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Alternative Funds

Germany

Heuking Kühn Lüer Wojtek

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Law and Practice

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Heuking Kühn Lüer Wojtek is a partnership of more than 400 lawyers, tax advisers and civil law notaries with eight offices in Germany, as well as offices in Brussels and Zürich, making it one of the major commercial law firms in Germany. It supports international clients and co-ordinates work in various jurisdictions. Internationally, it collaborates with leading law firms on a “good friends’ basis”. The firm’s investment fund team has 14 members, mainly based in the

Hamburg and Frankfurt offices. The team advises German and international clients and has significant expertise in structuring funds in all kinds of asset classes, with a focus on real estate funds and venture capital funds. In addition, the team advises funds on the acquisition of investments, assists foreign funds with aspects of marketing funds to Germany, and works with fund asset managers, eg, regarding all kinds of licence proceedings.

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1. General

1.1 General Overview of Jurisdiction

Even though Germany is the largest fund market in the EU, based on investments from investors within the EU, the German fund market is different to the markets in Luxembourg or Ireland in that it is very focused on German actors. Most of the managers and advisers based in Germany prefer Germany as the location for their alternative funds, particularly if they are targeting German investors. For alternative fund structures which target international investors, Germany is a less-used location. In this case, even German-based managers and advisers prefer other European locations, such as Luxembourg or Ireland. The open-end alternative investment fund (AIF) market is dominated by large alternative investment fund managers (AIFMs) which are either connected to banks or insurance companies, like Union Investment, Deka Investments, DWS or Allianz Global Investors, with a focus on their own products, or they act as so-called “service AIFMs” for independent fund managers like Universal Investment or Hansainvest. In the closed-end AIF market in Germany, the AIFMs have lower AUM and the market is not dominated by a few large AIFMs.

German investors in alternative funds include retail investors and institutional investors, such as HNWI, family offices, banks, corporates, insurance undertakings and pension funds for specific professions (*Versorgungswerke*). Insurance undertakings and pension funds for professions are the most important German institutional investors. Many of the German institutional investors structure their investments in different asset classes through an open-end German Special-AIF but also invest directly in alternative funds, in particular, non-German alternative funds.

2. Funds

2.1 Types of Alternative Funds

Alternative funds commonly established in Germany include real estate funds, private equity funds, venture capital funds, renewable energy funds and private debt funds. Real estate funds and renewable energy funds are structured as Special-AIFs (in which only professional and semi-professional investors are allowed to invest) as well as Retail-AIFs (in which retail investors are also allowed to invest). Most of the other alternative funds are structured as Special-AIFs in Germany, as this gives the fund manager more flexibility in structuring and managing the AIF.

2.2 Fund Structures

Contractual Funds

German alternative funds in the form of open-end funds (mostly real estate funds and private debt funds) are usually structured as contractual funds (*Sondervermögen*). The contractual fund is established by the AIFM on a contractual

basis with the investors, in the form of investment guidelines. The guidelines set out the details of the contractual relationship between the AIFM and the investors, including the investment limitations. The contractual fund has no separate legal personality and the assets of the fund are legally held by the AIFM in trust for the investors or by the investors themselves. The assets of contractual funds are separated by law and the investment guidelines from the assets of the AIFM and the assets of other AIFs managed by the same AIFM.

Investment Limited Partnership

Private equity, venture capital and renewable energy funds are typically structured as closed-end funds in Germany. But real estate funds, in particular, single asset funds, are also structured as closed-end funds in Germany. These funds are typically structured as a corporate fund in the form of an investment limited partnership (*Investmentkommanditgesellschaft*) with a limited liability company as the general partner of the investment limited partnership. For tax reasons, the management of the investment limited partnership might be conducted by a limited partner (so-called “managing limited partner”) which is usually identical to the AIFM of the AIF. Such managing limited partner is required to avoid limited partnership in order to be treated as being engaged in a trade or business for German tax purposes. Especially in the case of real estate investments, private investors benefit from an exemption of capital gains incurred after a 10-year investment term. In addition, funds with non-business assets are generally not subject to German Trade Tax (*Gewerbesteuer*) at fund level.

The relationship between the AIFM and the corporate AIF is governed by the management agreement between the AIFM and the AIF. The relationship between the investors of the corporate AIF is set out in the partnership agreement and the additional investment guidelines.

