investors in Alternative Funds

The spectrum of investors in AIFs ranges from retail investors to highly sophisticated institutional investors.

4.2 Side Letters

There is no strict limitation in statutory law on side-letter provisions, other than the principle of fair treatment of all investors in a fund. Typically, German fund agreements provide that the manager may grant special rights to individual investors by means of a contractual side letter. Usually, it is stated that the granted side-letter provisions need to be disclosed to all other investors shortly after the final closing. However, the electability of side-letter clauses is often restricted, either requiring a certain capital commitment by the electing investor and/or restricting the electability of certain clauses per se (eg, the selection may be limited to clauses that do not contain preferential economic terms as in management fee reductions, seats on the advisory committee, special regulatory or tax requirements for the investor, granting of co-investment rights, and the transfer and sharing of confidential information).

4.3 Marketing of Alternative Funds to Investors

Retail funds can be marketed to all types of investors. Special funds may only be marketed to professional investors and to semi-professional investors. The definition of a professional investor is in line with the AIFMD/MiFID II definition. In addition, Germany has introduced a special category of investor: a semi-professional investor is – broadly speaking – an investor who commits at least EUR200,000 (in the framework of EuVECA, those investing at least EUR100,000) and who

has shown certain investment experience and understanding of risk.

Local investors may invest in alternative funds established in Germany. This is, in particular, true for German institutional investors (typically qualifying as “professional investors” according to MiFID II) as well as other investors (eg, family office investors and HNWIs) qualifying as so-called “semi-professional” investors under German law. Special requirements and restrictions apply to funds targeting retail investors.

4.4 Rules Concerning Marketing of Alternative Funds

Marketing by an Intermediary

In the absence of reverse solicitation, if a firm would like to market an AIF in Germany, the firm would require either a MiFID licence or a MiFID passport. It is also possible to get a local financial intermediary licence under the German Commerce Act (*Gewerbeordnung* or *GewO*). The local financial intermediary licence is a non-MiFID licence and is based on the optional exemption from MiFID II in Article 3 of MiFID II.

In the case of holders of both licences (for MiFID firms and local financial intermediary firms), Germany considers the prospective investor as the regulatory client of the firm. Accordingly, the firms have to adhere to the MiFID II rules of good conduct towards the prospective investor (eg, requiring compliance with suitability or appropriateness checks). The MiFID application also means that marketing materials provided by the fund manager must comply with the MiFID II requirements on marketing materials (eg, with regard to past or simulated performance). The same applies for firms licensed under the Investment Firm Directive (Directive 2019/2034).

Marketing by the Fund Manager

The fund manager itself can always market its “own” funds. If the fund manager is fully authorised under the AIFMD, it can also market the investment funds of other managers. Pursuant to the new EU cross-border distribution of funds regulation (Regulation 2019/1156) fund managers are obliged to provide marketing materials to their prospective investors which are “fair, clear and not misleading”. Additionally, marketing materials have to be labelled as such.

Pre-marketing

Germany implemented the EU amendments of the AIFMD with regard to the pre-marketing and marketing communications of collective investment funds (Directive (EU) 2019/1160) with effect from 2 August 2021. The present regime entails slightly stricter regulation in Germany compared to the prior regulation on pre-marketing. It needs to be noted that Germany extended the new EU pre-marketing regime to non-EU managers as well. As a result, non-EU managers are required to notify BaFin about their pre-marketing activities in Germany.

Marketing Approval for Fund Interests

A licence is generally required prior to marketing fund interests in Germany. This is either a marketing licence granted by BaFin or an AIFMD marketing passport (or, as the case may be, an EuVECA, ELTIF or EuSEF passport).

German-based sub-threshold managers are an exception. They can market their funds on a private placement basis in Germany. However, sub-threshold managers can only approach professional investors and semi-professional investors and there is no AIFMD passport available.

Marketing of non-EU AIFs or EU AIFs by EU AIFMs

With regard to the marketing of non-German EU AIFs by EU AIFMs, the AIFMD marketing passport is available. The AIFMD marketing passport allows for the marketing of EU AIFs to professional and semi-professional investors in Germany. BaFin charges a registration fee of EUR466.

With regard to the marketing of Non-EU AIFs by EU AIFMs, these can be marketed on a private placement basis in Germany to professional and semi-professional investors. BaFin charges a registration fee of EUR1,641 per AIF.

It is also possible for sub-threshold EU AIFMs to market Non-EU or EU AIFs to professional and semi-professional investors in Germany, if the AIFM is registered in its home country and there is marketing reciprocity between Germany and the home country of the AIFM. BaFin charges a registration fee of EUR1,641 per AIF.

Marketing of non-EU AIFs or EU AIFs by non-EU AIFMs

Germany allows for the marketing of non-EU and EU AIFs managed by non-EU AIFMs to professional and semi-professional investors under the German implementation of Article 42 of the AIFMD. However, Germany has gold-plated Article 42 of the AIFMD, which still requires the appointment of a “depository light”. Furthermore, Germany also applies the Article 42 AIFMD regime to non-EU sub-threshold managers. Registration under Article 42 of the AIFMD requires fund managers to submit an annual report and a so-called Annex IV report under the AIFMD to BaFin, as well as paying a registration fee of EUR1,641 per AIF and a current annual fee of EUR113 per AIF.

