News alert
EU Direct Tax Group

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Germany – CJEU judgment on the tax treatment of participations in "black funds"– Wagner-Raith case

On 21 May 2015, the CJEU rendered its judgment on the compatibility of sec. 18 para. 3 Foreign Investment Company Act (Auslandsinvestment-gesetz with the free movement of capital (Art. 63 TFEU; Wagner-Raith, C-560/13).

Facts

If a foreign fund did not fulfill specific publication requirements (sec. 17 para. 3), following sec. 18 para. 3 the foreign fund was treated as a "black fund" and its domestic investors were taxed on a "flat rate" basis. In a pure domestic case, the tax authorities had the right to estimate the income of investors pursuant to sec. 162 General Tax Code if the fund did not provide the respective information. Therefore, the taxation at investor level was essentially higher in case of foreign black funds.

Since sec. 18 para. 3 was already in force on 31 December 1993 and remained essentially unchanged until its abolition in 2004, the referring German Federal Fiscal Court posed the question whether the legislation was in the scope of the stand-still clause in Art. 64 TFEU. The referring court expressed doubts whether sec. 18 para. 3 falls within the scope of the stand-still clause since only regulations aiming at the provider of those services may fall within this scope and sec. 18 para. 3 aims at the taxation of the investor.

In contrast, in its opinion dated 18 December 2014 Advocate General Mengozzi particularly expressed the opinion that sec. 18 para. 3 falls within the scope of legislation dealing with the "movement of capital involving the provision of financial services" and should therefore be protected by the stand-still clause in Art. 64 TFEU. The Advocate General distinguished between a straight-forward investment in e.g. shares in a stock corporation on one hand and shares in an investment fund on the other hand.

CJEU decision

The CJEU essentially confirmed the opinion of the Advocate General. The CJEU held that if it would be necessary for legislation to fall within the scope of the stand-still clause to aim at the provider of financial services, this "would effectively call into question the demarcation between the [....] freedom to provide services and [...] the free movement of capital".

The decisive criterion of the application of the stand-still-clause is the presence of a causal link between the movement of capital and the provision of financial services and not the personal scope of the national measure (sec. 18 para. 3). Since the investor of a foreign fund relies on the free movement of capital *because* the foreign fund is providing financial services sec. 18 para. 3 is protected by the stand-still-clause.

Takeaway

Since the stand-still clause only applies to third country situations, sec. 18 para. 3 should still be appealed against in EU/EEA-situations.

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