

# Private Equity - Fund Formation

in Germany

# Table of contents

## FORMATION

- Forms of vehicle
- Forming a private equity fund vehicle
- Requirements
- Access to information
- Limited liability for third-party investors
- Fund manager's fiduciary duties
- Gross negligence
- Other special issues or requirements
- Fund sponsor bankruptcy or change of control

## REGULATION, LICENSING AND REGISTRATION

- Principal regulatory bodies
- Governmental requirements
- Registration of investment adviser
- Fund manager requirements
- Political contributions
- Use of intermediaries and lobbyist registration
- Bank participation

## TAXATION

- Tax obligations
- Local taxation of non-resident investors
- Local tax authority ruling
- Organisational taxes
- Special tax considerations
- Tax treaties
- Other significant tax issues

## SELLING RESTRICTIONS AND INVESTORS GENERALLY

- Legal and regulatory restrictions
- Types of investor
- Identity of investors
- Licences and registrations

**Money laundering**

**EXCHANGE LISTING**

Listing

Restriction on transfers of interest

**PARTICIPATION IN PRIVATE EQUITY TRANSACTIONS**

Legal and regulatory restrictions

Compensation and profit-sharing

**UPDATE AND TRENDS**

Recent developments

## Contributors

### Germany



**Sebastian Käpplinger**

sebastian.kaepplinger@pplaw.com

*Pöllath and Partners*



**Tarek Mardini**

tarek.mardini@pplaw.com

*Pöllath and Partners*

## FORMATION

### Forms of vehicle

What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

The most common legal form is a closed-ended fund organised as a German limited partnership (KG) as it is tax-transparent, allows flexible structuring and provides limited liability to investors. KGs have separate legal personality. The general partner (GP) of the KG is personally liable for the debts of the KG. To reduce liability risks, typically a company with limited liability (GmbH) serves as GP (GmbH & Co KG). The investors join as limited partners. The fund manager is typically acting as managing limited partner of the KG. Besides the KG, several other legal forms are available for German private equity funds (eg, investment KG, investment AG, UBG). However, the KG is the market standard (in particular for registered, ie, 'sub-threshold', fund managers).

### Forming a private equity fund vehicle

What is the process for forming a private equity fund vehicle in your jurisdiction?

The formation of a KG is simple. The KG comes into legal existence with the signing of the limited partnership agreement (LPA) by the GP and the limited partners. To ensure limited liability for investors, the KG and its partners will be registered in the German commercial register. Also, the beneficial owners must be reported to the transparency register. Notarisation of the LPA is not required, but the filing with the commercial register must be effected by a notary. Signatures of investors must be notarised by a notary public (if taking place outside Germany, generally an apostille in accordance with the Hague Convention has to be provided by the notary public). Limited partners in the form of an entity must provide proof of their valid existence and due representation by the signatories. The fees and expenses for the notarisation of filing with the commercial register and the registration fees are fairly small and generally do not exceed €2,000. Filings can usually be effected within two to four weeks. The KG itself has no minimum capital requirements. A minimum registered capital of €25,000 applies to a GmbH serving as GP.

### Requirements

Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

A separate custodian is necessary if the fund is managed by a fully licensed manager under the KAGB (the German implementation of the Alternative Investment Fund Managers Directive (AIFMD)). A custodian is not necessary in the case of a registered (sub-threshold) manager. A fund in the form of a KG requires a domicile in Germany and must comply with the commercial law requirements regarding book-keeping. The fund manager typically serves as managing limited partner of the fund and also performs corporate secretarial and administrative tasks. A separate administrator is rather uncommon (as opposed to other jurisdictions).

### Access to information

What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

The records maintained at the commercial registry are public 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 its 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. The partnership is required to file its annual financial statements with the commercial register and to publish them in the electronic Federal Gazette. The articles of association of the GP are filed with the commercial register and are available to the general public. Fines and other enforcement measures can be imposed for failure to make required filings. In 2018, Germany introduced the transparency register under the EU anti-money laundering (AML) law. The transparency register must include all beneficial owners unless the beneficial owners are already shown in public documents in the commercial register.

