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By PwC Deutschland | 09. März 2011

Interest of British property LLP taxed in Germany as interest

The Supreme Tax Court has held that the interest income of a German-owned limited partnership in England is taxable in Germany as interest, and not exempt as trading income. The capital gain on the sale of the property is not exempt as taxable in the UK, merely because of the capital allowance claw-back.

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A set of nine German companies held the entire partnership capital in a GmbH & Co. KG. This body held as limited partner the entire capital in thirteen British limited partnerships, each owning a separate property. Because the general partner in each partnership was itself incorporated, no partner ultimately carried unlimited liability. This qualified each entity under German law as a trader and its income as trading income. The GmbH & Co. KG concluded from this that its share in the interest earnings of the British partnerships was exempt in Germany as the trading income of a UK permanent establishment. It found support for this conclusion in the Permanent Establishment Decree, an omnibus work dealing with almost all aspects of permanent establishments. The Supreme Tax Court, though, has now contradicted this position, holding that interest under the treaty retains its qualification as interest. In this, it has followed an earlier case on the US treaty. It has, however, allowed the taxpayer to take advantage of a good faith provision in the Tax Management Act under which a taxpayer is protected from retroactive disadvantages from having relied on a decree later held by the courts to have been invalid.

On a separate issue, but on the same case, the court also ruled on the taxation of the capital gain by one of the UK partnerships on the sale of its property. The treaty provides for taxation in the UK as the country of the site, but with reversion to Germany as the country of residence of the taxpayer if the UK does not exercise its right to tax. In these circumstances, the UK did not seek to charge capital gains tax, but did "claw-back" the capital allowances (tax depreciation) previously claimed on the fittings attached to the building. The taxpayer argued that the claw-back was effectively a tax on the gain, sufficient to prevent the taxing right from reverting to Germany. The Supreme Tax Court, however, saw the claw-back as an adjustment to current income, not as a tax on a capital gain. Accordingly, the gain was not, as such, taxable in the UK, but was taxable in Germany.

Supreme Tax Court case I R 49/09 of December 9, 2010 published on March 9, 2011

Schlagwörter

capital gain, interest, limited partner, property