

**Bundesministerium der Finanzen**  
Herrn MR Matthias Hensel  
Referat IV C 1  
Wilhelmstraße 97  
10117 Berlin

15 February 2018

nur via Mail:  
[IVC1@bmf.bund.de](mailto:IVC1@bmf.bund.de)  
[matthias.hensel@bmf.bund.de](mailto:matthias.hensel@bmf.bund.de)

**RE: Response to Guidance issued 25 January 2018 relating to Manufactured Dividend Rule pursuant to sec. 6 para. 3 no. 2 InvTA 2018**

Dear Mr. Hensel,

ISLA would like to thank the BMF for taking the previous suggestions in our submission dated 5 December 2017 into consideration, and for now giving us the opportunity to comment on the latest draft circular issued on 25 January 2018. ISLA remains committed to working with the BMF to ensure compliance with the provisions of the Investment Tax Act, whilst trying to find as well, possible solutions to the anticipated liquidity problems that we believe shall arise as a consequence of the Investment Tax Act as of 1 January 2018 to stock lending and repo transactions performed by investment funds.

In particular, we would like to comment on paragraph 1.b., Steuerabzug.

Withholding Tax

The draft circular mentions that it is not feasible for foreign persons (i.e. a non-German borrower) to apply a German withholding tax on the German source participation income in the form of a manufactured payment and/or fee income paid by non-German borrower to an investment fund as lender. The circular does not however mention whether a lender would be able to outsource or appoint a non-German third party (such as an agent, or the borrower) to undertake tax withholding and remittance.

ISLA would also encourage and appreciate the inclusion of details of the specific tax office to which such returns should be sent.

Whilst it is understood that a withholding tax based procedure is not available where the borrower is a non-German resident, we would like to highlight the potential impact this situation may have within the industry.

Many international investment funds (as defined by the Investment Act) are organised into sub-funds, thereby causing each fund to (i) file the required self-assessment, and, as a consequence, (ii) potentially consider whether it may become necessary to change its accounting year-end in order to comply with the German calendar year-end tax filing process.

The perception within the industry is that many investment funds will not be prepared to accept, nor undertake, the required German tax compliance obligation, particularly with securities lending generally providing small incremental low-risk returns. Instead, non-German investment funds may simply stop lending their German equity securities around income date periods, and thereby potentially compromising the liquidity of the German market.

To highlight this point, ISLA has polled the major securities lenders and currently, in light of the Investment Tax Act along with previously implemented “anti-cum/cum legislation”, approximately 70% of available German equities will be recalled over income dates.

Any shortage of liquidity, particularly in smaller cap, non-DAX stocks, could, we believe, potentially lead to market volatility where, for example, a prime broker may be forced to buy up those shares available to cover their own and their underlying clients’ short positions.

ISLA would like to highlight that the majority of lending supply is provided by agent lenders on behalf of underlying principals. This ultimately means that there are several thousand lenders facing a concentration of maybe twenty to thirty borrowers.

With this in mind, we believe that permitting a non-resident to withhold, in conjunction with a confirmation that this withholding would remove all obligations on the lender to file a tax return, would increase tax collection (as more lenders would be prepared to lend), concentrate compliance in a small number of withholding agents – thus reducing the operational overhead for both market participants and in the BMF, and improve the liquidity and functioning of the German equity market.

We do appreciate the legislative constraints around enforcing this, but felt it our duty to articulate the fact that a withholding based tax will be the most practicable solution in the longer term, and is the solution which has been reached in markets for example such as the US, where international borrowers can voluntarily become “Qualified Securities Lenders” responsible for the collection and reporting of withholding tax to the Inland Revenue Service.

ISLA acknowledges that this would require further discussion within the BMF. We therefore politely request that this option be kept open in the published circular for further consideration. The other matters in the draft circular need confirmation as a matter of urgency, so we would also request that any further discussion on this point does not delay publication.

Additionally, we would like clarity on some other points within the circular.

1a. Scope of taxable payments – loans over income date

In this section, it is stated that fees and remuneration are not subject to tax, if no income has been paid during the term of the loan. There is a specific possibility, however, that a security would be loaned after the ex-date but settled before payment date. In this instance, technically an income event HAS occurred during the course of the loan, but no manufactured payment would be due to the lender.

We do not believe there is an intention to tax fees on such transactions, and therefore ISLA would appreciate it being clarified in the circular that a tax is only due when the lender has transferred the entitlement to receive the real dividend.

1b. Withholding tax – deduction by German borrower

ISLA would be grateful for confirmation whether a foreign branch of a German borrower would be required (or, for that matter, able) to act as a withholding agent on such payments and deduct tax on manufactured payments and fees at source. Lending agreements may be signed with the head office of a German bank operating through trading desks in multiple countries; or the contract may be with a single, foreign branch. In both instances, we would appreciate guidance as to the foreign branch's obligation to withhold.

Once again, thank you for your ongoing engagement on this matter. There are a number of other, more detailed points, which we would like to raise with you – for instance the possibility of more detailed guidance as to which types of lender are in scope of the Investment Tax Act and which are not – which we will send to you in due course.

Sincerely yours,

**M. Hutchings**

-----  
Mark Hutchings - COO

International Securities Lending Association, London, United Kingdom