2.3 Regulatory Regime

Alternative funds are governed in Germany by the German Capital Investment Code (KAGB), which includes regulations for AIFMs and also for AIFs. The KAGB transposes the Directive 2011/61/EU (AIFMD) into German law. In addition, the KAGB also regulates German UCITS. The supervisory authority for AIFMs and AIFs in Germany is the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht* or BaFin).

The process for setting up funds in Germany is different for funds managed by registered small AIFMs and funds managed by licensed AIFMs (see **3.2 Regulatory Regime**). Funds managed by a small AIFM do not have to comply with most of the fund-specific regulations of the KAGB and do not have to comply with investment limitations. Special-AIFs and Retail-AIFs managed by a licensed AIFM have to comply with different statutory investment limitations.

Special-AIFs

For German Special-AIFs with fixed investment rules (*Spezial-AIF mit festen Anlagebedingungen*) the KAGB sets out specific investment limitations, which must be fulfilled to receive specific tax treatment. These limitations include a list of eligible assets and restrictions with regard to private equity investments (20% of the funds' assets). Furthermore, the use of leverage is limited to 30% of the funds' assets and in the case of a German Special-AIF investing mainly in real estate, to 50% of the funds' assets. Special-AIFs with fixed investment rules are often used by a single German institutional investor as a platform for its different investments. This has the advantage that the institutional investor receives a standard report from the AIFM for its different investments and is able to run an overlay management over the different asset classes, on the level of the Special-AIF with fixed investment rules.

Other German Special-AIFs are allowed to invest in all kinds of assets, as long as the relevant asset has a market value. Open-end Special-AIFs also have to comply with the principle of risk diversification, which requires that the AIFM of open-end funds invests in at least three assets with different investment risks. Only German Special-AIFs in the form of hedge funds are allowed to do short sales and use leverage in a significant volume (in excess of three times the fund's volume).

Retail-AIFs

Closed-end Retail-AIFs are only allowed to invest in specific eligible assets listed in Sec 261 of the KAGB, including real assets such as real estate, solar plants, wind farms or ships, as well as interests or shares in companies which may only hold real assets, interests or shares in companies with an operating business (private equity); interests or shares in closed-end (but not open-end) Retail-AIFs; and Special-AIFs and loans.

Furthermore, they have to comply with the principle of risk diversification. This requires that the funds invest in at least three different assets, so that the value of each asset is roughly evenly distributed. Alternatively, funds may invest in only one or two assets if the underlying assets have a diversified default risk portfolio (eg, shopping centres with multiple different tenants). If the individual funds do not comply with the principle of risk diversification, the investors have to commit to invest at least EUR20,000 into the AIFs, and the investors have to be able, based on their expertise, experience and knowledge, to understand the risks of the investment and to make their own investment decisions.

In addition, Retail-AIFs are only allowed to take up leverage up to 150% of the fund's capital, which is equal to the aggregated invested and committed capital minus the sum of all fees, costs and expenses which are borne by investors.

2.4 Loan Origination

German AIFs are allowed to grant loans under specific conditions. Closed-end Special-AIFs may originate loans under the conditions that they are restricted to taking up loans only up to 30% of the fund's capital and may not grant loans to a single borrower in excess of 20% of the fund's capital. The origination of loans to consumers is not allowed.

Shareholder loans may be granted notwithstanding the foregoing requirements. These loans may be granted up to 50% of the fund's capital if:

- the borrower is a subsidiary of the funds (majority stake); or
- loans are classified as subordinated loans; or
- loans do not exceed twice the acquisition costs of the share held by the funds.

In the case of subordinated loans, the Special-AIF may use up to 100% of the fund's assets for the origination of such loans.

The provisions regarding shareholder loans, in particular, enable private equity and venture capital funds to structure their investments in target companies in an efficient way.

In addition to the abovementioned investment restrictions regarding the origination of loans, the AIFM itself is subject to specific risk-management requirements in this regard, which are similar to the risk-management requirements for the credit business of banks.

Only other Special-AIFs and Retail-AIFs are allowed to originate shareholder loans, and Retail-AIFs are restricted to 30% of the fund's assets for the origination of shareholder loans.

For the origination of shareholder loans by open-end real estate funds to real estate companies, the KAGB provides specific provisions which allow the origination of shareholder loans up to 50% of the value of the real estate held by the real estate company and up to 25% of the assets of the real estate fund. The condition of such loans must be in line with market conditions and the loan must be sufficiently collateralised. The AIFM has to ensure that the loan will be repaid within six months after the AIF has sold its interest in the real estate company.

