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## German investment fund lump-sum taxation violates free movement of capital

[http://docs.bepartners.pro/news/9-10-2014\\_ECJ\\_C-326-12\\_english.pdf](http://docs.bepartners.pro/news/9-10-2014_ECJ_C-326-12_english.pdf)

**The European Court of Justice (ECJ) ruled that the German lump-sum taxation of non-transparent foreign investment funds according to Sec. 6 of the German Investment Tax Act (GITA) violates the principle of free movement of capital in Art. 63 TFEU (Treaty on the Functioning of the European Union). Although the German lump-sum taxation applies equally to domestic and foreign investment funds that do not comply with the reporting requirements of Sec. 5 (1) GITA, it de facto aims only at foreign funds.**

Non-resident investment funds will generally not have an incentive to comply with the German reporting obligations under Sec. 5 (1) GITA if they are neither active in the German market, nor have a desire to seek investors in Germany. Thus, the regime of Sec. 6 GITA prevents German investors from investing in a foreign fund as such an investment enhances the risk of disadvantageous taxation, particularly as it is not possible for the investor itself to provide sufficient evidence of the actual income from the non-transparent fund (ECJ, decision dated 9 October 2014, "Van Caster" – C-326/12).

According to German investment tax law, investors in a domestic or foreign investment fund are taxed on a lump-sum basis if the fund does not comply with the disclosure requirements demanded by Sec. 5 (1) GITA. In the case at hand, the investors held shares in foreign non-transparent investment funds and were taxed on a lump-sum basis according to Sec. 6 GITA as the foreign investment fund did not comply with the necessary disclosure requirements. In consequence thereof, the German tax authorities assessed the investor's income four times as high as estimated and valued by the taxpayer. Following such excessively high assessment, the investor contested the decision of the German tax authorities before the Finance Court of Düsseldorf.

The Court dealt with the question whether the German lump-sum taxation could lead to an indirect discrimination against non-transparent foreign investment funds as, although Sec. 6 GITA applies to both domestic and foreign investment

funds, resident funds would generally meet the requirements of Sec. 5 (1) GITA, whereas this would not be the case with respect to non-resident investment funds that are not active in the German market. Accordingly, the Court referred this issue to the European Court of Justice.

The ECJ claims that the consequences of the German lump-sum taxation may affect the investor as it may lead to an excessive assessment of the taxpayer's real income, in particular during periods of low interest rates. Thus, the tax mechanism of Sec. 6 GITA may prevent taxpayers from investing in funds that do not satisfy the required disclosure obligations. This might generally be the case for foreign investment funds as those often do not have an incentive to fulfill the requested reporting obligations due to their lack of desire to seek investors in the German market. As the information required for the assessment of the tax bases may only be provided by the fund itself, and the investor is not allowed to provide evidence proving the actual income, the lump-sum mechanism triggered thereby may prevent German taxpayers from investing in foreign investment funds and thus constitutes a restriction of the free movement of capital guaranteed by Article 63 TFEU.

The ECJ further stated that said restriction of the free movement of capital can be justified neither by the necessity to safeguard the balanced allocation of taxation rights between the Member States, nor by the need to ensure an effective fiscal supervision and tax collection.

First of all, the purpose of the German lump-sum provision is not to prevent taxpayer's conduct that may jeopardize the power of Germany to tax activities within its territory or to tax the income of its residents in another Member State, so that it does not safeguard the appropriate allocation of taxation rights.

Secondly, the effective fiscal supervision and collection of taxes might also be achieved if the fund itself does not provide the information necessary for determining tax bases for the investor's income of the fund, but if the taxpayer could provide evidence and information to allow German tax authorities



to ascertain the correct taxation. Thus, the German lump-sum taxation of Sec. 6 GITA goes beyond what is necessary to achieve the objective under consideration. Further, the German tax authorities could rely on other eligible measures, such as an internal exchange of information amongst German tax authorities or the mutual assistance with other Member States' tax authorities.

In consequence of the ECJ's judgment, the degree of precision the German Tax authorities will require to prove the

actual income of investors in funds that do not comply with the reporting requirements themselves will now be of particular importance for the investor. Foreign investment funds, which wish to attract the German market, will continue to report the tax bases. However, their German investors will not face the risk of a delayed reporting anymore as in consequence of the recent ECJ decision the respective reporting period of 4 month de facto becomes obsolete.

**be** in touch: If you have any questions, please do not hesitate to contact us!



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