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Penalty tax on “intransparent” investment fund hinders free movement of capital?

An ECJ advocate general has suggested the court rule the German rules for “penalty” taxation on a unit holder of a foreign investment fund to be an unjustified hindrance on the investor’s freedom of capital movement.

Investment funds are in principle free of tax. However, unit holders (the investors) are charged to tax on their share of the fund's income and gains during the year. To this end, funds are required to notify unit holders annually of their performance in the prescribed detail and in German. They are also required to publish their results in the on-line version of the Federal Gazette. If these obligations are not met, the fund is deemed to be "instransparent" and unit holders are charged to tax on the total of the distributions actually received and 6% of the closing redemption price (or market value if available) of the units. German funds meet the requirements as a matter of course – failure to do so leads to action against them under other regulations – and most foreign funds also comply, if only in the interests of marketing their units. However, a Belgian unit holder resident in Germany who had invested in a Belgian fund not otherwise active on the German market objected to this "penalty" taxation for non-compliance on the grounds that it was excessive (it led in the case under review to an income tax charge on an amount over three times greater than the actual income of the fund).

The advocate general on the ECJ case has suggested the court rule this tax to be a hindrance on the freedom of capital movement. It discriminates against foreign funds in so much as, in the ordinary course of events, it is never charged to investors in German funds. An annual growth assumption of 6% is clearly excessive in the present low interest climate. This hindrance on the freedom of capital movement is not justified by an overriding need to protect tax revenue. The legal obligation to supply the required details is on the fund. However, that entity is not subject to German law. Penalising the German unit holder is not an appropriate means of persuading the fund to comply with a German legal requirement. Even if it were, it would go beyond what is necessary to ensure fair and equal taxation of all unit holders, as the provision gives the taxpayer no chance of obtaining the information for himself, for example with a request as unit holder to the fund management.

The ECJ case reference is C-326/12 *van Caster*, opinion of November 21, 2013.

Keywords

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