2.5 Cryptocurrencies and Non-traditional Assets

Special-AIFs, except for Special-AIFs with fixed investment rules, are allowed to invest in cryptocurrencies or other digital assets as long as the asset has a market value which can be determined. The direct investment of Retail-AIFs into cryptocurrencies is not possible, as the KAGB defines a list of eligible assets for Retail-AIFs which does not include cryptocurrencies or crypto assets. But Retail-AIFs could build an

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exposure on cryptocurrencies by using derivatives or investing in certificates with cryptocurrencies or crypto indices as underlying assets.

The KAGB does not provide any specific regulations with regard to investment in cryptocurrencies or crypto assets, but these assets have to be kept safe by the custodian of the Special-AIF. From 1 January 2020 onwards, keeping the crypto assets of others in safe custody will require a licence under the German Banking Act (*Kreditwesengesetz*). Currently, German custodians for AIFs do not offer safe-keeping of cryptocurrencies. Therefore, only Special-AIFs managed by registered small AIFMs invest in crypto assets, as they are not required to appoint a custodian for the AIF.

2.6 Regulatory Approval Process

The investment guidelines of Retail-AIFs require the prior approval of BaFin. Such approval has to be provided within four weeks of BaFin receiving the relevant application, which must be filed by the AIFM of the fund. In general, BaFin provides its approval in two to four weeks. The investment guidelines of Special-AIFs do not require separate BaFin approval, but an application does have to be filed to BaFin. In a case where the AIF is set up as a corporate, the AIF has to be registered in the commercial register before investors can invest in the AIF. This can take between a few days and two weeks.

Prior to marketing Retail-AIFs and Special-AIFs in Germany, a marketing notification to BaFin is required and marketing may only commence after BaFin has approved the marketing notification (see **4.3 Rules Concerning Marketing of Alternative Funds** for more details).

2.7 Requirement for Local Investment Managers

Retail-AIFs can only be managed by AIFMs located in Germany. However, Special-AIFs may also be managed by AIFMs located and licensed in another member state of the EU or the EEA, in accordance with the European passport regime, which allows the management of AIFs on a cross-border basis or via a German branch of the EU AIFM.

2.8 Other Local Requirements

The KAGB requires that German AIFs which are managed by a licensed AIFM have to be set up in one of the legal forms provided by the KAGB, which are contractual fund, investment stock corporation (*Investmentaktiengesellschaft*) and investment limited partnership. These legal forms meet the specific requirements of funds better than alternative forms of entities.

An AIF in the form of a corporate fund which is managed by an AIFM is required to have two separate directors, who must be reliable and have sufficient professional experience with regard to the business of the AIF. These directors are typically located in Germany, even though this is not explicitly required by the KAGB. In the case of an AIF in the form of a limited partnership, the general partner may also be located outside Germany, but this arrangement does raise concerns from a corporate legal perspective and it is therefore advisable that the general partner is located in Germany.

Furthermore, German AIFs in the form of a corporate fund must have a German address and a German bank account.

2.9 Rules Concerning Other Service Providers

The AIFM is responsible for all aspects of the management of the AIF, so it is responsible for the appointment of service providers for the AIF (regarding the outsourcing of the services of the AIFM to service providers, such as compliance function, MLRO or fund administration, see **3.6 Outsourcing of Investment Functions/Business Operations**). The KAGB only includes specific provisions for custodians as service providers of an AIF. The custodian of a German AIF must be located in Germany or have a branch in Germany and must have the licences required under the German Banking Act to perform the functions of a custodian for the AIF.

2.10 Requirements for Non-local Service Providers

Non-local service providers must be licensed to provide the relevant regulated service in Germany. They are regarded as providing the service in Germany if they actively target the German market (regardless of where their registered office is). As service providers are appointed by the AIFM, the AIFM is responsible for ensuring that the relevant service provider has the required registrations or licences.

2.11 Tax Regime

The special tax regime of the German investment tax act or GITA (*Investmentsteuergesetz*) generally applies to funds in the sense of the KAGB. However, certain funds, notably investment limited partnerships, are in principle excluded from application of the GITA. Closed-end AIFs are generally structured as such an investment limited partnership. For these funds, the ordinary tax regime applies, whereby, the investment limited partnership is transparent for German income tax and corporate income tax purposes. In the case of investment limited partnerships engaged in a trade or business, eg, real estate developments, the funds will be subject to German trade tax.

