

YPOG Briefing:

German Parliament adopts VAT Exemption for all Alternative Investment Funds

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Today, the German Parliament (*Bundestag*) passed the Future Financing Act (*Zukunftsfinanzierungsgesetz*), thereby extending the VAT exemption for the management of investment funds to all Alternative Investment Funds (AIF). The VAT exemption will be effective as of January 1, 2024, provided that the German Council (*Bundesrat*) consents to the act on November 24.

The VAT exemption will apply to the management of all private equity, venture capital or crypto funds, without the requirement of being comparable to open-end mutual funds (UCITS) or qualifying as certain venture capital funds, the so-called *Wagniskapitalfonds*, as was previously the case.

The legislation eliminates the [current legal uncertainty](#) and [the risk of unlawful state aid under EU law](#). It also creates a level playing field with competitor fund locations where the VAT exemption for the management of funds has long been established (in particular Luxembourg, France and the UK).

In the following, we summarize the most important changes resulting from the legislation and point out possible action items.

1. Scope of the Revised VAT Exemption as of January 1, 2024

As expected, the legislation extends the VAT exemption to the management of all AIFs within the meaning of Section 1 (3) of the German Investment Code (Kapitalanlagegesetzbuch – KAGB). This means that the management of all closed-end funds will be exempt from VAT regardless of the type of investment. The exemption now applies in particular to private equity, venture capital, real estate, infrastructure and crypto funds.

The VAT exemption does not depend on whether the manager has a full license according to the German Investment Code or is only registered with the German Federal Financial Supervisory Authority (*BaFin*) as a sub-threshold manager. Likewise, the EuVECA status of the manager or the respective funds is irrelevant for the VAT exemption. The VAT exemption comprises the "management" of funds. In our view, the VAT-exempt management includes all services provided by a manager to its funds and compensated with the respective management fee.

From January 1, 2024, the manager must invoice the management fee agreed in the partnership agreement without VAT.

The VAT exemption must be explicitly mentioned in the invoice. If – as is often the case – a net amount has been agreed ("plus VAT, if any"), only this net amount may be charged. This also regularly affects the capital call amounts. Only if a gross amount was agreed between the manager and a fund, the previous amounts may continue to be charged. If the manager incorrectly invoices the management fee plus VAT, it may be held liable for VAT incorrectly charged.

*Insofar as the fund management was already VAT-exempt under the previous VAT rules (e.g., in case of the management of "venture capital funds" – *Wagniskapitalfonds*), the revised VAT-exemption has no tax*

consequences. However, the management of investment structures that do not qualify as AIFs (in particular investment clubs and single-investor funds) remains subject to VAT.

2. Relevant Consequences of the VAT Exemption

2.1. Limited input tax deduction by the Manager

Because the manager will provide VAT-exempt output services (the fund management), its entitlement to deduct input VAT for related input services will be excluded accordingly. The exclusion of input VAT deduction affects all services (in particular services or consulting services) that are provided directly to the manager and are not borne by the fund as fund expenses. This applies, for example, to legal and tax consultancy fees, other consultancy fees (e.g. for venture partners), travel expenses and other expenses for supplies and services subject to VAT that are not borne by the fund. The VAT applying to these input services will no longer be deductible as input VAT. Besides, the manager may not opt for the application of VAT in relation to its fund management services to avert detrimental effects of the excluded input VAT deduction. In addition, for assets acquired by the manager that are not only used once for the execution of sales, a (*pro rata*) input tax adjustment may have to be made.

Fund managers should reflect their limited input VAT deduction in their financial planning.

2.2. In Particular: Potential Claims for Damages in Lease Agreements or Other Leasing Consequences

Following the extended VAT exemption, fund managers may, as a tenant of office space, in individual cases be confronted with contractual claims for damages. This applies to cases in which the landlord has opted for VAT applicability of the lease and the fund manager undertakes to use the office space only for activities which entitle the manager to deduct input tax. If the manager does not comply with this obligation (as will be the case according to the extended VAT exemption), the landlord consequently loses its right to deduct input VAT. If the lease agreement contains a respective provision, the manager as the tenant is obliged to compensate the landlord, regardless of fault, for the damage caused by the loss of the landlord's right to deduct input VAT. The landlord's damage can exceed the VAT on the rent substantially. In some cases, lease agreements also stipulate a flat-rate rent increase in the event that the tenant provides VAT-exempt output services.

If a fund manager is a party to a lease agreement, any information and compensation obligations of the manager towards the landlord should be clarified immediately.

Before entering into negotiations with the landlord and possibly considering an extraordinary termination or cancellation or adjustment of the lease, it should, however, always be considered whether the landlord will suffer any damage from its excluded input VAT deduction at all (often not the case with old buildings), whether the agreed clause in the specific case covers the situation of a legislative change at all (or whether the clause rather requires a change in the tenant's behavior) and whether the clause has been effectively agreed.

Even without a corresponding provision in the tenancy agreement, the landlord may have a statutory right to adjust the contract for the loss of its right to deduct input VAT. This is a question of the rental agreement provisions in the individual case.

2.3. VAT Exemption also Possible for Outsourcing of Administrative Services

The VAT exemption can also extend to the outsourcing of management services by the manager to another person (outsourcing case). According to the case law of the Court of Justice of the European Union (ECJ), the VAT exemption in an outsourcing scenario requires that the outsourced service forms a "package" and as such is "specific and essential" for the management of investment funds.



The latter must always be assessed in light of the circumstances of the individual case: While the investment advisor in the standard advisor model should be covered by this, the VAT assessment will always depend on the specific activity with respect to other (investment) advisors or fund administrators. If the VAT exemption does not apply to the outsourcing case and the costs are borne by the manager, its cost burden is increased by the VAT, as input VAT deduction will be excluded.

VAT exemption in the case of outsourced management services is possible, but is subject to special requirements which must always be examined on a case-by-case basis.

2.4. VAT Treatment of Equalization Payments

The VAT exemption also has tax implications if an investor is admitted to a fund after its first closing and has to make an equalization payment relating to the previously incurred management fee. Even if the equalization is payable after 1 January 2024, the equalization may relate to a period in which the fund management was still subject to VAT.

The VAT consequences of an equalization should be examined on a case-by-case basis, taking into account the relevant LPA provisions of the fund.

3. Outlook and Summary

The extension of the VAT exemption to the management of all AIFs increases Germany's competitiveness as a fund location within Europe and is therefore good news for all fund managers based in Germany. Nevertheless, the VAT exemption may also have detrimental consequences in individual cases. In any case, fund managers should adapt promptly to the new legislation and specifically

- review their financial planning due to the limited deduction of input VAT;
- adjust processes if necessary (*e.g.*, when calculating future capital calls or when invoicing management fees to the fund);
- identify possible further consulting needs or action items (*e.g.*, in case of outsourced management services or due to lease agreement provisions).

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