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By PwC Deutschland | 05 September 2024

Update: Taxation of foreign investment funds under the German Investment Tax Act 2004 not compatible with EU law

In a most recent decision, the Supreme Tax Court held that a foreign investment fund who received dividends from domestic stock corporations which were subject to tax withholding (capital gains tax) under the 2004 Investment Tax Act is in general entitled to a refund of this tax under the principles of EU law.

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In the **case of dispute**, a French investment fund, Fonds Commun de Placement (FCP), had received dividends from German stock corporations from 2008 through 2013. Capital gains tax was withheld and paid to the German tax authorities according to the statutory provisions applicable at the time (Investment Tax Act 2004).

The fund later applied for a refund of these taxes. It claimed that a domestic fund was tax-exempt, and no withholding tax was due here. This unequal treatment between a domestic and a foreign fund under German investment tax law was not justified.

First, **the Supreme Tax Court** states that - according to the clear wording of the German provisions valid at the time - the tax exemption is reserved for domestic funds or domestic investment stock corporations and therefore does not apply to the plaintiff as a foreign investment fund.

However, the plaintiff is entitled to tax exemption for reasons of EU law. To the Supreme Tax Court this is evident from the judgment of the European Court of Justice (ECJ) of 27 April 2023 in the case *L Fund* C-537/20. Here the ECJ was confronted with the German tax provisions existing in the years in dispute 2008 through 2010, where resident and non-resident special real estate funds were treated differently, and which was disadvantageous for non-resident special real estate funds. In this decision the ECJ saw a restriction on the free movement of capital which cannot be justified by overriding reasons of public interest (see **blog post of 2 February 2024**).

The **Supreme Tax Court considers this as comparable to the situation in the case of dispute**. In quite a few cases, domestic investors in a tax-exempt domestic fund do not have to bear any tax (no tax at both fund and investor level; with no tax burden whatsoever), whereas an investment in a foreign fund always results in a tax burden at fund level if the tax-relief provisions in the Investment Tax Act 2004 - if interpreted verbatim - were not applicable.

Due to the four-year limitation period the French FCP's claims were unfounded in as far as they related to dividends received in 2008 and 2009 since the FCP's claims were only filed in 2014.

As a result of the ECJ case law the capital gains tax incurred upon distribution to the foreign fund must therefore be refunded to the fund. This is also a result of ECJ case law. In addition, interest of 6% p.a. must be paid on the refund claim. The Court left it undecided whether the interest rate must be reduced to 1.8% per annum as of 1 January 2019 because the lawsuits were already filed in 2017.

In its press release, the Supreme Tax Court points out that this current decision has considerable financial implications as numerous foreign funds in the past submitted comparable refund applications wich are currently on hold. According to estimates by the Federal Court of Audit (*Bundesrechnungshof*, the supreme federal audit institution in Germany) the claims will be well into the billions.

Under the **new Investment Tax Act** in the version applicable from 1 January 2018 both domestic and foreign funds are treated equally and are subject to income tax in the same way.

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Supreme Tax Court, decision of 13 March 2024 (I R 1/20) – published on 22 August 2024.

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The PwC**EUDTG newsalert** with an indepth analysis of this judgment to be found **here**.

Keywords

Investment Tax Act, foreign investment trust