### **Limited liability for third-party investors**

In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

The investor's liability as limited partner in relation to the partnership is limited to such investor's capital commitment. Liability in relation to third-party creditors of the fund is limited to the liability amount registered with the commercial registry, typically a small percentage of the actual capital commitment. If this amount has been paid into the partnership, then there is no additional liability of such limited partner to third parties. Potentially, there is a risk that a limited partner is treated as GP (ie, fully liable to third parties) for the period of time between its admittance to the partnership and registration of such limited partner with the commercial register (whether when subscribing to a fund in the fundraising process or in the case of a transfer). However, technical solutions are available and common to avoid such risk (eg, making the registration with commercial register a condition precedent for the formal admission to the partnership). Otherwise, there are generally no circumstances in which the limited liability of limited partners would not be respected as a matter of German law.

### **Fund manager's fiduciary duties**

What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

A fund manager's fiduciary duties are mainly based on the rules of conduct imposed by the AIFMD. This means a fund manager must act honestly, fairly and with due skill, act in the best interests of the fund and its investors and treat all investors fairly. Furthermore, the fund manager must take all reasonable steps to avoid conflicts of interest where possible. These fiduciary duties cannot be altered by agreement. However, the fund manager and the investor can agree on higher threshold for the fund manager's liability (see question 7).

### **Gross negligence**

Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

The management of the fund (ie, the GP, the managing limited partner, or both) must by law apply the standard of care of a prudent business person. In particular, the management must follow the legal requirements for book-keeping, preparing of statutory accounts and filing of tax returns of the fund. In practice, however, partnership agreements typically restrict the liability of the GP and the managing limited partner to gross negligence and wilful misconduct. Some commentators in legal publications dispute, however, whether such a restricted standard of liability can be enforced in court as between the partners of a partnership.

### **Other special issues or requirements**

Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

Fund sponsors need to be aware of the special rules on the taxation of a private equity fund - for more information see question 17 et seq. German regulated investors, such as insurance companies, require a free transferability of their interest in the fund. If the sponsor uses the limited partnership (GmbH & Co KG) as the most common private equity fund vehicle in Germany, investors need to be registered with the commercial register of the KG in order to be shielded from unlimited liability.

There are no specific rules for a conversion of a non-domestic vehicle into a domestic vehicle. Possible from a legal perspective is redomiciling of a non-domestic vehicle to Germany. This would result in the case of a limited partnership to a conversion of the vehicle into a German limited partnership (GmbH & Co KG). The most material change of such redomiciling will be the fact that the KG and its investors need to be registered with the local commercial register in order to benefit from limited liability. Potential negative tax effects of such conversion or redomiciling have to be analysed in advance on a case-by-case basis.

### **Fund sponsor bankruptcy or change of control**

With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

There are no legal or regulatory rules directly connecting an event at the fund sponsor level with the private equity fund and its GP and investment adviser. It is possible, though - depending on the group structure - that events such as bankruptcy, insolvency, change of control or restructuring at the sponsor level will lead to regulatory consequences at the manager level or at the level of the investment adviser. For instance, change of control events in the top holding company of a group will require a notification process to the regulator. Furthermore, a bankruptcy or insolvency of the GP leads to an automatic removal of the GP from the fund and the fund being switched into 'run-down mode'.

In practice, it is common that the fund LPA contains at least change of control provisions with regard to the GP and the fund manager. It is then left to the negotiations with the investors how extensive these provisions are with regard to other events and other entities of the manager group.

### REGULATION, LICENSING AND REGISTRATION

#### Principal regulatory bodies

What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

The regulatory body in Germany is the Federal Financial Supervisory Authority (BaFin). The regulation of private equity funds in Germany is based on the AIFMD. The regulatory regime is therefore foremost a regulation of the manager and only indirectly a regulation of the fund itself. BaFin has inspection rights towards managers as well as the right to perform an audit. In addition, each fully licensed manager must itself have an auditor perform an audit on the manager's regulatory compliance.

The regulatory reporting requirements are as follows.

Registered managers (AIFMD sub-threshold managers)

- Reporting obligations to BaFin:
- reporting obligations to the German federal bank (Bundesbank):

Fully licensed managers

- Reporting obligations to BaFin:
- reporting to Bundesbank:

As for the regulatory reporting to investors, half-yearly and yearly reports are mandatory for fully licensed managers. For registered managers, there is no regulatory investor reporting requirement; however, annual reports are required by German commercial law.

#### Governmental requirements

What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

Regulation of private equity funds is primarily exercised through the regulation of the managers. It requires that the manager is either fully licensed or registered with BaFin under the KAGB.

Registered managers (AIFMD sub-threshold managers): registration process

Availability

The registration process is only available to certain small or medium-sized managers. The most important category of these small to medium-sized managers are known as sub-threshold managers under the AIFMD/KAGB. In practice, most German private equity fund managers fall within this category.

