

## **Tax treatment of cross-border donations: German Court asks for Preliminary Ruling of the European Court**

### **Outline**

According to current German tax law, only donors who give to German-based public benefit organisations may benefit from tax incentives. The tax incentives are denied if the donation goes to a foreign-based public benefit organisation. This rule may be in conflict with the EC Treaty. The German Federal Court of Finances *Bundesfinanzhof* decided on May 9<sup>th</sup> 2007 to ask for a preliminary ruling by the European Court of Justice (ECJ) in this regard according to Article 234 EC Treaty. The case deals with an important issue which was also the key question in some recent EC Treaty infringement procedures initiated by the European Commission: Do Member States discriminate against foreign-based public benefit organisations if they only allow tax incentives for donations to public benefit organisations based in the country of the taxpayer?

The current case at hand deals with donations in kind and therefore with the very interesting question whether donations in kind are covered by the free movement of capital. A German taxpayer gave gifts in-kind (towels, bed sheets, etc) to a Portuguese home for the elderly and wished to deduct the donation from his taxes in Germany in 2003. The Portuguese organisation presented a confirmation showing their certificate for tax exemption due to its charitable status under Portuguese law. The donation receipt is sufficient for a tax deduction according to Portuguese tax law. The German tax authorities did not allow the tax deductibility because the organisation is based in another country. According to German tax law, only donations to German-based public benefit organisations may be tax-deductible. The taxpayer challenged the tax authority's decision and the case finally went to the *Bundesfinanzhof*. It is the same German court which started the "Stauffer" case (Judgment C-386/04 of the ECJ, September 14th 2006) in which the European Court of Justice ruled in favour of equal treatment of public benefit organisations in their cross-border activities. For further information on this, please consult the EFC Briefing on the matter at <http://www.efc.be/content/alert.asp?ContentID=982>

The German Court asked the following three questions as a preliminary ruling (translated by EFC):

1. Does the freedom of capital movement (Art. 56 EC) include in-kind donations of objects of daily use of an individual based in one Member State to an organisation whose seat is in another Member State and which is accepted as public benefit and tax-exempt according to its national law?
  2. If the answer to question 1 is yes:  
Is there a violation – taking into account the tax authorities' duty to verify the tax filing and under the principle of proportionality – of the freedom of capital movement (Art. 56 EC), if donations - according to the law of one Member State- to public benefit organisations are only tax-privileged if these organisations have their seat in the same Member State?
  3. If the answer to question 2 is yes:  
Does the Mutual Assistance Directive RL 77/799/EWG establish the duty of one Member States tax authority to ask the administrative authority of another Member State for help with clarifying issues related to the case in that other Member State? Or is it possible to require the person who is subject to tax, to have the burden of proof – according to the respective law for foreign issues of the Member State?  
Comments of the German court to the three questions:
1. It may happen that the ECJ will soon decide that the freedom of capital movement does not include in-kind donations. Up to now, this question has not yet been decided by the ECJ. Some legal experts claim that the term "capital movement" would in any case be connected to a capital investment and the intention to invest. But a donation (in-kind or cash) to a public benefit organisation can hardly be connected to a capital investment. However, the prevailing opinion of experts stresses that the intention of an investment is not required. They state that Mutual Assistance Directive 88/361 (June 24th 1988) also mentions "gifts" and an intention of an investment would not be needed.

2. If donations in kind are included in the freedom of capital movement according to the European Court of Justice, it needs to be clarified if the different tax treatment of donations to local and foreign-based public benefit organizations would conflict with Art. 56 ff. EC. This question has not been clarified by the Stauffer decision, which dealt with the tax treatment of public benefit foundations in a cross-border context and not the tax treatment of donors. The “Stauffer” decision made clear that requirements for tax exemption for public benefit organisations are designed at the national level, but if a foreign-based public benefit organisation fulfils the criteria of public benefit at the national level, it cannot be excluded from tax breaks just because it has a seat in a different country. The German court lists a series of open and controversial questions:

- a) Advancement of the “general public” must benefit German citizens: The ECJ judged in the “Stauffer” case that the term “general public” is not limited to citizens of Germany. This opinion is however controversial. The German Federal Ministry of Finance stated on September 20th, 2005 that the German state grants a tax exemption to charitable organisations as they take on tasks for the general public and the “general public” therefore needs to be defined as benefiting German citizens. For further information, please consult the EFC Briefing on the matter at <http://www.efc.be/content/alert.asp?ContentID=969>.
- b) Verification of “public benefit”: The German court is of the opinion that the administrative support by a foreign authority could only be sufficient if the tax authorities of the foreign Member States were also obliged to execute external controls according to German principles. The court doubts that such an obligation exists.
- c) Violation of the principle of proportionality: The German court is of the opinion that the principle of proportionality would be violated if German tax authorities would have to examine the public benefit status of a foreign-based organisation, which itself is not liable to tax according to German tax law (only the donor/taxpayer is). Even if administrative support was given by other Member States, it would mean an extensive, unjustifiable and disproportional administrative effort, in particular for smaller donations.

3. Relationship between national procedural law and administrative assistance according to Directive 77/799:

According to German law, a taxpayer who wishes to get a tax exemption may be asked by the German fiscal authorities to hand over all necessary documents to give evidence concerning the public benefit character of an organisation having its seat in another Member State. In case the fiscal authorities decide that the documentation is not sufficient, they are allowed to decide against a tax exemption. The ECJ ruled in the “Stauffer” case that the tax authorities can ask for administrative assistance of the Member States according to Mutual Assistance Directive 77/ 799/ EWG to get further information. The German court now wishes to know if this is up to the discretion of the local authority to choose as it wishes according to the national procedural law or whether it has the duty to ask for administrative assistance of other Member States according to EU law.

### **Impact for the broader foundation sector**

Most national tax laws do not treat donations to resident and foreign public benefit organisations on an equal footing and they could therefore be in conflict with the EC Treaty. The European Commission could be asked to go to other EU countries to review their legislation in this respect. The preliminary ruling in the German/Portuguese case as well as the infringement procedures could be an important breakthrough for cross-border giving.

### **Action Point**

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The EFC and its Legal Committee will continue to monitor the issue. For more information, please contact the EFC at [eu@efc.be](mailto:eu@efc.be). Promoting tax-effective cross-border giving is one of the key objectives of the EFC Legal Committee, which has developed short country profiles and a series of comparative charts of the different fiscal systems affecting foundations and their donors in the EU. For more information, please go to: <http://www.efc.be/projects/eu/tax/default.asp>