Reverse Solicitation

Germany recognises the reverse solicitation concept. Reverse solicitation requires that the offer or placement is genuinely initiated by the investor. In addition, the prospective investor must be a professional or semi-professional investor. Since the specific requirements for reverse solicitation are not sufficiently outlined by the legislator, BaFin is taking a rather strict position on reverse solicitation on a very limited basis. Cases of reverse solicitation should therefore at least be well documented.

4.5 Compensation and Placement Agents

Placement Agents

Some fund managers (in particular, mid-size and larger fund managers) solicit investors for the fund through a placement agent. Placement agents often provide investment brokerage services, which require a regulatory set-up (ie, either acting with a licence as a MiFID II firm for investment brokerage (reception and transmission of orders – RTO) and/or investment advice or, alternatively, acting as a tied agent on behalf and under the liability shield of a licensed MiFID II firm). See **4.4 Rules Concerning Marketing of Alternative Funds** for the regulatory requirements. The remuneration of placement agents is usually based on a certain percentage of the capital raised. Such payments are typically excluded from the category of organisational expenses of the fund, and therefore cannot generally be charged into the fund. This is in line with international market practice. In addition, some German regulated investors have internal policy or regulatory requirements that do not allow for placement agent fees to be charged as fund expenses.

In addition to being engaged in fundraisings and larger secondary transactions (especially port-

folio sales and GP-led transactions), placement agents are also regularly engaged by sellers as well as fund managers, as intermediaries for the sale on the basis of an advisory agreement.

Manager Personnel

Manager personnel are usually not compensated by the fund for the distribution of fund units to potential investors (but will indirectly profit as the management fee is typically tied to the amount of total capital commitments of investors).

4.6 Tax Regime for Investors

Overview

Different investor groups trigger different tax regimes with respect to their investments in German funds. Also, the taxation differs based on whether the general tax rules apply (in the case of funds in the form of a partnership) or whether the special tax regime of the German Investment Tax Act applies (in the case of funds in the form of a corporation or a contractual-type fund).

The following is a short summary of the tax effects at investor level under the German general tax rules in the case of partnerships (see **2.5 Tax Regime for Funds** for the tax effects at investor level in the case of the applicability of the German Investment Tax Act).

There is no special treatment of income from a fund in the form of a partnership. The income is taxed at the level of German-resident investors in accordance with the general rules applicable to the respective investor and the respective type of income.

German Investors

In the case of German-resident investors, the taxation rules will depend on the type of investor as well as whether the fund (ie, the partnership)

is treated as being engaged in a trade or business, or engaged in private asset management.

Individual investors

For individual investors, the actual rate of investor-level taxation depends on whether the investor holds the fund interests as part of their non-business or business assets. For individuals that hold their investment fund interests as part of their non-business assets, such items are generally subject to flat income tax (effectively at 25% plus solidarity surcharge, in aggregate, effectively around 26.5%) if the fund qualifies for treatment as private asset management (and provided further that (i) in the case of capital gains, such investor holds less than a 1% indirect shareholding in the target company, and (ii) in the case of income from interest, such investor holds less than a 10% indirect shareholding in the target company).

For individuals that principally hold their fund interests as part of their business assets, the full amount of such items is subject to income tax at their personal rate (up to 45%).

The same would be true for individuals (irrespective of whether they hold their investment fund interests as part of their non-business assets or business assets), if the fund is engaged in a trade or business. The partial income tax regime (40% of income is exempt) would apply to capital gains and dividends. The full tax rate is applicable to interest income. In certain cases, trade tax paid at the level of the fund is (partially) refundable at the level of the respective investor.

Corporate investors

For corporate investors, both corporate income tax (ie, the German corporate tax rate, generally 15% if no exemptions apply) as well as (potentially) trade tax (the trade tax rate will depend

on the tax residency of the corporate investor, as the trade tax rate differs based on municipality, but typically the general tax rate is around 15–18%, if no exemption applies) is applicable at their level, if such corporate investor is not tax-exempt. For corporate taxable investors, the general rule is that the full amount of such items is subject to corporation tax. In addition, German trade tax may be triggered (in particular, if the fund is treated as private asset management). For certain corporate investors (in particular, property insurance companies as well as general corporate entities), the partial income taxation and the exemption pursuant to Section 8b of the German Corporation Tax Act may be applicable to both corporate tax as well as trade tax. In particular, this applies in the case of capital gains as well as dividends (in the latter case, only if certain holding percentages are satisfied – 10% in the case of corporate tax applicable to dividends and 15% in the case of trade tax applicable to dividends).

Non-German Investors

In general, non-resident investors of a fund structured as a partnership will be subject to taxes in Germany pursuant to the German general tax rules for non-residents.

