

FEATURED PERSPECTIVES

Persche: European Court Leads the Way for Cross-Border Deduction of Donations

by Wolfgang Kessler and Rolf Eicke

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There cannot be any reasonable doubt that the European Court of Justice is a blessing — at least for those who believe in the power of harmonization and free flow of capital. Without the ECJ, the European Union would consist of 27 “tax islands” with completely different and irreconcilable tax regimes and obstacles for those who try to reach out of their tax island — for instance, to donate to an organization in another member state. Speaking of donations and their deductibility leads us to the ECJ case *Hein Persche v. Finanzamt Lüdenscheid* (C-318/07) of January 27, 2009, and the new guidance of the German Ministry of Finance of April 6, 2010 (docket number IV C 4 — S 2223/07/0005). (For the court opinion in *Persche*, see *Doc 2009-1701* or *2009 WTD 16-12*.)

Donation Deduction Denied

In 2003 *Persche*, a certified German tax adviser, filed his tax return, in which he claimed exceptional deductible expenses in the amount of €18,180. The deduction was claimed for a gift of bed linen and towels, Zimmer frames (walkers), and toy cars for children, which he made to the Centro Popular de Lagoa in Portugal. Enclosed with his tax return, *Persche* submitted a confirmed receipt of that donation along with a declaration that in 1982 the center was registered as a private social solidarity body with the General Directorate of Social Services that entitled the center to all exemptions and tax benefits conferred by Portuguese law on charitable bodies.

The tax office in charge denied the deduction of the donation expenses on the ground that taxpayers may deduct charitable contributions only if the recipient is a *resident* legal person governed by public law, a resident public office, a corporation, or an unincorporated association of a fund under corporate law. The legal basis is in paragraph 10b(1) of the German Law on Income Tax (Einkommensteuergesetz) in connection with paragraph 49 of the Regulations Implementing Income Tax (Einkommensteuer-Durchführungsverordnung). However, this does not mean that German tax law prohibited the deduction of donations abroad — not as such. Deductions of donations abroad are deductible if they are performed by a resident “conduit company” (*Durchlaufgesellschaft*) that is recognized as a promotion corporation under paragraph 58, number 1 of the German General Tax Code (Abgabenordnung) or its auxiliaries abroad.

The objection against the denial lodged by *Persche* was as unsuccessful as the appeal at the Münster District Tax Court (Finanzgericht). In the last instance, the German Supreme Tax Court in Munich (Bundesfinanzhof, or BFH) referred the case to the ECJ. Yet the BFH doubted that donations were covered by the scope of the freedom of capital movement. Moreover, the ECJ found the denial of deduction to be justified on the ground of safeguarding an effective fiscal supervision.

Freedom of Capital Movement

Contrary to the view of the BFH and the submissions of several member states, the ECJ found that the

Persche Judgment

- Freedom of capital movement grants deduction of charitable donations to a body in another member state unless requirements are not sufficiently documented.
- No distinction between gifts made in money or in kind.
- No justification on grounds of safeguarding the effectiveness of fiscal supervision.
- However:
 - Member states are not required to have recourse to mutual assistance if the information provided by the donor is insufficient.
 - Member states have discretion to determine which activities are recognized as charitable.

freedom of capital movement does cover donations, whether granted in money or in kind.

The ECJ pointed out that the freedom of capital movement does not only cover capital movements made for the purposes of an economic activity, but also gifts made for altruistic motives to bodies that are not managed for self-enrichment and whose activities must not be profit-making. The ECJ derived its opinion from the definition of movement of capital in an annex to Council Directive 88/361/EEC of June 24, 1998. The nonexhaustive list contains gifts and endowments under Heading XI, “Personal capital movements,” in Annex I to Directive 88/361.

Moreover, the ECJ found that it does not matter whether the underlying gifts were made in money or in kind.

Infringement

The ECJ found that there is an infringement on the freedom of capital movement because the possibility of obtaining a deduction for tax purposes can have a significant influence on the donor’s willingness to donate. Thus, a legislation such as the German one constitutes a restriction on the free movement of capital.