Sub-threshold managers under the KAGB are managers with assets under management of not more than €100 million (in the case of leverage) or not more than €500 million (no leverage) and who only manage special alternative



investment funds (special AIFs). Special AIFs are AIFs whose interests or shares may only be acquired according to the fund documents by professional investors or semi-professional investors (ie, non-retail funds). Besides the requirements mentioned above, special private equity AIFs managed by sub-threshold managers are in principle not regulated.

An interesting option for a sub-threshold manager in the small to mid-cap market segment is to get additionally registered under the EU EuVECA regime to benefit from an EU marketing passport.

### Registration procedure

The registration procedure for sub-threshold managers is comparatively simple. It requires the submission of an informal registration request together with certain 'corporate' documents on the manager and the managed funds (such as the fund's limited partnership agreement (LPA) and the manager's articles of association). In addition to being a special AIF, the fund may not require the investors to additionally pay in capital beyond the investor's original commitment.

The possible EuVECA registration is in line with the EuVECA requirements on the manager and the fund.

### Ongoing issues

An advantage of the registration is that only few provisions of the KAGB apply to a registered-only manager, mainly the provisions on the registration requirements, ongoing reporting requirements and the general supervisory powers of BaFin. However, fund-specific requirements do not apply to registered-only managers and their funds. In particular, the depositary requirements and marketing requirements as well as the additional requirements of the KAGB for fully licensed managers do not apply.

On the downside, the registration restricts the manager to the type of funds and investors for which the registration was obtained (ie, only special AIFs and professional or semi-professional investors). Furthermore, a registered manager does not benefit from the EU marketing passport under the AIFMD. A registered manager can, however, opt in to become a fully licensed manager.

### Fully licensed manager: licensing process

#### Availability

Fund managers who do not qualify for a registration or who opt out of a registration must apply for a full fund-management licence with BaFin under the KAGB. A full fund-management licence opens the door for a manager to market funds to retail investors as well as to the EU marketing passport under the AIFMD.

#### Licensing procedure

The licensing procedure is a fully fledged authorisation process with requirements equivalent to the requirements for granting permission under article 8 AIFMD. The licensing procedure checks requirements, such as sufficient initial capital or own funds, sufficiently good reputation of the directors and shareholders, and organisational structure of the manager.

#### Ongoing issues

The licensing of the manager results in the manager being subject to the entirety of the KAGB. This means, in particular, the following:

- the required appointment of a depositary for the funds;
- access to setting up contractual funds;
- adherence to the corporate governance rules for funds set up as investment corporations or investment limited partnerships (investment KGs);
- adherence to the fund-related requirements of the KAGB;
- adherence to the marketing rules of the KAGB;

- access to the marketing passport under the AIFMD;
- access to the managing passport under the AIFMD; and
- adherence to the reporting requirements of the KAGB.

### Registration of investment adviser

Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

The German regime requires the entity that is conducting the portfolio and risk management of a fund to have a licence as a fund manager under the KAGB/AIFMD. There is no separate registration as an investment adviser. If a separate entity is advising the fund manager, such entity might need a MiFID licence for investment advice.

### Fund manager requirements

Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

The regulatory requirements differ depending on whether the manager is fully licensed or a registered manager.

A registered manager does not have to meet any regulatory capital requirements or suitability requirements. It is sufficient for the manager to meet the capital requirements under company law (eg, €25,000 for a German GmbH). In practice, though, BaFin prefers to see that a registered manager has sufficient substance to be able to manage the fund.

The possible EuVECA registration requirements are in line with the EuVECA requirements on the manager and the fund.

A fully licensed manager must hold at least €125,000 initial capital. In addition, the manager must have additional own funds if the value of the assets under management exceeds €250 million. The additional own funds amount to 0.02 per cent of the value of the investment assets under management that exceeds €250 million. This corresponds to €20,000 per €100 million. Regardless of these calculations, the manager must have own funds amounting to at least 25 per cent of the fixed overhead costs.

A fully licensed manager needs at least two managing directors. The managing directors must be reliable and professionally suitable. The professional suitability is regularly given if the managing director has held a managerial position with a fund manager for at least three years. BaFin assesses the professional suitability individually, however, so the suitability can also be proven with less relevant professional experience.

