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Significant Relief for Founders and Beneficiaries of Foreign Family Foundations and Family Trusts with Registered Office and Management in a Third Country

Information on the Judgments of the German Supreme Tax Court of 3 December 2024 - IX R 31/22, IX R 32/22, IX R 15/24 and IX R 16/24 (essentially identical in content) Published on 24 April 2025.

A few days ago, the Supreme Tax Court (Bundesfinanzhof - BFH) published four long-awaited decisions on foreign family foundations which neither have their seat nor their effective place of management in the EU or an EEA state, but in a third country such as Switzerland, England or the U.S. The decisions are of considerable importance for the taxation of persons subject to unlimited tax liability in Germany who are founders or beneficiaries of such family foundations or family trusts.

I. Introduction

Family foundations are very popular not only in Germany but also in other countries, and the same applies to trusts, especially in the Anglo-American region. In case foreign settlors appoint relatives living in Germany as beneficiaries of foreign family foundations (or family trusts), settlors or beneficiaries subsequently move to Germany, or foreign family foundations are established by persons already resident in Germany, important and often difficult tax issues arise.

Payments from foreign family foundations are usually subject to income tax for the beneficiaries as income from capital assets or other income. In the event that the beneficiaries are entitled to rights in rem or contractual claims in relation to the assets or income of the foundation and are therefore to be regarded as 'intermediate beneficiaries', distributions to them may also be subject to gift tax. The question of how to treat the income of a foreign family foundation with its registered office and management in a third country that has not yet been distributed to the beneficiaries but is retained is highly controversial and has not yet been clarified by the Supreme Tax Court. The tax authorities generally want to attribute such income to persons with unlimited tax liability in Germany, so that they have to pay tax on the income even if they have never received a

distribution. Thus, for tax purposes the foreign family foundation and the founder or beneficiary are not separated any more. An exemption in the Foreign Tax Act (Außensteuergesetz – AStG) avoiding this consequence, which from its wording only applies to family foundations with management or registered office in EU/EEA countries, is currently not applied by the tax authorities to corresponding entities in third countries. However, the Supreme Tax Court has now decided that this exception must also be applicable to third-country family foundations, as otherwise there would be a violation of the free movement of capital under EU law pursuant to Art. 63 TFEU.

II. Overview of Imputed Taxation

In principle, income from foreign family foundations, which are comparable to domestic foundations in terms of their structure, is attributed either to the founder, if he is subject to unlimited tax liability in Germany, or otherwise to the persons subject to unlimited tax liability in Germany who are allowed to receive distributions (i.e. the beneficiaries) in accordance with their respective entitlement in such distributions pursuant to Section 15 para. 1 sentence 1 of the German Foreign Tax Act and is taxed income from capital assets, irrespective of whether they receive a distribution or not. Pursuant to Section 15 para. 2 of the German Foreign Tax Act, family foundations are foundations in which the entitlement of the founder, his relatives and their descendants in possible distributions or property transfers (notwithstanding the fact that specific distributions are often at the discretion of the foundation committees) exceeds 50%. Sec. 15 Foreign Tax Act and the relevant case law also apply to a large extent to trusts which are comparable to domestic foundations in terms of their purpose, i.e. to most trusts from the Anglo-American legal system. This may result in tax consequences for the settlor being resident in Germany or, if the settlor is resident abroad, for the beneficiaries being resident in Germany, even though they do not receive any distributions from the foundation.

The law makes an exception to this very strict consequence for the taxpayer, which is of great importance in practice: According to Section 15 para. 6 of the German Foreign Tax Act, there is no imputation of income and thus no taxation of the founder or beneficiary under Sec. 15 Foreign Tax Act if the assets foundation are legally and factually separated from founder's and beneficiary's power of disposal and there are extensive information rights between Germany and the country in which the foundation is domiciled (in particular on the basis of the EU Directive on administrative cooperation or the relevant double taxation treaty). However, according to the wording of the provision, the exception only applies to foundations with effective place of management or legal seat in an EU or EEA member state.

Despite of the fact that the restriction of the exemption to EU and EEA foundations was strongly criticized, the tax authorities have taken a clear position in their most recent Foreign Tax Decree (Federal Ministry of Finance, letter regarding principles for the application of the Foreign Tax Act, BMF v. 22.12.2023 – IV B 5, Section 15.6.1.1):

> "The possibility of providing evidence of exemption pursuant to Section 15 para. 6 of the German Foreign Tax Act only applies to family foundations with their seat or management in an EU member state or an EEA state."

The same applies to trusts. This means that, in the view of the tax authorities, income from third-country family foundations/family trusts is usually attributable to and taxable for the domestic founders or beneficiaries.

Although the amounts already attributed and taxed by the founders or beneficiaries are not again subject to subsequent income taxation, Section 15 para. 11 sentence 1 of the German Foreign Tax Act and although this provision also provides for the crediting of taxes already paid abroad under certain conditions, attribution nevertheless leads to an extremely burdensome "dry income" taxation if the founders or beneficiaries receive no or only small amounts from the foundation. The tax consequences are also particularly harsh because domestic founders and beneficiaries are often unaware of their tax liability for years, for example because they do not benefit from the foundation/trust assets in any way.

III. The Decisions of the Supreme Tax Court

It is therefore very pleasing that the Supreme Tax Court has now decided in its published rulings on a Swiss family foundation that, for reasons of the free movement of capital under EU law, the exemption provision of Section 15 para. 6 of the German Foreign Tax Act also applies to family foundations in third countries. Founders and beneficiaries liable to tax in Germany can therefore hope that the tax authorities will give in and no longer attribute income from family foundations in third countries to them in future, provided that the other requirements of the exemption provision in Section 15 para. 6 of the German Foreign Tax Act are met. In addition to the aforementioned extensive information rights, these other requirements include the legal and actual separation of the foundation assets from the power of disposition of the founders/beneficiaries.

IV. Concluding Practical Advice

The decisions of the Supreme Tax Court are very welcome news for the founders and beneficiaries of foreign family foundations who are tax resident in Germany, as they can now under the conditions of Section 15 para. 6 of the German Foreign Tax Act avoid the extremely burdensome situation of having to pay tax on income which they did not receive. It is hoped that the tax authorities will also adapt their legal opinion to the case law of the Supreme Tax Court in good time.

However, the decisions of the Supreme Tax Court do not change the fact that German resident founders and beneficiaries of foreign family foundations are still generally obliged to submit separate declarations pursuant to Section 18 para. 4 of the German Foreign Tax Act. The same applies to settlors and beneficiaries of trusts. Only in the process of the assessment of such declaration the tax authorities examine whether, in the individual case, income is not to be taxed in accordance with Section 15 para. 6 of the German Foreign Tax Act, or whether taxation should not take place for other reasons, or at least be reduced by a tax credit.

The taxation of foreign foundations and trusts also involves other highly controversial, unresolved legal issues and delimitation difficulties which cannot be discussed in detail here. This applies all the more to trusts, as trusts do not have a equivalent under and are therefore unknown to German law. In some cases, there is also a considerable risk of double taxation with income tax and gift tax, for example in case of payments to beneficiaries who are entitled to rights in rem or contractual claims in relation to the assets or income of the foundation or in case the foundation/trust is dissolved. Careful examination of each individual case is therefore highly recommended in order to avoid risks as far as possible, to ensure that reporting obligations are not neglected and to ensure that any unjustified tax assessments can be challenged and corrected in good time.

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