**Case C-537/20**

**Summary of the request for a preliminary ruling pursuant to Article 98(1) of the Rules of Procedure of the Court of Justice**

**Date lodged:**

21 October 2020

**Referring court or tribunal:**

Bundesfinanzhof (Germany)

**Date of the decision to refer:**

18 December 2019

**Applicant and appellant in the appeal on a point of law:**

L Fund

**Defendant and respondent in the appeal on a point of law:**

Finanzamt D (D tax office)

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**Subject matter of the main proceedings**

Specialised property fund – Corporate income tax – Distinction between domestic and foreign specialised property funds – Exemption from corporate income tax only for domestic specialised property funds – Difference of treatment – Justification

**Subject matter and legal basis of the reference**

Interpretation of EU law, Article 267 TFEU

**Question referred for a preliminary ruling**

Does Article 56 of the Treaty establishing the European Community (now: Article 63 of the Treaty on the Functioning of the European Union) conflict with a rule in a Member State, by virtue of which domestic specialised property funds with exclusively foreign investors are exempt from corporate income tax, while foreign specialised property funds with exclusively foreign investors are subject to

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limited liability for corporate income tax on their rental income obtained within the Member State?

**Provisions of EU law cited**

Article 63 TFEU

**Provisions of national law cited**

Körperschaftsteuergesetz (Law on corporate income tax, 'the KStG'), in particular Paragraph 1(1)(5) and Paragraph 2(1);

Investmentsteuergesetz 2004 (Law on investment income tax, 'the InvStG 2004'), in particular Paragraph 4(2)(7), Paragraph 11(1)(1) and (2), Paragraph 15(2)(2).

Loi du 13 février 2007 relative aux fonds d'investissement spécialisés (Luxembourg Law of 13 February 2007 relating to specialised investment funds)

**Summary of the facts and proceedings**

1 The applicant is a *fonds commun de placement* ('common fund') in the form of a specialised investment fund, which was launched in 2008 in accordance with the Luxembourg Law of 13 February 2007 relating to specialised investment funds, and which is subject to investment supervision in Luxembourg (Commission de Surveillance du Secteur Financier; 'CSSF'). The applicant has neither a registered office nor company management in Germany.

2 A specialised investment fund concerns an undivided collection of assets authorised by CSSF, which is structured according to the principle of risk spreading and managed by a management company on behalf of the collective of investors. The liability of investors is limited up to the amount of their deposit and the rights of investors are embodied in their shares (see Article 4 of the Luxembourg Law of 13 February 2007 relating to specialised investment funds). A fund of this type has no legal personality of its own.

3 As a specialised investment fund, the applicant is not subject to taxation in Luxembourg, with the exception of the capital duty payable by civil-law companies and commercial companies, and subscription tax in accordance with Article 68 of the Luxembourg Law of 13 February 2007 relating to specialised investment funds. The amounts distributed by the applicant are not subject to withholding tax in Luxembourg and are not taxed where a recipient is a non-resident (see Article 66 of the Luxembourg Law of 13 February 2007 relating to specialised investment funds).

4 The applicant was initially set up for ten years as a closed-end property fund without stock market valuation.

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5 When the applicant was terminated, all property investments that were not already liquidated were liquidated, and the sale proceeds were distributed to the shareholders. The management company is prohibited from distributing the portfolio whether in whole or in part to the shareholders in the form of a distribution in kind. Accordingly, the shareholders also have no entitlement to a distribution in kind. The shareholders are not permitted to request redemption prior to expiry of the applicant's contractual term.

6 The applicant has two institutional investors that have neither a registered office nor company management in Germany. The fund is managed by a management company. The company in question is a limited liability company established on 25 March 2008 in accordance with Luxembourg law and registered in the Luxembourg Trade and Companies Register, with its registered office in Luxembourg, which was authorised by CSSF. The purpose of the management company is to set up, administer and manage the fund.

7 By means of a contract dated 31 March 2008/1 April 2008, the management company acquired a property portfolio in its own name but while acting as a management company on the applicant's behalf. The portfolio specifically consisted of 1 241 properties in Germany, which were let after being acquired, and some of them were subsequently sold at a later date.

