ZIA German Property Federation

Special Investment Funds:
Fiscal Barriers for Renewable Energy-Production

Expanding Energy Capacities and Preventing a Loss of Status

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Summary

Special investment funds are a type of investment funds targeted mainly at institutional investors such as pension funds and insurance companies. These funds are tailored to the individual needs and objectives of investors, offer customised investment strategies and can invest in various assets such as real estate. Special funds are primarily intended for professional investors and are subject to strict regulatory requirements set on EU and national level. In recent years, these funds have grown in importance for the real estate industry and have gained traction as providers of capital in times of rising interest rates. In 2022, German special investment funds alone represented nearly 25 % of all transaction-volume in the commercial real estate sector. In total, they hold more than 50 % of the floor space in real estate used for logistical and commercial purposes. Today, however, only few photovoltaic systems are installed on these properties. This is predominantly due to **obstacles in the German investment tax law**, which **significantly inhibits the use of PV to its full capacities**. Although income from the production of solar energy is subject to corporate income tax and local trade tax, special investment funds are only allowed to generate commercial income to a very limited extent **based on the current de minimis limits set by the German investment tax law**[1]. This maximum threshold is currently set at 10 % of the total income of special investment funds. If this de minimis limit is exceeded, the investor will face a **loss of status as special investment fund** and the accumulated increase in value of the fund, *inter alia* from undisclosed reserves in increased land value, becomes taxable at once. **To avoid that scenario, hardly any PV systems are used**.

Since a large number of logistics halls or retail buildings that are ideal for the installation of PV are held by special investment funds, the current tax-provisions are a significant obstacle to extending the PV-coverage and supporting the renewable energy production. To avoid the risk of surpassing the 10%-threshold in years of low revenue from the property but relatively high revenues from the generated electricity, fund operators will keep a large safety margin from the de minimis limit. Even though there are initiatives to potentially increase the de minimis limit, such an increase alone would not suffice, given the risk of a loss of status remains and thus represents a disproportionate risk to the funds.

If the installation of PV systems on rooftops should become mandatory, it would appear logical to consider the generation of electricity as an integral part of the economic activity acquisition and ownership of buildings.

1 The de minimis limits cap the percentage of active income which a special investment fund may generate in relation to its total income.

Legislative developments regarding the support for PV-installation

In recent years, various adjustments of the German tax law have already been implemented to promote the operation of photovoltaic systems. For example, the Fund Jurisdiction Act (*Fondsstandortgesetz*) of 2021 extended the possibility[2] to introduce further activities in connection with the production and sale of renewable energy.

The Annual Tax Act 2022 introduced further tax benefits for photovoltaic systems. For example, the German legislator created an income-tax-exemption for certain photovoltaic systems and a zero-tax-rate with input VAT deduction for the supply and installation of certain photovoltaic systems in VAT-law. In addition, the Act raised the de minimis limit[3] to prevent the risk of special investment funds losing their status when operating photovoltaic systems. For certain investments in the production of renewable energies, the general 5 %-limit was increased to 10 %. In 2023, the German government suggested with the draft of the so-called Growth Opportunities Act (*Wachstumschancengesetz*) which would provide for a further increase of the de minimis limit to 20 %.

Nevertheless, the problem remains: the risk of an automatic loss of status is disproportionate and prevents special investment funds from installing possible PV-capacities.

Status Quo: Disadvantages of Special Funds

The adjustment of the regulation on the loss of status for special funds is of particular importance: Currently, exceeding limits of the Investment Tax Act[4] would **result in a loss of status and trigger significant consequences**. The loss of status as special fund leads to a fictitious sale of all assets with the disclosure of all hidden reserves of the special fund. This is due to the fact that in the event of dissolution, the special investment units are deemed to have been sold, which results in the disclosure and taxation of hidden reserves. However, **compliance with the limits cannot be planned reliably**; in particular, rent defaults and reclassifications of income following from audits can lead to a **breach of the limits due to reasons beyond the control of the Special Fund**.

Some argue an adjustment of the Investment Tax Act regarding the loss of status was unnecessary since the energy production activity in the building-context can be outsourced to a subsidiary.

In practice, however, this currently is a risky way to prevent the loss of status: The investment fund must invest at least 90 % of its assets in assets as listed in the Investment Tax Act[5]. Thus, only a maximum of 10 % of the fund's assets may be invested in other assets. Since companies, to which energy production could be outsourced, are not explicitly listed, considerable legal risk remains. Moreover, this proceeding would unnecessarily lead to further complexity of the fund structures, as various additional regulations would be needed, for example to regulate the structure of the electricity supply contracts or the distribution of operator risks. Furthermore, problems regarding state subsidies for photovoltaic systems can arise if subsidies are granted to a real estate company and then outsourced (not to a

2 The adjustments were made in § 9 (1) Sentence 2 GewStG (Gewerbesteuergesetz, German Trade Tax Act).
3 The Annual Tax Act 2022 adjusted the Investment Tax Act (Investmentsteuergesetz, InvStG) - Section 26 No. 7a InvStG.
4 The limits are set out in § 26 No. 7a InvStG.
5 The catalogue of permissible assets is laid out in list is defined in § 26 No. 4 letters a to m InvStG.

real estate-holding, but an electricity-generating company). The draft law of the Growth Opportunities Act does not contain any amendments resolving this problem.

Need for Adjustment

The slight increase in the de minimis limit for income from the operation of renewable energy power generation systems or charging stations from 5 to 10 %, as introduced in the Investment Tax Act 2022, still is a disproportionate risk compared to the value added. It will therefore lead to an expansion of photovoltaic roof areas for a small proportion only of real estate held by special funds, given that **buildings with large roof areas, such as retail buildings and logistics halls, generate a significantly higher relative share of electricity generation income compared to rental income**. However, it is precisely these buildings that have major potential for the advancement of energy supply through photovoltaics, as commercial and industrial properties are especially well suited for photovoltaic systems due to their flat roof surfaces, which are particularly large in relation to their total area. Accordingly, the increase in the de minimis limit from 10 to 20 % provided for in the draft bill of the Growth Acceleration Act is welcomed, yet it does not lead to the full potential being realised.

The **wasted potential is significant**: more than 50 % of the over 7.5 million m² of usable space in domestic industrial and warehouse buildings and more than 6 million m² of usable space in domestic retail/restaurant properties are held by German special investment funds, which generate more than 80 % of their income from these types of properties. For these funds, the previous increase in the limit means that they could continue to equip most small parts of their roof area with photovoltaic systems.

The **exclusion of a risk of a loss of status would most likely boost investment in photovoltaic systems**. Currently, activities are only carried out to a very small extent or not at all; therefore, at this stage, there is little or no trade tax revenue.

Rectifying this problem of an impending loss of status would have positive effects both on the energy-supply and thereby the targets set by legislation on the national level as well as the EU-level, for instance with the Renewable Energy Directive (RED III). Additionally, it would **result in positive fiscal effects**, as the **special fund would even generate additional trade tax revenue** with the energy production and levy, since the construction of the renewable energy-systems and the energy levy are in principle subject to trade tax.

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The German Property Federation (ZIA) is the umbrella organisation of the German real estate industry. Through its members, including 33 associations, it speaks for around 37,000 companies in the industry along the entire value chain. The ZIA gives the real estate industry in all its diversity a comprehensive and uniform representation of interests that corresponds to its importance for the national economy. As an association of companies and associations, it gives the entire real estate industry a voice at national and European level - and in the Federation of German Industries (BDI). The president of the association is Dr Andreas Mattner.

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