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By PwC Deutschland | 30. Oktober 2013

Global estimate of taxable income from foreign fund inhibits free movement of capital?

The Supreme Tax Court has laid a preliminary question before the ECJ on whether the provision setting the taxable income derived from an investment in a non-compliant foreign fund at 90% of the increase in the unit redemption price during the year is to be disapplied as a restriction on the free movement of capital going beyond what is necessary to combat tax evasion.

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A resident investor held units in a Cayman Island investment trust through a depot with a Liechtenstein bank. The tax office applied a provision in the Foreign Investment Funds Act setting the taxable income of a domestic unit holder in a “black” foreign fund at 90% of the increase in the redemption price of units over the year, but at a minimum of 10% of the unit redemption price at year-end. A “black” fund is one that does not comply with the German registration, publication and disclosure requirements on foreign funds with German resident investors, or appoint a German agent to represent it before the German authorities. The fund in question was not compliant in either regard. The investor protested against this assessment as excessive, claiming that the provision on which it was based infringed her fundamental freedom of capital movement. The tax office responded that the restriction on her freedom of capital movement was permitted under the provision of the Treaty on the European Union allowing such restrictions in connection with direct investments or financial services to continue in force in a substantially unchanged form since December 31, 1993. In any case, the restriction was justified by the overriding need to protect tax revenue from evasion.

The Supreme Tax Court feels that the taxpayer is in the right. The provision in question clearly inhibits the freedom of capital movement. It also sees no justification in penalising an investor with excessive taxation for a fund’s failure to comply. As regards the “stand-still” clause permitting continuation of third country restrictions in force on December 31, 1993 it takes the view that an investment in a fund does not constitute a direct investment within the meaning of the provision, as it confers no management rights over either the fund, or the fund’s own investments. The financial services condition is also irrelevant as that condition can only apply to the provider, not to the recipient or customer. It also feels the tax evasion justification advanced by the tax office to be disproportionate in two respects. Firstly, it offers the taxpayer no possibility of furnishing the required information from his own sources, and, secondly, it applies to all non-compliant (non-EU) foreign funds, regardless of any mutual assistance or information exchange agreement with Germany that the home country might have. The provision therefore goes beyond what is necessary to achieve its legitimate aim. However, these are questions of community law which the Supreme Tax Court felt obliged to lay before the ECJ.

Supreme Tax Court decision VIII R 39/12 of August 6, 2013 published on October 30

Schlagwörter

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