8 The applicant received income between 2008 and 2010 from the letting and sale of the aforementioned individual properties.

9 In July 2013, the applicant submitted corporate income tax returns for the periods between 2008 and 2010, taking account of a limited liability for corporate income tax. However, it pointed out at the same time that, according to its interpretation of the law, it is not liable for payment of corporate income tax in Germany.

10 The defendant, on the other hand, assumed a limited liability for corporate income tax and determined corporate income tax. Finanzgericht Münster (Münster Finance Court), which heard this case, confirmed the interpretation of the law by the Finanzamt (Tax Office) in its judgment of 20 April 2017 dismissing the action. The applicant subsequently lodged an appeal on a point of law with the Bundesfinanzhof (Federal Finance Court).

**Brief summary of the basis for the reference**

11 The appeal on a point of law would be without merit in accordance with national law. The referring court initially makes some remarks relating to taxation of foreign investment funds, and it explains that foreign investment funds are only subject to corporate income tax liability, whether limited or unlimited, if they are equivalent to a taxable person for the purpose of German corporate income tax according to their economic and legal structure, irrespective of any legal personality that may exist in accordance with another country's law. According to the referring court's established case-law, investment funds equate to a 'different

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special-purpose fund under private law' as referred to in Paragraph 1(1)(5) KStG, and are subject to unlimited or limited liability for corporate income tax depending on their registered office or the location of their company management.

12 For the purpose of taxation, national tax law makes a distinction between foreign and domestic funds, and between public and specialised funds.

13 A domestic fund is taxed in accordance with the Law on investment income tax. It is generally characterised by the fact that the fund is regarded as a special-purpose fund as referred to in Paragraph 1(1)(5) KStG and therefore as a taxable person for the purpose of German corporate income tax; however, as such a taxable person, it is exempt from corporate income tax (Paragraph 11(1)(1) and (2) InvStG 2004). This exemption from tax is systematically linked to taxation of investors. The tax exemption of the fund and the corresponding taxation of the investor implements the transparency principle, according to which tax is withheld once at the level of the investor. The fund investor is treated as a direct investor to this extent. In order to ensure taxation of the investor, tax is withheld at source at the level of the fund (Paragraph 7 InvStG 2004).

14 The legislature also follows the transparency principle with regard to taxation of a specialised fund. The domestic specialised fund is therefore exempt from corporate income tax in accordance with Paragraph 11(1)(2) InvStG 2004, and tax is withheld at the level of the investors. The specialised fund is distinguished from a public fund by the fact that only non-natural persons are permitted to participate in a specialised fund (known as institutional investors), while an indefinite number of different investors participate in a public fund. Specialised funds often have just one or very few institutional investors that are actually able to exert an influence on investment decisions.

15 In the case of a domestic specialised property fund, income from property is also not taxed at fund level but rather at the investor level. The legislature thereby also implements the transparency principle in relation to specialised property funds. If a domestic specialised property fund has foreign investors, the domestic rental income of the fund is directly (proportionately) attributed to the foreign investor as personal income with limited tax liability. In order to ensure taxation of the foreign investor, a requirement exists to withhold tax at source at fund level (Paragraph 15(2)(4) InvStG 2004). The transparency principle and the requirement to withhold tax at source are used by the German legislature to safeguard its right of taxation of income from domestic property in its capacity as the state of situs.

16 The legislature has implemented the transparency principle in order to counteract claims for unjustified tax relief by (large-scale) foreign investors in the property sector. Such an investor would, in fact, have been liable for tax to a limited extent if investing directly in domestic property. He would have been able to avoid this tax liability without any major difficulty when investing via a specialised property fund.

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17 Consequently, a foreign specialised property fund is not exempt from corporate income tax (Paragraph 11(1)(2) InvStG 2004). The direct application of this exemption to the applicant fails on the basis of its unequivocal wording, according to which only domestic investment funds are exempt from corporate income tax. The analogous application of Paragraph 11(1)(2) InvStG 2004 is excluded because it lacks any unintentional loophole. The legislature intentionally made a distinction between domestic and foreign investment funds.

