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By PwC Deutschland | 19. Oktober 2023

No specific determination of capital contributions account for foundation

Since the wording of Section 27 (7) of the German Corporation Tax Act does not cover estates, private foundations under civil law with legal capacity are not eligible for the specific determination of the special tax contributions account which is necessary to establish the amounts of tax neutral repayments of capital contributions. This was decided by the Supreme Tax Court in two similar cases. Contrary to the view held by other local tax courts the Supreme Tax Court gives precedence to the strict wording of the law.

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Legal background

Section 27 Corporation Tax Act (CTA) covers the treatment of capital contributions other than paid-in capital: A company with unrestricted tax liability must record as at the end of each business year contributions paid in other than on account of share capital on a special contributions account for tax purposes which will be specifically determined and assessed by the tax office. To the balance on this contributions account at the end of the preceding year are to be added or deducted the contributions and repayments of the current business year. According to Sec. 27 (7) this applies accordingly to other corporations and associations with unrestricted that liability that are to make distributions within the meaning of Sec. 20 (1) No. 1, 9 or 10 of the Income Tax Act (ITA). Section 27 (8) CTA extends the application of the provision on returns of capital to foreign corporations and associations of persons subject to unlimited tax liability in other EU Member States.

Case of dispute

The plaintiff is a private family foundation under civil law with legal capacity which was established in 2010. Together with the corporation income tax return for 2013 the plaintiff submitted the return on the balance on the contributions account for tax purposes as per 31 December 2013. The tax office refused to determine the balance of the tax contributions account because the legal status of the foundation was not covered by the wording of Sec. 27 (7) CTA.

The tax courts of Rhineland-Palatinate and Nuremberg (courts of first instance) partially granted the appeal of the plaintiff by assuming that Sec. 27 (7) CTA also covered private foundations under civil law with legal capacity. In the opinion of the courts, this was mainly justified by the fact that these foundations could provide benefits to their beneficiaries, which would then be taxable under Section 20 (1) No. 9 ITA as „*Income from services provided by a corporation, association or estate which is not exempt from corporate income tax …*“.

Decision

The Supreme Tax Court confirmed the view of the tax office. In its two parallel decisions, the Supreme Tax Court ruled that there was no legal basis for the separate determination of the balance of the tax contributions account for private foundations under civil law as the wording of Sec. 27 (7) CTA did not include estates.

According to Sec. 27 (7) CTA the rules for return of capital contributions and determination of the special contributions account applies accordingly to payments similar to distributions from other corporations and associations with unrestricted that liability. According to the court, these requirements are met in the case of a private foundation under civil law with legal capacity at any rate if the beneficiaries of the foundation (beneficiaries) can directly or indirectly influence the distribution activities of the foundation.

However, private foundations under civil law with legal capacity are neither corporations nor associations of

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persons, but rather estates which the legislator generally distinguishes from corporations and associations, as in Sec. 1 (1) CTA and in Sec. 20 (1) No. 9 ITA).

The Supreme Tax Court rejects a broader interpretation of Section 27 (7) CTA due to a purported loophole in the law, which would result in taxation of the repayment of contributions in an unmethodical way that is prejudicial to the system. The court thus expressly rejects the various decisions of lower tax courts and the prevailing opinion in the literature.

In the case of private foundations under civil law, a separate determination is not mandatory to achieve the application of Sec. 20 (1) No. 1 Sentence 3 ITA for the beneficiaries (namely to exempt remunerations for which the tax contributions account was utilized from taxation as investment income). By this, the Supreme Tax Court refers to its case law on the repayment of capital from third countries (cases VIII R 47/13 and I R 15/16 **)**, where it had affirmed such a possibility despite the lack of a statutory basis. For this reason, the Supreme Tax Court finally also points out that the question of the non-taxation of the distribution of foundation (endowment) capital to the beneficiaries must be answered solely in the course of the tax assessment of the beneficiaries.

Source:

Supreme Tax Court, decisions of 17 May 2023 in cases I R 42/19 and I R 46/21 – published on 12 October 2023.

) **Note: *In its judgment of 13 June 2016 (**VIII R 47/13)**, the Supreme Tax Court ruled upon the legal situation after the introduction of Section 27 (8) CTA. According to the decision, a repayment of capital can also be made by a company that is domiciled in a third country and for which no tax contribution account has been maintained in accordance with Section 27 CTA. In its decision of 10 April 2019 (**I R 15/16**), the Supreme Tax Court confirmed this view and also ruled that, although the amount of the distributable profit of a third-country company is to be determined in accordance with the respective foreign commercial and corporate law, its treatment and thus also that of the (subordinated) return of contribution was subject to the statutory fiction under Section 27 (1) sentences 3 and 5 CTA.*

Schlagwörter

capital contribution, family foundation