### Political contributions

Describe any rules - or policies of public pension plans or other governmental entities - in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

There are no such detailed rules or restrictions in Germany (other than the general criminal laws on bribery). This probably reflects the fact that investments of public pension plans and other governmental activities in private equity funds are still rather limited in Germany.

### **Use of intermediaries and lobbyist registration**

Describe any rules - or policies of public pension plans or other governmental entities - in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

None. Where applicable, the disclosure requirements under MiFID II apply if intermediaries are used in the marketing of the fund interests. German law treats potential investors as the regulatory client of the MiFID intermediary. This results in the application of the MiFID rules of good conduct and cost-disclosures rules to the relationship between the intermediary and the potential investor.

### **Bank participation**

Describe any legal or regulatory developments emerging from the recent global financial crisis that specifically affect banks with respect to investing in or sponsoring private equity funds.

As a consequence of the global financial crisis, credit institutions in the meaning of the Capital Requirements Regulation are prohibited from conducting guarantee and credit business with private equity funds. However, this prohibition only applies if the balance sheet total of the credit institution exceeds a certain threshold. Under the same conditions, credit institutions are also prohibited from conducting proprietary business.

## **TAXATION**

### **Tax obligations**

Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Please describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

#### **Partnerships**

For funds in the form of a partnership (eg, KG), the general rules of taxation are applicable (ie, the special tax regime for corporate funds under the German Investment Tax Act, see below, is not applicable). Therefore, if the fund is structured as a partnership that is not engaged in trade or business, it is neither subject to German income tax nor German trade tax (ie, the partnership is treated as 'transparent' for tax purposes). Any income derived by the 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 partner. On the other hand, if the fund vehicle qualifies as engaged in a trade or business, the fund itself is still not subject to German income tax, but it is subject to German trade tax.

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

#### **Investment funds**

Funds in the form of a corporation or of a contractual type are covered by the Investment Tax Act (investment funds).

Under the opaque regime, the fund is subject to taxation in respect to 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) at fund level (15 per cent tax rate (ie, German corporate tax)). 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 per cent) is exceeded. In addition, German trade tax may be triggered at fund level if it 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 investment fund. In return, at the level of the investor investment fund proceeds 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 a lump-sum taxation for investment fund proceeds (ie, distributions, predetermined tax bases and capital gains from dispositions or redemptions). 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 subject to flat income tax. For individuals that hold their investment fund interests as part of their business assets, principally, 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. 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 are subject to partial exemptions depending on the respective fund type. With respect to equity funds, the partial exemption is:

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

With respect to mixed funds, half of the applicable partial exemption rate applicable to equity funds is available. With respect to real estate funds, the partial exemption is 60 or 80 per cent of the proceeds, depending on whether the fund invests at least 51 per cent 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, half of the applicable partial exemption rate applies.

In addition, 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 would not be subject to taxation.

### Local taxation of non-resident investors

Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

In general, non-resident investors of a private equity 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, is not deemed to be in business and not engaged in business activities for German tax purposes), non-resident investors are generally (if holding less than 1 per cent 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, income of non-resident investors might be subject to the German

withholding tax (eg, with regard to dividend distributions from a portfolio corporation held by the private equity 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.

The distributions to a non-resident investor of an investment fund 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 a 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 there a double taxation agreement is applicable.

### Local tax authority ruling

Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

It is desirable to obtain a binding ruling from the local tax authorities on the tax classification of the fund to increase the level of comfort of both investors (including foreign investors) and fund managers as the tax status may not be clear (also depending on the investment strategy). If the fund is structured as a partnership, an advanced tax ruling should ideally ensure that the asset management criteria are met from the point of view of the tax administration. For investment funds under the German Investment Tax Act that want to be taxed transparently, it may be desirable to obtain a binding ruling to ensure that the criteria for a specialised investment fund are fulfilled. In certain cases, rulings regarding VAT treatment can be obtained.

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. Domestic and foreign investors of investment funds are formally treated equally. 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 the investment fund investor.

### Organisational taxes

Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

There are no significant organisational taxes (including no stamp duties) required to be paid with respect to private equity funds organised in Germany.

### Special tax considerations

Please describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

The carried interest of a sponsor of an asset managing (ie, non-trading) private equity fund is not subject to German trade tax. In addition, there is a 40 per cent income tax exemption, resulting in an effective rate of income tax of around 28.5 per cent, if certain cumulative criteria are fulfilled (in particular, the fund must qualify for asset management status and the carried interest must be paid only after the investors have had all their invested capital paid back).

