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Non-deductible foreign losses not taken into account for tax rate

The Supreme Tax Court has held that where domestic law excludes a foreign loss, that loss cannot be taken into account when setting the rate to be applied to the other, taxable income.

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A specific provision in the Income Tax Act excludes certain types of foreign losses (mainly from farming, tourism, licensing, leasing and renting) from offset against other income. Rather, the losses concerned may only be set against profits from the same type of activity in the same country, either immediately or in a future year. A taxpayer faced with a tax office refusal to take letting losses from the US into account when calculating his overall effective rate to be applied to his income taxable in Germany has challenged this provision as being in conflict with the German/US double tax treaty. His main argument was that the treaty provides for taxation of income from property in the country of location, but also that income excluded from taxation in the country of residence must be taken into account when setting the rate to be applied to the overall income taxable there. If the activity results in a loss the same consequence must be taken.

The Supreme Tax Court has now rejected this argument. The loss arose from an activity in the USA and was, under the treaty, a matter for the US. Independently of the treaty provision, German domestic law excluded it from a German deduction. The treaty provision on taking income items taxable in the source country into account when fixing the rate in the country of residence applied only to those items excluded under the treaty. Since the item concerned – the property loss – had already been excluded under domestic law, it was outside the treaty. There was no conflict between treaty and statute because the rate-setting provision in the treaty allowed the state of residence to take income solely taxable in the other state into account, but did not require it to do so.

Supreme Tax Court judgment I R 35/10 of January 12, 2011 published on April 20

Schlagwörter

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