The GITA does distinguish between investment funds and special investment funds. Investment funds, regardless of their country of residency or incorporation, are subject to German corporate income tax and solidarity surcharge with regard to certain German-source income. Other income, such as German domestic or non-German funds, is not taxable in Germany. To mitigate the tax at fund level, investors subject to German taxation receive a partial tax exemption. The rate of exemption depends on the type of fund (real estate, stocks, mixed and other) as well as the tax status of the

investor (private or held as a business asset). Special investment funds have to meet a range of requirements, eg, with regard to the assets invested as well as debt financing, and are, in principle, exempt from German corporate income tax; however, they are generally required to withhold tax for investors.

2.12 Double-tax Treaties

Alternative funds structured as investment limited partnerships are generally not eligible for benefits under double-tax treaties. However, investors may (indirectly) be entitled to treaty benefits as individuals, and corporations are in principle eligible for tax treaties. From a German tax perspective, German special investment funds are generally found to be tax-resident in Germany regardless of their tax exemption.

2.13 Use of Subsidiaries for Investment Purposes

Open-end AIFs generally only use subsidiaries for investments in real estate – in particular, if the real estate is not located in Germany.

For closed-end AIFs, the use of subsidiaries for investment purposes is normal. If these funds invest in real assets (eg, real estate, solar plants, wind farms, ships) each asset is typically held by a subsidiary. Assets may be acquired indirectly by acquiring the company which holds the assets, or directly by acquiring the assets via a subsidiary.

The use of subsidiaries is often driven by legal reasons. In some countries, for example, real estate cannot be acquired by foreign investors, while indirect acquisition via a company based in the specific country is possible within the regulatory legal framework. However, using a subsidiary is more often tax driven, typically to avoid triggering real estate transfer tax. As long as no more than 95% (as of 1 January 2020 – 90%) of the interests in such subsidiary are transferred within a period of five years (as of 1 January 2020 – 10 years) or more German real estate transfer tax will not be triggered.

2.14 Origin of Promoters/Sponsors of Alternative Funds

The promoters/sponsors of AIFs established in Germany are typically also based in Germany or in a German-speaking country. The establishment of German AIFs by non-German promoters/sponsors is presently an exception.

2.15 Origin of Investors in Alternative Funds

Due to the volume of the German market, most of the investors in German AIFs are based in Germany. Non-German investors in German AIFs are typically from other member states of the EU or Switzerland.

2.16 Destination of Investments Made by Alternative Funds

German AIFs invest in Germany, as well as in other countries of the world. The main focus of investments is Germany, followed by Europe and North America. German AIFs are not restricted by the KAGB to make investments in specific destinations.

2.17 Key Trends

One of the key trends in recent years has been the success of registered small AIFMs, which in particular are used to launch and manage private equity and venture capital funds. Their popularity is based on the fact that the process for the establishment of small AIFMs, which only manage Special-AIFs, is very efficient and the BaFin registration usually takes less than four weeks. In addition, non-professional investors which commit to a minimum investment of EUR200,000 are also allowed to invest in Special-AIFs.

Furthermore, more funds are investing (partly) in crypto assets and it is assumed that this trend will continue, as the German government recently published its blockchain strategy to support blockchain projects in Germany and to provide a regulatory framework for investment into crypto assets.

2.18 Disclosure/Reporting Requirements

In addition to the disclosure requirements for investors (see **4 Investors**) the AIFM has to report information about the managed AIFs and the AIFM to BaFin on an ongoing and ad hoc basis. The information regarding the AIF includes information about the investments of the AIF, its risk profile and liquidity management. Additional information has to be provided for each AIF if the AIFM also manages hedge funds. In addition, BaFin can request the filing of financial statements for managed Special-AIFs and a list of all the managed AIFs that form the AIFM.

Furthermore, the AIFM has to notify BaFin about any material amendments to the information provided in the licence application and about the occurrence of specific events as set out in Sec 34 KAGB, such as the appointment or dismissal of a managing director, relocation of the registered office, or the acquisition or disposal of a substantial holding in the AIFM.

2.19 Anticipated Changes

The German Federal Ministry of Finance aims to strengthen the protection of investors. According to this plan, AIFMs which are registered, but not fully licensed, may only manage Special-AIFs and not Retail-AIFs. AIFMs with limited AUM would be obliged to apply for a full – costly and time-consuming – authorisation.

