By PwC Deutschland | 27. April 2025

Attribution taxation for foundations under the Foreign Tax Act in violation of EU principles

In a most recent judgment, the Supreme Tax Court decided that the restriction for exemption from taxation of the retained income of foreign foundations with their management or registered office in a member state of the European Union or a contracting state of the EEA to be in conflict with the EU free movement of capital.

Background

Section 15 (1) Foreign Tax Act (FTA) states that the **assets and income of a family foundation** that has its management and registered office outside the scope of this Act (foreign family foundation) shall **be attributed to the founder** if he is subject to unlimited tax liability, otherwise to the persons subject to unlimited tax liability who are entitled to receive or accrue tax in proportion to their share.

According to **the „escape clause“** in Section 15 (6) FTA the aforementioned **attribution does not apply** if (No. 1) a family foundation has its management or registered office in a member state of the EU or a contracting state of the EEA and it is demonstrated, among other things, that the assets of the foundation are legally and effectively withdrawn from the power of disposal of the persons concerned,**and** (No. 2) information is provided between Germany and the state in which the family foundation has its management or registered office to carry out taxation based on the Mutual Assistance Directive pursuant to Section 2 (11) of the EU Administrative Assistance Act or a comparable bilateral or multilateral agreement.

The plaintiffs were the beneficiaries of a Swiss family foundation living in Germany. The tax office had attributed the income for years from 2012 onwards. The plaintiffs therefore had to pay income tax on the earnings/income of the Swiss family foundation even though they had not received any distributions. The tax office refused to make use of the exemption clause in Section 15 (6) FTA because this only applied to family foundations with their management or registered office in a member state of the EU or a contracting state of the EEA.

Decision

The Supreme Tax Court now ruled in favor of the plaintiffs. The statutory conditions of Section 15 (1) sentence 1 FTA for attributing the income (for 2012) or the income (for 2013 to 2016) of the foundation to the plaintiffs are met. However, taking into account the precedence of EU law, an attribution of income is not possible based on Section 15 para. 6 FTA.

The free movement of capital also applies to third-country situations and therefore the exemption from the income attribution must also be applied to family foundations with their management or registered office in a third country.

Article 63 of the Treaty on the Functioning of the European Union (TFEU) shall be without prejudice to the application to third countries of any restrictions which exist on 31 December 1993 under national or Union law adopted in respect of the movement of capital to or from third countries involving direct investment — including in real estate — establishment, the provision of financial services or the admission of securities to capital markets. Movements of capital covered by that provision include, in particular, direct investments in the form of participation in an undertaking through the holding of shares which confers the possibility of effectively participating in its management and control (‘direct’ investments) and the acquisition of shares on the capital market solely with the intention of making a financial investment without any intention of influencing the management and control of the undertaking.

The attribution of assets and income of a family foundation according to Section 15 (1) Foreign Tax Act in the version applicable in the years in dispute (2012 through 2016) does not meet these requirements. Insofar as this could deter a potential founder from setting up a foundation abroad, the endowment of the foundation's assets is not one of the capital movements listed in Art. 64 (1) TFEU. It is not a direct investment because the founder is not granted participation in the foundation that enables him to be involved in the management of this company and its control.

Finally, the Supreme Tax Court points out that the major information clause in Art. 27 DBA-Switzerland 1971 is a bilateral agreement comparable to Sec. 2 para. 11 of the EU Administrative Assistance Act and thus within the meaning of Sec. 15 (6) no. 2 FTA.

In its press release, the Supreme Tax Court also points out that its decision, in practice, means that the beneficiaries of trusts, which are widespread in the *common law area**, can also invoke the exemption from the attribution tax. Although, it remains to be seen how this will affect the scope of attribution taxation under the umbrella of the FTA.

**Common law*, also known as case law, is a legal system in which the main body of law is formed by court opinions, which play a defining role in determining how laws are interpreted and applied. In a common law system, previous court decisions are usually respected as precedent and applied to current decisions. Common law is often contrasted with a codified legal system, in which the legal codes and statutes are more meticulous and less open to interpretation and previous court decisions do not necessarily influence the outcome of current cases (Source: World Population Review).

Source:

Supreme Tax Court decision of 3 December 2024 IX R 32/22 – published on 10 April 2025.

Schlagwörter

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