18 The result of this rule is that a foreign specialised property fund is required to pay tax itself on its income from the letting of property situated in Germany. Incidentally, this does not result in taxation of the foreign investors in the foreign specialised property fund, and therefore the double taxation of rental income, because the national provisions applicable in the main proceedings did not provide for any tax liability for foreign investors in the foreign specialised property fund in respect of the amounts distributed to them from the fund.

19 The referring court doubts, however, whether the exclusion of the applicant from tax exemption under Paragraph 11(1)(2) InvStG 2004 is compatible with EU law, particularly the free movement of capital (Article 63 TFEU).

20 It makes reference to the judgments of the Court of Justice of 10 May 2012, *Santander Asset Management SGIIC* (C-338/11 to C-347/11, EU:C:2012:286); of 10 April 2014, *Emerging Markets Series of DFA Investment Trust Company* (C-190/12, EU:C:2014:249); and of 21 June 2018, *Fidelity Funds and Others* (C-480/16, EU:C:2018:480), which it does not regard as relevant, however. In the present case, in fact, by imposing the limited liability for corporate income tax on the rental income obtained by the applicant, this ensures that domestic income tax is only levied once on this income in accordance with the customary international situs principle. For a comparable resident specialised property fund, the single taxation of domestic rental income is ensured by taxing the investors with limited liability for corporate income tax. Consequently, this means that the property investment is subject to the same taxation, and the question is raised as to whether non-resident funds are actually being prevented from investing in domestic property as a result of not being granted tax exemption in accordance with Paragraph 11(1)(2) InvStG 2004.

21 Furthermore, the referring court considers it rather unlikely that domestic investors will actually be prevented from purchasing shares in foreign funds that are not tax-exempt but rather involve limited liability for corporate income tax. In addition to the tax burden at the level of the foreign fund with limited liability for corporate income tax, this group of investors who receive distributed payments from the fund would have their own unlimited liability for corporate income tax. This double taxation is eliminated, however, by the means of withholding in Paragraph 4(2)(7) InvStG 2004. Rather, what is more significant is that there is a clear distinction between a public fund and a specialised fund. In the latter, a narrowly defined group of institutional investors or even an individual investor uses such a fund as an investment vehicle for its planned investment in a particular

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investment object. Where the group of investors is so exclusive, the inclusion of potential domestic institutional investors in an examination of the restriction of basic freedom may seem a purely theoretical and therefore negligible possibility.

22 It is also questionable whether the unequal treatment resulting from Paragraph 11(1)(1) and (2) InvStG 2004 concerns situations that are objectively comparable. In the aforementioned case-law, when assessing the comparability, the Court of Justice only referred to the level of the fund but not the investors' tax situation, and it affirmed the comparability of resident and non-resident funds in each case.

23 However, the Court also ruled that, in the examination of comparability, the level of the fund could be abandoned and, by way of an exception, the investors' tax situation could also be taken into account, if the statutory rule makes the tax exemption of the fund conditional on the requirement that all the profits of the fund be distributed to its shareholders, in order to make the tax burden on investment proceeds through this fund the same as that on direct investments by private investors (see judgment of 10 May 2012, *Santander Asset Management SGIIC*, C-338/11 to C-347/11, EU:C:2012:286, paragraph 40). In the present case, although the German legislature did not assume such complete distribution, the direct attribution of rental income to the foreign investors resulting from Paragraph 15(2)(2) InvStG 2004 and the express attribution of the limited liability for corporate income tax on this income extends far beyond the effect of (assumed) complete distribution. It particularly expresses that the tax situation of the fund is only relevant to the extent that we are concerned with its qualification as a specialised property fund, otherwise the investors' situation must be taken into account. As the taxation of property income therefore does not depend on the level of the fund but rather on the residence of the investors, this could not support the comparability of the situations.

24 It is furthermore doubtful whether compelling grounds of public interest could justify the rule in Paragraph 11(1) InvStG 2004. In each of the three aforementioned judgments, the Court of Justice explained that a Member State that has chosen not to tax resident funds in receipt of nationally sourced dividends cannot rely on the argument that there is a need to ensure a balanced allocation between the Member States of the power to tax in order to justify the taxation of a non-resident fund in receipt of such income.