In June 2019, the European Commission published new guidelines on corporate climate-related information reporting, as part of its Sustainable Finance Action Plan. These

guidelines will provide companies, also AIFMs, with practical recommendations on how to better report the impact that their activities are having on the climate, as well as the impact of climate change on their business. Also due to the Sustainable Finance Action Plan, AIFMs and funds should integrate sustainability risks and, where relevant, other sustainability factors in the areas of organisational requirements, operating conditions, risk management and target market assessment.

Upcoming changes to the German real estate transfer tax act may result in increased interest in open-end funds, as in the case of contractual funds the AIFM is regularly the legal owner of the real estate. In consequence, a change in investors does not result in real estate transfer tax. In the case of investment limited partnerships, the change of currently 95% or more (as of 1 January 2020, 90% or more) of the equity participations in the partnership within a five-year (as of 1 January 2020, 10-year) period will result in real estate transfer tax.

3. Managers

3.1 Legal Structures Used by Fund Managers

The legal structure used by fund managers depends on the assets of the fund and the potential investors. For private equity and venture capital funds, many fund managers make use of the option of the small registered AIFM and manage the AIF in this function.

With regard to real estate funds, many fund managers use a so-called service AIFM, which sets up and manages the AIF so that the fund manager only acts as investment adviser for the service AIFM with regard to the investments of the AIF. In addition the advisers often also provide the asset management of the real estate held by the AIF. This structure has the benefit that the fund manager does not require a licence in Germany to provide the advice, as providing investment advice with regard to real estate is not an activity regulated under the German Banking Act.

Where the provision of investment advice to the AIFM requires a licence under the German Banking Act, some fund managers provide such investment advice as tied agent of a regulated financial institution, while others apply for the relevant licence under the German Banking Act to provide investment advice or portfolio management.

AIFMs may only be structured in the legal form of a stock corporation, a limited liability company or a limited partnership with a limited liability company as the general partner.

3.2 Regulatory Regime

Before commencing their business activities, AIFMs with a registered seat in Germany require prior approval from

BaFin for managing AIFs in Germany. Such approval can be in the form of a registration for small AIFMs or in the form of a full licence under the KAGB.

To receive a licence from BaFin, the AIFM has to meet specific capital requirements (including a minimum capital of EUR125,000 for external AIFMs), and has to have at least two directors who are reliable and professionally qualified with regard to the kind of AIFs the AIFM plans to manage. In addition, the AIFM has to file a business plan with the application describing the contemplated business as well as the organisational set-up. The AIFM also has to document how it complies with the organisational requirements of the KAGB for AIFMs (eg, risk management policy, conflict of interest policy, remuneration policy and compliance policy). Furthermore, the AIFM has to disclose any person holding a substantial participation in the AIFM. The licence proceeding with BaFin takes between six and 12 months.

Small AIFMs may only register with BaFin if:

- they manage Special-AIFs with assets under management:
 - (a) not exceeding a threshold of EUR100 million when applying leverage through debt financing or otherwise; or
 - (b) not exceeding a threshold of EUR500 million and where investors cannot exercise redemption rights within five years of the first investment; or
- they also manage German Retail-AIFs and the volume of all assets of the managed AIFs, including leverage, does not exceed a threshold of EUR100 million.

In a case where the small AIFM only manages Special-AIFs, the AIFM only has to comply with a reduced set of regulatory rules (especially some ongoing reporting requirements). In addition, most of the fund-specific requirements do not apply to small AIFMs and their AIFs. The registration procedure is much easier than a licence proceeding and takes about two to six weeks. It requires the filing of a registration request together with certain documents on the AIFM and the AIF (inter alia, articles of association for the AIFM and AIF, notarised excerpts from the commercial register and a description of the AIF). The directors of the small AIFM do not have to prove their reliability and professional qualifications as part of the registration process.

3.3 Tax Regime

AIFMs are generally subject to ordinary tax rules. The carried interest in the case of certain PE funds might qualify for a partial tax exemption, however.

3.4 Rules Concerning “Permanent Establishments”

No special rules are available to exempt funds with German-resident managers from permanent establishment taxation.

3.5 Taxation of Carried Interest

Carried interest is typically defined as a share in the profits of the AIF accrued to the AIFM as compensation for management, ie, a performance-related component, which is treated as taxable income. Subject to transparent tax treatment the qualification of the income depends on the qualification of the fund, ie, business income or in the case of a non-business-type fund structure, the income may qualify as income from self-employment. There is a preferential tax regime for the latter, ie, 40% is exempt from tax and the remaining 60% is subject to tax at the marginal income tax rate of the carried-interest recipient. Beneficial carried-interest taxation is not only available to individuals, but also to corporations.