Otherwise, such income is generally fully taxable at normal German income tax rates.

In general, the management fee payable to the managing partner of a fund was subject to the German VAT until end of 2017 (regardless of whether such management fee is structured as a priority profit share). According to the revised German VAT Act as of 2018, the management of UCITS and of certain AIFs that are comparable to UCITS, are exempt from VAT. The German VAT Act does not stipulate which types of AIF are comparable to UCITS. The German tax authorities have established criteria that must be fulfilled in order to benefit from the VAT exemption (eg, the AIF has to offer shares to the same group of investors and be subject to similar obligations and controls as UCITS). In addition, it was clarified that open-ended special AIF will be exempt from VAT without fulfilling the established criteria, whereas the administration of closed-ended AIF will only be exempt from VAT if certain previously established criteria were cumulatively met.

### **Tax treaties**

Please list any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

Germany has signed tax treaties with most OECD states and with many other states. Because of tax transparency, such treaties generally do not apply to a fund structured as a partnership, but directly to its partners. For the specific taxation under a tax treaty, it may be relevant whether the fund qualifies as a commercial or asset-managing partnership and if there is any permanent establishment. If the fund vehicle is structured as a corporation, such tax treaties generally apply to the corporate fund itself. However, each case must be carefully assessed for tax consequences arising from the applicable treaty and the relevant rules in each jurisdiction (eg, whether there is an applicable treaty override).

### **Other significant tax issues**

Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

Depending on the structure of the fund and its assets, different German tax regimes apply. The structure of the specific investment may have far-reaching tax consequences at the fund level, but also at the investor level (eg, the structure may be relevant for the question whether the income of a foreign investor in a German is taxable (and subject to German tax filings), subject to withholding tax or whether double taxation treaties apply). The German tax landscape is complex and subject to constant change. Thus consulting experienced tax counsel regarding the establishment and investment activities of the fund as well as fund investments by investors is highly recommended.

## **SELLING RESTRICTIONS AND INVESTORS GENERALLY**

### **Legal and regulatory restrictions**

Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

Only funds managed by German registered sub-threshold managers (see questions 11) can be marketed on a private placement basis to professional and semi-professional investors in Germany. Also, marketing under the EuVECA regime is still rather simple and the regime provides an EU marketing passport. In the case of a fully licensed manager,

the marketing of the fund requires BaFin approval.

### Types of investor

Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

It is possible to form a private equity fund for retail investors. However, market practice is that private equity funds are only formed for participations by semi-professional and professional investors.

### Identity of investors

Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

There are no regulatory filing requirements towards BaFin with regard to the identity of the fund investor. A fully licensed manager must notify BaFin of every change of ownership and every change of management with regard to the fund manager. A registered manager does not have these obligations. In the case of funds in the form of a KG, investors and any transfer of interests must be registered in the commercial register.

### Licences and registrations

Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

In principle, a person who sells financial instruments (including fund interests) needs a MiFID licence under the German Banking Act. However, if the person sells only fund interests of a fund managed by fully licensed AIFM, a simpler licence under the German Trade Act suffices if the respective fund is approved for marketing in Germany. Unlike in the United Kingdom, German law considers the potential investor to be the regulatory client of the placement agent.

### Money laundering

Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

The German Anti-Money Laundering Act is based on the EU Anti-Money Laundering Directive. Every investor must be identified and the investor's beneficial owner must be disclosed (know-your-customer-process). The obtained documents and information must be stored. In addition, Germany has implemented a transparency register with regard to beneficial owners in a vehicle. In a typical private equity structure, the aforementioned AML requirements do not extend to the members of the sponsor (except for disclosures in the transparency register).



## EXCHANGE LISTING

### Listing

Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

Private equity funds in Germany are typically structured as limited partnerships (KG). Partnership interests in these funds are not tradable on the stock exchanges. However, there are very few private equity companies structured as a corporation that are listed on the stock exchange. Such listing provides investors with greater liquidity as the shares are publicly traded, thus retail investors may invest. Unlike a fund organised as a partnership, however, a fund organised as a corporation is not transparent, but is subject to German corporate tax at the fund level.

### Restriction on transfers of interest

To what extent can a listed fund restrict transfers of its interests?

According to German listing rules, it is practically impossible to restrict transfers of listed securities.

