Legal and tax develop-
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Asset Management Tax & Legal Newsflash

‘ECJ challenges German legislator: Previous lump sum taxation disadvantageous to non-German investment funds - investors have a right to fair taxation’

Upon request of the Finance Court Duesseldorf the ECJ has ruled that the lump sum taxation of investors in so-called non-transparent investment funds limits the free movement of capital.

A) The Case

The plaintiffs invested in non-German accumulating investment funds in the years 2004 to 2008. These did not fulfill the transparency requirements set out in the German Investment Tax Act (GITA) and therefore fell under the **lump sum taxation** rule. The plaintiffs instead declared their taxable income to the financial authorities via information they prepared themselves. However, the financial authorities followed the rules set out in the GITA and applied the lump sum taxation approach.

B) The Judgement

The ECJ is, based on the following points, of the opinion that the taxation based on a lump sum approach which is currently applied **does not conform to the principle of free movement of capital** set-out in EU law:

- The lump sum approach can lead to a disadvantageous **overestimation** of the actual income of the taxpayer
- The lump sum taxation can be seen as a means to hinder German taxpayers from investing in foreign investment funds as the disadvantageous regulation applies almost entirely to investors in non-German investment funds

Especially interesting with regard to the ruling is that the ECJ sees a **veiled limitation of the principle of free movement of capital**. Even though the lump sum taxation regulation applies to German as well as non-German investment funds, the transparency requirements set out in national law are only regularly fulfilled by German investment funds according to the ECJ, while in most cases the lump sum tax regime is applied to non-German investment funds. As a consequence, German investors in non-German investment funds should be able to independently transmit their tax-relevant information to the financial authorities in those cases where transparency reporting has not been performed. The exact content, format as well as the level of precision required of this information has been left to be decided by the financial authorities.

C) The conclusion

What **consequences this ruling** will have is at this point not predictable. To draw the conclusion that (non-German) investment funds are no longer required to publish German annual tax numbers within the set deadlines and in the publication medium of the German Federal Gazette would be premature. Furthermore, the publication of the NAV frequent tax figures of Equity Gain and Interim Profit will still be required by the German Federal Central Tax Office. To only publish this information upon redemption or subscription of a German investor would not be advisable, as it is not even clear yet in how far a calculation of the tax numbers by way of **estimation** is indeed allowed and feasible.

Likewise, it remains to be seen whether investors, who were hit by lump sum taxation in the past, may be able to reduce their tax burden by **presenting their retroactively determined German tax numbers** for their non-transparent fund investments.

Now the **Finance Court Duesseldorf** and potentially the **German Finance Court** have to judge in this particular case to what extent the taxation of investors may be based on information presented by taxpayers. As long as there is uncertainty German investors will continue to insist on a **complete fulfilment of all transparency requirements**.

However, the **legislator** is now challenged to amend the **German Investment Tax Act**. In addition, the consequences of this court decision on fund taxation regimes in Europe, e.g. UK, must be elicited.

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