3.6 Outsourcing of Investment Functions/Business Operations

AIFMs may outsource investment functions or business operations to service providers. Based on an internal risk analysis, the AIFM has to determine which functions can be outsourced from a risk perspective. The outsourcing requires that the AIFM has objective reasons for the delegation and its overall delegation structure (such as an increase in efficiency or reduction of costs). Furthermore, the service provider must have sufficient resources for the execution of the delegated functions, and the personnel managing the service provider must be experienced and of good repute. The AIFM has to ensure effective supervision of the service provider, including contractual termination and instruction rights vis-à-vis the service provider, and has to continuously monitor the services provided.

Where the AIFM wants to outsource portfolio management or risk management, it has to ensure that the service provider is either licensed or registered as an AIFM or is licensed to provide portfolio management services. If such functions are outsourced to service providers that are not based in a member state of the EU or EEA, effective collaboration between BaFin and the other competent regulatory body has to be ensured. Portfolio management and risk management may not be outsourced to the custodian of the fund. In addition, functions controlled by the custodian of the AIF may not be outsourced to the custodian if no organisational measures have been taken to avoid any potential conflict of interest arising from such arrangement. The same applies to the outsourcing of services or functions to another company that has interests which conflict with those of the AIFM or the investors of the AIF.

The AIFM may only outsource functions to service providers to the extent that the AIFM does not become a “letter box” entity, which requires that it has at least sufficient knowledge and resources to control the outsourced activities and provides portfolio management or risk management with regard to an AIF.

Prior to outsourcing any function, the AIFM has to notify BaFin about the intended outsourcing.

3.7 Local Substance Requirements

A small AIFM must have its registered seat and place of business in Germany as well as at least one director who is German resident. There are no regulatory capital requirements for a small AIFM, except that it needs to comply with capital requirements under company law, eg, in the case of a limited company (GmbH), the share capital of the AIFM must amount to EUR25,000.

A fully licensed AIFM is also required to have its registered seat and place of business in Germany. Furthermore, the AIFM must have at least two managing directors, one responsible for portfolio management and the other for risk management. Based on BaFin administrative practice, each managing director must also have one representative responsible for the relevant business department in the absence of the relevant managing director. Therefore, the AIFM must have at least four employees, including the managing directors, but in practice the minimum personnel resources are around six to eight employees (including managing directors). At least one managing director must be German resident, to ensure that the AIFM has its place of business in Germany. In addition, the majority of the employees should be resident in Germany to ensure that the place of business is in Germany.

The external AIFM must have a starting capital of at least EUR125,000 and additional own funds in the amount of 0.02% of the AUM exceeding EUR250 million. The AIFM must also have additional own funds to cover operational risks. Furthermore, the AIFM must at all times have own funds in the amount of a quarter of their preceding year's fixed overhead costs.

Both small and fully licensed AIFMs must also have an office in Germany, the required IT and other equipment for the administration of the AIFs, and a German bank account.

3.8 Local Regulatory Requirements for Non-local Managers

Non-local AIFMs may manage German Special-AIFs either via a German branch or on a cross-border basis. In both cases, the non-local AIFM has to comply with the provisions of the German Capital Investment Code regarding the requirement of a custodian for Special-AIFs, the legal form of the Special-AIF, the eligible investments and investment restrictions for German Special-AIFs, and the marketing provisions for German Special-AIFs. In the case of a branch, the non-local AIFM also has to comply with the specific organisational requirements of the German Capital Investment Code.

4. Investors

4.1 Types of Investor in Alternative Funds

In contrast to the AIFMD, the German Capital Investment Code distinguishes between three different kinds of investors. Professional and semi-professional investors are eligible for Special-AIFs. Retail investors are only allowed to invest in Retail-AIFs.

Professional Investors

Professional investors are those listed in Annex II of Directive 2004/39/EC (MiFID) which include, for instance, credit institutions, investment firms, other authorised or regulated financial institutions, insurance companies, pension funds and large companies.