25 At first glance, this affirms that the tax exemption granted to resident funds by Paragraph 11(1)(2) InvStG 2004 cannot be justified by relying on the argument of the need to ensure the balanced allocation between the Member States of the power to tax. However, the legal and factual details of the present dispute could give rise to a different assessment in this regard.

26 By denying tax exemption in accordance with Paragraph 11(1)(2) InvStG 2004 and justifying the limited liability for corporate income tax on domestic rental income in respect of the applicant as a non-resident specialised property fund, the

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German legislature is protecting its right of taxation as the state of situs. Article 6(1) of the OECD Model Tax Convention also grants the state of situs the right of taxation for income from immovable property. In the cases that the Court ruled on previously, the nature of the income of the fund was also of relevance to this extent in the examination of justification, when it pointed out that the dividend income received from the fund had already been subject to taxation on income at the level of the distributing company (judgment of 21 June 2018, *Fidelity Funds and Others*, C-480/16, EU:C:2018:480, paragraph 72). There is no such withholding tax burden on the rental income received by the applicant.

27 In the case of a foreign fund with foreign investors, it must be taken into account that the right of taxation of the state of situs for domestic rental income cannot be ensured without taxation at the fund level. Specifically, a resident fund can be required to withhold tax at source, which ensures that foreign investors are taxed; this is not possible in the case of a non-resident fund, however. Unlike dividend income, there is also no (withholding) tax levied on rental income.

28 Finally, the exclusion of the applicant from the tax exemption under Paragraph 11(1)(2) InvStG 2004 could be justified in order to safeguard the coherence of the tax system.

29 In accordance with the case-law delivered by the Court of Justice in relation to funds, an argument based on this justifying circumstance can only be successful if there is a direct relationship between the tax benefit in question and its offsetting by means of a particular tax burden, whereby the directness of this relationship must be assessed in relation to the purpose pursued by the rule in question.

30 In a case such as the present one, such a direct relationship could be considered to exist because the tax exemption of the domestic specialised property fund is cancelled out by the direct taxation of foreign institutional investors.

31 It must still be examined whether or not the denial of tax exemption for the foreign specialised property fund extends beyond what is necessary to safeguard the coherence of the German system of investment taxation.

32 If the Court's remarks in its judgment of 21 June 2018, *Fidelity Funds and Others* (C-480/16, EU:C:2018:480, paragraph 84) are applied to the German taxation system, it would depend on the non-resident investment funds, which are not granted tax exemption in accordance with Paragraph 11(1)(2) InvStG 2004 and are therefore required to pay German corporate income tax, proving that they pay a tax that corresponds to German corporate income tax. In the view of the referring court, this proof cannot be furnished in a case such as the present dispute, because the applicant, as a specialised property fund in Luxembourg and having obtained rental income in Germany, is subject to neither (personal) income tax nor a requirement to withhold tax at source.

33 Furthermore, in its judgment of 21 June 2018, *Fidelity Funds and Others* (C-480/16, EU:C:2018:480, paragraph 85), the Court remarked that the refusal to

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grant funds resident in a Member State other than the Kingdom of Denmark exemption from withholding tax leads to a series of charges to tax on the dividends paid to their investors resident in Denmark, which runs counter to the objective pursued by the national legislation.

34 If these remarks are also applied to the circumstances of the German taxation system, it would depend on whether the refusal to grant funds resident in a Member State other than Germany exemption from corporate income tax in accordance with Paragraph 11(1)(2) InvStG 2004 leads to a series of charges to tax on the income paid to investors resident in Germany. In this context, however, we must refer once again to the legal and factual details of the present case. On the one hand, intended domestic investors would not be subject to double taxation as a result of the means of withholding provided for in Paragraph 4(2)(7) InvStG 2004. On the other hand, while the applicant, as a foreign fund, is excluded from exemption from corporate income tax in accordance with Paragraph 11(1)(2) InvStG 2004, it has no investors that are resident in Germany and that could be subject to a series of charges to tax on income from property (initially at fund level, then at investor level). Its activity as a closed-end specialised fund is also not designed to attract such investors, since funds of this type typically involve a fixed small number of institutional investors with the same interests, which are using the fund as a vehicle for their own investments.

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