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Taxation of income from a foreign investment fund

According to the ruling of the Supreme Tax Court published on 28 August 2025, taxation under the Investment Tax Act 2004 represents the final tax burden and for private investors it takes precedence over taxation under the general provisions. This also hinders a fund's capital investments being allocate to the shareholder under Section 39 (2) No. 1 of the Tax Code.

Background:

In 2007, the plaintiff invested in a reinvestment investment fund (foreign special fund) established under Luxembourg law. This special fund was aimed exclusively at institutional, professional and other knowledgeable investors within the meaning of Article 2 (1) of the Luxembourg Law of 13 February 2007 on Specialised Investment Funds. The fund could also be set up as a ‘single-investor fund’. Private individuals with a minimum investment of €1.25 million could be the sole investors in a special fund. Capital gains from these special funds were generally tax-exempt under the provisions of the Investment Tax Act and, as foreign income, were not subject to German withholding tax.

The tax office was of the opinion that the plaintiff had wrongfully claimed the investment tax exemptions, as an investment fund must be managed independently and without influence from investors. Tax-privileged investment assets under the former Investment Act (Investment Act) and Investment Tax Act 2004 therefore require external management. In the case of so-called millionaire funds, the requirement of external management was deliberately circumvented.

The tax court had ruled in favour of the plaintiff. The plaintiff's sustained influence on the investment decisions of the fund manager did not preclude the application of the Investment Tax Act 2004. According to the versions of the law applicable to the year in dispute, the existence of external management in the case of foreign investment funds was not a necessary prerequisite for the applicability of the Investment Tax Act.

Decision of the Supreme Tax Court

The Supreme Tax Court concurred with the previous decision: The tax court had rightly ruled that the plaintiff's fund participation under review was a foreign investment share within the meaning of Section 1 (1) No. 2 in conjunction with (2) sentence 1 Investment Tax Act. The tax court correctly also did not accept that the conditions under Section 39 (2) No. 1 German Fiscal Code (AO) had been meet allowing for an attribution of fund income that deviates from Section 2 (1) Investment Tax Act.

In the context of the attribution of income to the investor (plaintiff) from the contested Luxembourg single-investor reinvestment fund (special fund for securities in the form of a so-called FCP), the central issue was whether the plaintiff - given his significant influence on the fund's investment and divestment decisions vis-à-vis the capital management company and a fund manager appointed by the latter - was obliged to have income or assets attributed to him from the fund assets, in contravention of the provisions of the Investment Tax Act ('reinvestment privilege') under Section 39 (2) No. 1 of the German Fiscal Code (AO).

The Supreme Tax Court ruled that, it is not a requirement for the application the Investment Tax Act 2004 that the asset management by the fund manager must be free from any influence by the investor or investors (as argued by the tax office).

Taxation under the Investment Tax Act 2004 is final and takes precedence over taxation under the general provisions for private investors. According to the Supreme Tax Court, this also precludes the allocation of a fund's capital investments to the shareholder in accordance with Section 39 (2) No. 1 AO.

Source

Supreme Tax Court, decision of 1 July 2025 (VIII R 18/22), published on 28 August 2025.

Keywords

Tax-free investment income, investment income