Semi-professional Investors

By introducing a new category of investors, semi-professional investors, Germany goes beyond the requirements of the AIFM Directive. Semi-professional investors are defined by a minimum investment commitment of EUR200,000 and a certain degree of sophistication. Semi-professional investors are treated the same way as professional investors. This requires the investment firm to adequately assess the expertise, experience and knowledge of the prospective semi-professional investor in light of the nature of that investment. The investor has to be capable of making their own investment decisions and has to understand the risks involved. Semi-professional investors are entitled to waive some of the protection provided by the German Capital Investment Code.

Semi-professional and professional investors have their main investment focus within alternative funds on real estate. But, in addition, these investors also invest in private equity or venture capital funds and crypto funds, as such funds are predominantly structured as Special-AIFs.

Retail Investors

Finally, the German Capital Investment Code defines retail investors as investors that do not qualify as professional and semi-professional investors. Retail investors mainly invest in alternative funds with an investment focus on real estate and other real assets (like solar plants, wind farms or ships).

4.2 Marketing of Alternative Funds

The marketing of AIFs in Germany depends on the structure of the relevant AIF. German Retail-AIFs can be marketed to retail investors, semi-professional investors and professional investors in Germany. However, German Special-AIFs may only be marketed to semi-professional and professional investors in Germany.

AIFs located in other member states of the EU or the EEA, or in third countries, can in principle also be marketed to retail investors in Germany. This requires, inter alia, that:

- the AIFM and the management of the AIF is in compliance with the AIFMD;
- the AIFM appoints a person for the AIF in Germany who is qualified to act together with the AIFM as compliance function for the AIF;
- a custodian is appointed for the AIF; and
- the AIFM has appointed a bank in Germany to act as paying agent for the AIF.

Furthermore, the fund documents for the AIF must include specific regulations and information as set out in the German Capital Investment Code.

The marketing of AIFs located in other member states of the EU or the EEA, or in third countries, to semi-professional investors also requires that the AIFM and the management of the AIF is in compliance with the AIFMD. Therefore, most foreign funds will be marketed only to professional investors in Germany.

4.3 Rules Concerning Marketing of Alternative Funds

The marketing of AIFs in Germany requires a prior marketing notification to BaFin. Marketing in this context means the direct or indirect offering or placement of units or shares of an AIF. The term "offering" covers all kinds of offering, including the invitation to make an offer. The term "placement" requires an active selling of the shares or units of the AIF, which means that merely responding to an order does not qualify as marketing.

Based on the administrative practice of BaFin, share of units of AIFs which have not been launched can be marketed in Germany and, therefore, trigger the prior marketing notification requirement where fund units or shares are ready for sale, ie the fund terms and investment guidelines rules are fully negotiated. The fact that the name of the AIF is already specified in the documents is seen as an indicator by BaFin that the terms of the AIF are already fully negotiated.

Furthermore, with regard to professional and semi-professional investors, BaFin does not consider cases in which the offering or placement of the shares or units of the AIF have not been made on the initiative of the AIFM, or any person acting on behalf of the AIFM, as "marketing" (reverse solicitation). In addition, in cases where the AIF is only marketed to investors that were involved in the negotiation of the terms and investment guidelines of the AIF, BaFin does not consider the activities as "marketing" within the meaning of the German Capital Investment Code.

In marketing shares or units of an AIF to retail investors, the AIFM has to comply with pre-contractual information duties and has to provide the key investor information, the most recent net asset value of the investment fund or the most recent market price of the units or shares to the retail

investor. In addition, the retail investor has to be provided with the prospectus and the last published annual and semi-annual report of the AIF. This information has to be provided in German or together with a German translation.

The pre-contractual information duties in marketing an AIF to semi-professional or professional investors are less strict. In this case, the investor only has to be provided with the information set out in Sec 307 KAGB, which transposes the information duties of Art 23 para 1 AIFMD into German law.

In addition, the German Capital Investment Code sets out rules regarding marketing communication to retail investors and provides a liability regime if information contained in sales documents provided to investors is inaccurate or incomplete.

4.4 Local Investors

German retail investors are only allowed to invest in German Retail-AIFs and in non-German Retail-AIFs which have filed a marketing notification to BaFin for marketing to retail investors. German professional and semi-professional investors are allowed to invest in German Retail-AIFs and Special-AIFs, as well as in non-German AIFs, which have filed a marketing notification to BaFin for marketing to the relevant type of investor.

4.5 Regulatory Regime

The marketing of units or shares of AIFs in Germany requires a prior marketing notification to BaFin. The requirements for such a marketing notification depend on the type of investor to which the AIF will be marketed and the country in which the AIF has its registered seat. While the marketing notification for a German AIF is a straightforward process, marketing notifications for non-German AIFs, in particular for foreign AIFs, are more complex.

