

By PwC Deutschland | 22 February 2022

German tax implications on benefits granted by foreign foundation

Are payments and contributions in kind from a foreign family foundation subject to German income tax? And what is the situation as regards the gift tax? Two tax court decisions shed some light. According to the Supreme Tax Court there is no gift tax liability for the beneficiary. The Regional Tax Court of Hamburg is of the opinion that a one-time payment from the foundation is subject to German income tax.

Payments/Distributions from Swiss family foundation...

...not subject to gift tax (Supreme Tax Court)

A Swiss family foundation had made a one-time payment to a 29-year-old beneficiary resident in Germany. The foundation's articles of association provide for support payments for start-up financing to family members in their youth. There is no legal entitlement to this. The foundation selects the beneficiaries at its discretion. It was the opinion of the tax office and the Regional Tax Court of Baden-Württemberg that the family foundation was liable to gift tax. The Supreme Tax Court took a different view.

In his judgment the Supreme Tax Court decided that a benefit granted by a foreign foundation to a domestic recipient who has no rights to or claims on the foundation's assets or income in accordance with its articles of association is not subject to German gift tax.

...but subject to income tax (Regional Tax Court of Hamburg)?

The relevant Sec. 20(1) No. 9 Sentence 1 Income Tax Act (ITA) states that income from benefits provided by a corporation, association of persons or estate within the meaning of Section 1 (1) No. 3 to 5 Corporation Tax Act (CTA) is subject to tax as capital investment income, provided the income is economically comparable to profit distributions (...).

In the case of dispute, the Swiss family foundation is a specific type of foundation of private law and as such comparable to „other legal persons of private law“ as enumerated in Sec. 1 (1) No. 4 CTA. According to the Regional Tax Court the criteria of „economic comparability with profit distributions“ must be interpreted in a broad sense and it is irrelevant whether the recipient of the benefits has the legal position of a shareholder and holds an interest in the assets of the foundation as is the case with ordinary dividend distributions. In conclusion the Regional Tax Court held that the distributions made by the foundation to its beneficiary are to be taken by the latter as taxable capital investment income as long as such distributions are made out of the earnings of the foundation.

There is still no Supreme Tax Court ruling on the question under which circumstances the income from such a benefit is economically comparable to a regular profit distribution within the meaning of Sec. 20 (1) No. 1 ITA. In light of this and the fact that questions dealing with the influence of a beneficiary is viewed by the lower courts and the literature in a controversial and different way, the appeal of the plaintiff was admitted (case pending at the Supreme Tax Court: VIII R 25/21).

Source:

Supreme Tax Court decision of 3 July 2019 (case ref. II R 6/16), published on 10 October 2019

Regional Tax Court of Hamburg judgment of 20 August 2021 (case ref. 6 K 196/20)

Keywords

beneficiary, family foundation, foreign foundation, gift tax