Justifications: Budgetary Compensation

An argument some governments made in the proceedings was the underlying purpose of allowing deductions for charitable contributions is that charitable bodies relieve that state of some charitable tasks that it would otherwise have to fulfill itself using tax revenue. Yet the ECJ did not follow this argument of budgetary compensation as it referred to settled case law that the need to prevent the reduction of tax revenue is neither among the objectives of the free movement of capital nor an overriding reason in the public interest capable to justify any restriction on a freedom.

Safeguarding Effective Fiscal Supervision

Defending the denial of deduction, Germany made the argument that the denial is justified to safeguard the effective fiscal supervision. On this point, the ECJ referred to the preceding nonprofit case *Stauffer* (C-386/04), upholding its view that a member state cannot invoke the requirement for effective fiscal supervision to justify a refusal to grant an exemption to a foundation established in another member state. The Court agreed that safeguarding an effective fiscal supervision constitutes an overriding reason in the public

interest capable of justifying a restriction on the exercise of the freedoms of movement. However, the Court maintained that the justification must comply with the principle of proportionality. The principle requires in the case at hand that the possibility of a deduction cannot be excluded a priori if the taxpayer is able to provide documentary evidence enabling the tax authorities of the member state of taxation to ascertain, clearly and precisely, the nature and genuineness of the expenditure incurred in another member state.

In short, deduction may be denied, but only if the taxpayer does not provide sufficient evidence.

Comparison of Charitable Contributions

The member states advocating a denial of deduction during the proceedings got their point when they questioned the comparability of nonprofit tax regimes across Europe. Even though almost every EU member state implements a nonprofit tax regime, the concepts are different and depend on different requirements for recognition of acts of benevolence and are often dependent on a political will to grant a subsidy to a special type of body. Therefore, the ECJ found that it is appropriate for each member state to determine whether it will provide for tax advantage for a special type of body under specific requirements. If a member state does not fulfill its member state taxation requirements, unequal treatment is permitted under EU law. However, the denial is not permitted in cases of arbitrary discrimination, which is the case when the denial of deduction is based on the mere fact that the recipient resides in another member state.

Duties of Taxpayer and Recipient

The ECJ gives duties for both taxpayers and recipients. The taxpayer must provide all relevant evidence to identify expenditure as a charitable contribution under the law of the member state of taxation. The tax authorities may deny the deduction if there is insufficient evidence supplied.

The recipient must assist the taxpayer in providing that information for the taxpayer's tax advantage. The ECJ motivates the recipient to provide the best documentation possible, as the staff of the charitable body is well aware that the donation depends strongly on its deductibility.

No Obligation of Mutual Assistance

The ECJ points out that there is no obligation of any member state to investigate the compliance with the requirements having recourse to the mechanism of mutual assistance according to Directive 77/799/EEC. Thereby, the ECJ referred to the wording of article 2 of the directive and the word "may," which cannot be interpreted as "must." Thus, the risk of missing or incomplete documentation rests exclusively with the taxpayer. (See figure.)

New Guidance

On April 6 the German MOF issued guidance (*BMF-Schreiben*) referring to the ECJ decision in *Persche*. The MOF said it will follow the ECJ's opinion in all open cases until new legislation is enacted. However, it will only approve expenditures given to charitable organizations in those European Community and European Economic Community countries that perform mutual assistance in accordance with Directive 77/799/EEC (regarding tax assessment) and Directive 2008/44/EC (regarding tax enforcement). A future guidance letter will address documentation requirements. However, the MOF clarified that the deduction will be denied if there is insufficient documentation.

Follow-Ups

The judgment of the ECJ in *Persche* is consistent with the preceding nonprofit cases *Stauffer* and *Jundt* (C-281/06), leading the way for a European nonprofit and contribution law. Complete harmonization will never be achieved because the political interests and subsidy desires in this field are simply too diverse. However, the ECJ cases give rise to the hope that the member states can agree on the core elements of nonprofit activities, making it easier for the member state of taxation to verify the compliance with the deduction requirements.

To provide for legal certainty and to handle cases of cross-border donations in the most economic way, the member states would be wise to set up a national authority with which foreign charity organizations can register.

There is the vague hope that a European Foundation statute will open a genuine and unlimited nonprofit market within the European Union. At least with *Persche* the ECJ took one step toward that goal. ♦