If the fund is structured as a partnership having asset management status (ie, it is not deemed to be in business and is not engaged in business activities for German tax purposes), non-resident investors are generally (if they hold less than a 1% indirect share in such portfolio company) not taxed on capital gains realised by the fund from the sale of a portfolio company and they are not required to file tax returns in Germany. However, the income of non-resident investors may be subject to German withholding tax (eg, with regard to dividend distributions from a portfolio corporation held by the fund). A refund,

an exemption or a reduction of withholding tax may depend on certain filing procedures. This may also apply with regard to certain double-taxation treaties.

If the fund is structured as a partnership having a trade or business status, non-resident investors are generally subject to limited tax liability on the proportionate income from such trade or business allocated to such investors, to the extent that it is attributed to a permanent establishment of the fund in Germany. In such a case, a foreign investor would also be obliged to file a personal tax return statement in Germany.

4.7 Double Tax Treaties

Germany has a vast network of double tax treaties with a large number of countries (including most OECD states and with many other states). The applicability of such double tax treaties will depend on the legal form of the fund in question. Most German alternative funds are structured as partnerships. As such, they are tax transparent. As a result, double tax treaties typically do not apply directly to a fund, but rather to the investors (ie, the partners of the partnership). One of the main issues with income received from a German alternative fund is whether the activities of the fund qualify as a trade or business that is related to a permanent establishment in Germany. No special exemptions exist for funds in this regard in German domestic laws (unlike in Luxembourg).

If the alternative fund is structured as a corporation, or as a contractual-type fund, the specific double tax treaty may be applicable to the fund itself, but this will have to be analysed for each specific treaty and legal form of the fund on a case-by-case basis. In certain cases, domestic laws may override double tax treaties.

4.8 Foreign Account Tax Compliance Act (FATCA)/Common Reporting Standard (CRS) Compliance Regime

Regarding FATCA (the Foreign Account Tax Compliance Act), Germany has signed an inter-governmental agreement (IGA) with the USA based on the Model 1 IGA. As a result, German funds are “deemed compliant” but certain information has to be provided to the German tax authorities. Germany has transposed the agreement with the USA into German national tax law and the German tax authorities have issued a clarifying FATCA ordinance. Germany has also implemented the CRS (Common Reporting Standard) rules into German tax laws. The German tax authorities issued further administrative guidance on both FATCA and the CRS in late 2017 and in June 2022.

Both FATCA and the CRS oblige all German funds and their fund managers to comprehensively screen their investors, collect information about non-resident investors (and their ultimate beneficial owners), and report this information to the BZSt, together with information about the participation of such persons/entities. This information will be passed on to the US (in the case of FATCA) or to other European countries (in the case of the CRS).

4.9 Anti-Money Laundering (AML) and Know Your Customer (KYC) Regime

During the subscription process, managers have to carry out anti-money laundering checks in accordance with the provisions of the German Money Laundering Act (*Geldwäschegesetz* or *GWG*). For this purpose, the identity of the investors, any person acting on their behalf and their beneficial owners must be verified and, generally, transmitted to the transparency register. Managers are also required to appoint an anti-

money laundering officer and a deputy, who are entrusted in particular with the following tasks:

- to conduct a risk analysis, which includes a complete assessment of all risks related to money laundering and terrorist financing;
- to create, monitor and further develop a company-specific risk management system towards AML; and
- to communicate on all money-laundering issues within the company (ie, both with the management and employees).

A money-laundering check is run largely in parallel with the determination of controlling persons as part of the FATCA/CRS check. As the manager is obliged to check the self-disclosures for FATCA and CRS purposes for obvious inconsistencies, an inner conformity check should also be carried out between AML disclosures and FATCA/CRS disclosures.

Since August 2021, sub-threshold AIFMs (not the AIFs themselves) are required to instruct a qualified independent third party (eg, an auditor) to audit how funds are being used pursuant to the German Investment Code (Section 45a KAGB). The AIFM must notify BaFin about the appointed auditor. In the audit report, the auditor must state separately whether the AIFM has complied with its obligations under the KAGB and the Money-Laundering Act (*Geldwäschegesetz* or *GWG*). The report is to be submitted to BaFin by the auditor. In the event that the AIFM does not provide the auditor with sufficient information, or does not provide it correctly, completely or in a timely manner, a fine of up to EUR1 million may be imposed; and in the case of legal entities, a fine of up to 2% of the total annual turnover may also be imposed.

4.10 Data Security and Privacy for Investors

The requirements for data security and privacy compliance are primarily determined by the General Data Protection Regulation (GDPR). Managers regularly request the investor's consent to the processing of personal data in the course of the subscription process, even if such consent is often not required due to applicable carve-outs in statutory law. However, managers must comply with their transparency obligations and inform investors comprehensively about the processing of their personal data and their rights in this context (eg, to rectification, blocking or deletion) in accordance with the provisions of the GDPR.

4.11 Anticipated Changes Management of Mutual Funds Requires Full Authorisation

The special regulations according to which sub-threshold AIFMs were allowed to manage retail funds pursuant to Section 2 paragraph (4a) and (5) KAGB were recently abolished. Thus, all AIFMs must be fully authorised (Section 20 KAGB) to manage retail funds.

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