When marketing units or shares of EU AIFs or foreign AIFs to retail investors, the obligations under Sec 317–320 KAGB must be fulfilled. Whereas Sec 317 KAGB states the conditions governing the admissibility for marketing of EU AIFs or of foreign AIFs to retail investors, Sec 320 KAGB governs the notification procedure with BaFin. Additionally, Sec 318 KAGB sets out the requirements for the content of the sales prospectus and the key investor information.

Sec 323 KAGB (Art 32 AIFMD) provides the requirements for marketing EU AIFs or German Special-AIFs to professional and semi-professional investors in Germany by an AIFM based in another member state of the EU or EEA (EU AIFM). The marketing notification must be made to the competent authorities in the home member state of the EU AIFM. As part of the procedure, BaFin verifies whether the competent authorities of the home member state have sent a certificate to BaFin confirming that the EU AIFM is

authorised to manage the relevant AIF. In addition, the EU AIFM has to take measures to ensure that the units or shares of the AIF will not be marketed to retail investors.

The marketing of units and shares of foreign AIFs or EU AIFs that are managed by a non-EU AIFM to professional investors or semi-professional investors is regulated in Sec 330 KAGB, which sets out additional requirements to those set out in Art 42 AIFMD. Sec 330 1 KAGB provides, inter alia, that non-EU AIF management companies must appoint an independent third party to assume certain functions of a depositary pursuant to Art 21 para 7–9 AIFMD (paying agent, custodian and control function – so-called depot light function) and must inform BaFin about such appointment accordingly. Where the foreign AIF will be marketed to semi-professional investors, the non-EU AIFM and the management of the foreign AIF must be in compliance with the requirements of the AIFMD. In both cases, the AIFM has to take measures to ensure that units or shares of the AIF will not be marketed to retail investors in Germany.

4.6 Disclosure Requirements

As part of pre-contractual information duties, key investor information and a prospectus must be provided to investors along with the annual financial statement of the AIF. The latter must include specific minimum information for non-German AIFs as set out in Sec 299 KAGB, with regard to marketing to retail clients, and in Sec 308 para 1 KAGB, with regard to marketing to professional and semi-professional investors.

The AIFM has to inform German investors in the AIF about any changes to the liability of the custodian. In addition, for each AIF marketed in Germany on a regular basis, the AIFM has to disclose to German investors information about:

- the percentage of hard-to-liquidate assets of the AIF;
- the liquidity management of the AIF;
- the risk profile of the AIF; and
- the use of leverage for the AIF.

A German AIFM also has to disclose on its web page information about its:

- conflict of interest policy;
- remuneration policy;
- best execution policy;
- voting policy;
- inducement policy;
- whistle-blower hotline; and
- complaint procedure.

4.7 Tax Regime

Special rules apply in the case of investment funds or special investment funds in the sense of the GITA. German tax-resident investors benefit from partial exemptions which

depend on the type of funds and the investor. For instance, exemption for income from stock investment funds would amount to 30% for individuals if held as a private asset. In the case of business assets of individuals, the exemption would increase to 60%. In the case of corporate tax payers, the exemption would increase to 80%. For real estate funds, exemptions distinguish between German domestic and non-German funds.

As regards investment limited partnerships, tax treatment is generally similar to that of investors carrying out such activity themselves. This could result in special tax rates – for instance, a flat tax rate for income from capital might apply. A capital gain could be tax exempt. In the case of investment limited partnerships with non-business assets, capital gains from the sale of real estate after an investment term of ten years could be fully exempt.

4.8 FATCA/CRS Compliance Regime

FATCA and CRS rules have been implemented by the Financial Account Information Act (*Finanzkonten-Informationsaustauschgesetz* or FKAustG) according to which, EU member states and certain other states (USA; CRS-partner states) will be provided with information on financial accounts. In principle, financial institutions and similar obligors have various reporting and disclosure obligations. Such provisions apply in particular to items which are paid, secured or held by a paying agent, ie, an economic operator (such as, a financial institution, a bank or an investment fund), for the direct or indirect benefit of a beneficial owner who is a natural person resident in the USA (FATCA) or a CRS partner state. This includes dividends, capital gains, any other income generated with respect to the assets held in a financial account, and any amount with respect to which the financial institution is the obligor or debtor, including any redemption payments and account balances.

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