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By PwC Deutschland | 14. November 2025

ECJ: Higher gift tax for foreign family foundation not necessarily in breach of free movement of capital

In a currently published judgment, the European Court of Justice held that the German regulation providing favorable inheritance tax classes for domestic family foundations which are not available to foreign family foundations does not contravene the fundamental principle for free movement of capital provided that the legislation in question complies with the principle of proportionality.

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A. Background

A family foundation established abroad by a resident of Germany is treated less favorably than one established in Germany. That difference is based, according to the German tax authorities, on the fact that domestic family foundations are liable to the payment of a ‘substitute inheritance tax’ every 30 years to which family foundations established abroad are not. The referring tax court of Cologne is called upon to resolve a dispute between, on the one hand, a family foundation established in Liechtenstein by a person resident in Germany and, on the other, the German tax authorities. The referring court saw the need to ascertain whether, in relation to gift tax, the German tax legislation respects the free movement of capital recognized in Article 40 of the Agreement on the European Economic Area.

In his Opinion delivered on 13 March 2025 the Advocate General interpreted said Article as not precluding the contested German legislation (see our **blog post of 13 March 2025**).

B. Decision of the ECJ

The ECJ concluded that, **subject to compliance with the principle of proportionality**, the principle of free movement of capital within the meaning of Article 40 of the EEA Agreement does not preclude national legislation granting the tax class privilege between the most distant beneficiary under the foundation deed and the founder whereas such privilege is not available for foreign family foundations owing to the fact that, unlike the domestic family foundation, the foreign foundation is not liable to pay substitute inheritance tax.

(1) Restriction on the free movement of capital

Foremost, the ECJ ascertained, that – as regards the transfer of assets to a family foundation, equated to a gift inter vivos – the rules providing for a more favorable tax treatment of gifts made to family foundations established on national territory than that of gifts made to similar entities established in other Member States, with the effect of reducing the value of the property gifted to that similar entity, **constitute a restriction on the movement of capital** within the meaning of Article 40 of the EEA Agreement.

To the ECJ, a cash-flow disadvantage which arises from a cross-border situation can form a restriction on a fundamental freedom where such a disadvantage does not arise in a purely national situation. This restriction may only be justified if the difference in treatment relates to **situations which are not objectively comparable**, or, otherwise, whether it is **justified by an overriding reason in the public interest**.

(2) The situations are objectively comparable

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Germany exercises its power to impose taxes with regard to the transfer of assets from a person residing within its territory to a family foundation irrespective of the place where the foundation is situated. Thus, as regards the incurrence of tax liability with respect to transfers of assets to a family foundation, the legislation at issue places the situations where such a foundation is situated on national territory on the same footing as the situations where the foundation is situated in another State.

Consequently, in the light of that legislation, and in so far as it concerns the taxation of the transfer to a family foundation of the assets of a resident establishing that foundation, the situation of a resident foundation is objectively comparable to that of a non-resident foundation.

(3) Overriding reason in the public interest

For such justification to succeed a direct link must be established between the tax advantage concerned and the offsetting of that advantage by a particular tax charge by examining the direct nature of that link in the light of the objective pursued by the legislation in question.

By providing that only resident family foundations, which are subsequently subject to substitute inheritance tax, may benefit from the preferential tax-class treatment, the configuration of that tax advantage reflects a logical symmetry as that advantage is offset by a specific tax charge relating to the same tax and the same taxpayer. That logic would be invalidated if that tax advantage were also to benefit non-resident family foundations which are not subject to substitute inheritance tax in Germany.

It follows that, under the German tax regime for family foundations, there is a direct link between the advantage in the form of preferential tax-class treatment, granted to resident family foundations, and the substitute inheritance tax, applied recurrently to the assets of those foundations only.

(4) Proportionality

Furthermore, since substitute inheritance tax is levied at intervals of 30 years it is not uncertain in nature, and that mechanism reflects, first, the objective pursued by the legislation at issue in the main proceedings to place the transfer of assets through family foundations on an equal footing with ordinary inheritances, and, second, the fact that such foundations generally tend to last for several generations.

The ECJ went on to say that the German legislation, by limiting the advantage of the preferential tax-class treatment to situations where Germany subsequently has the power to tax the assets of the family foundation, appears not go beyond what is necessary to attain the objective pursued. However, **it will be for the referring court to ascertain** whether the legislation at issue complies with the principle of proportionality in such a way that it is not disproportionate to the objective pursued.

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