## PARTICIPATION IN PRIVATE EQUITY TRANSACTIONS

### Legal and regulatory restrictions

Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

There are no legal or regulatory restrictions for funds managed by German sub-threshold managers to participate in private equity transactions. Fully licensed AIFMs, however, must comply with the AIFMD anti-asset stripping rules as well as with the investment-related restrictions of the specific fund category. For instance, open-ended funds may invest only a limited percentage of their assets into unlisted companies.

### Compensation and profit-sharing

Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

BaFin mentioned in an unofficial statement that carry beneficiaries may only be persons that promote the purpose of the fund. In addition, under the European Securities and Markets Authority's remuneration rules, carried interest is deemed to comply with the risk alignment and other requirements of the AIFMD if it is paid only after contributed capital and hurdle payments to the investors (and if there is a clawback). The taking of transactions fees should be disclosed in the fund documents. Typically, transaction fees are deducted from the management fee.



## UPDATE AND TRENDS

### Recent developments

#### Updates and trends

In December 2017, BaFin published a new investment circular with regard to the German Insurance Ordinance. The Insurance Ordinance is relevant for investments by certain non-Solvency II investors, such as local pension funds and small insurance companies. A prior draft had included severe restrictions for investments in non-EU (managed) private equity and debt funds. However, the final version of the circular, while not perfect, contains some helpful clarifications. In particular, the circular explicitly allows the incurring of debt, at least for purposes of bridging of capital calls in the case of directly investing private equity funds. A time limit for such borrowing is also no longer included. Certain limitations apply, however, for private equity fund of funds. Also, the circular clarifies that direct investments in closed private equity funds by 'special funds', which are relevant for institutional investors, remain eligible. Thus such investors can continue to invest up to 20 per cent of the value of their special funds in private equity funds without hereby burdening the quota for alternative investments. Regarding investments in certain debt funds that invest in non-subordinated debt, certain restrictions, unfortunately, remain in place (geographic limitations, requirement of a fully licensed AIFM and a 7.5 per cent quota for alternative investments rather than participation quota). German lawmakers do not currently intend to extend the MiFID rules for high-frequency trading, commodity position limits or capital adequacy to fund managers. In 2016, Germany expressly regulated the activities of German debt funds and thereby addressed 'shadow banking' concerns.

Regarding the issue of VAT on management fees, there is an update on the legislative side. As of 1 January 2018, a new provision under the German VAT Act became effective with the purpose of implementing the European Court of Justice's (ECJ) jurisprudence (in particular, the *Fiscale Eenheid* case (No. C-595/13) of December 2015) by 'selectively extending' the scope of application of the relevant VAT exemption (see question 21). However, the rather narrow framework laid out by the German tax authorities with the requirement of a catalogue of cumulative criteria is unsatisfactory - and in our view not in line with the spirit of the ECJ jurisprudence. However, there is hope that this strict interpretation will not stand as the VAT exemption of special AIFs is on the agenda of the EU VAT Committee and courts may take a different view.

A new German federal government was formed based on a coalition agreement dated 7 February 2018. This agreement lays out the plan of the new government for the next four years. It stipulates that the existing flat income tax on interest income will be abolished (in connection with the establishment of an effective automated exchange of information). This relatively brief statement in the coalition agreement raises many questions that will have to be clarified by the legislature (eg, the term 'interest income' is not specified). It also remains unclear whether the currently applicable lump-sum savings allowance will apply to interest income in the future. If this is the case, it must be clarified whether the true income-related expenses can be deducted if the lump sum savings allowance is exceeded. In the case of an investment in an investment fund, it remains to be seen how the taxation of interest income with the personal rate will be ensured. This is unclear as an obligation of investment funds to publish their tax bases no longer exists. Currently, all fund income of a private investor is taxed on the basis of the flat income tax. If the flat income tax on interest income would indeed be abolished, a split between interest income and other income would have to be made. In general, it remains true that the tax landscape is complex and subject to constant change.

The German Federal Ministry for Economic Affairs and Energy published in November 2018 the long-awaited draft law revising the German Placement Agent Regulation (FinVermV). FinVermV is relevant for all brokers and advisers whose work is subject to §34f GewO (Placement Agents). The changes aim to conform FinVermV to the European regulation under Directive 2014/65/EU (MiFID II), such that the requirements of MiFID II now apply to Placement Agents. We expect that the revised FinVermV will enter into force in March 2019. Transitional provisions have not been included. If this is not changed, Placement Agents will need to implement and apply the new requirements, in particular regarding

recording conversations, at very short notice.