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# Foreign tax credit to reflect personal allowances

**The Supreme Tax Court has followed an ECJ judgment in basing the maximum foreign tax credit on the total German tax payable on the foreign income as calculated under the assumption that personal allowances and reliefs are first set against the domestic income. The court also held the “per country” limitation to be in accordance with community law.**

The credit against the German tax due on foreign income is the lower of the foreign tax actually paid and the German tax to be charged on the income in question. Under the Income Tax Act, this comparison is to be made separately for each country of source (per country limitation) and the German tax to be charged is to be based on the tax due on the worldwide income allocated over the countries of source. A resident couple with investment income from Germany and six other countries disputed these calculations and pressed for credit limitation to the total incremental German tax due on the foreign income. The case went to the ECJ, which held that the limitation should be based on the comparison of the foreign income to the worldwide income remaining after deduction of the personal allowances and other reliefs based on individual personal circumstances. The main point made by the ECJ in this judgment was that personal reliefs should be granted by the country of residence and they should not be “watered down” by effective exclusion in proportion to the foreign income.

The Supreme Tax Court has now followed this judgment in respect of all personal allowances and reliefs except for the saver’s allowance (€801 per person p.a.).This allowance is to be allocated over investment income from all sources, that is, over the foreign income in the proportion that income bears to the total. The court also turned to the calculation of the limitation on a per country basis. This is prescribed in the statute (Income Tax Act) and does not hinder the free movement of capital. On the contrary it is necessary in the public interest in the preservation of taxing rights between states. Otherwise Germany would effectively be crediting irrecoverable excess tax credit from one country against her claim to taxation on the income from another.

Supreme Tax Court judgment I R 71/10 of December 8, 2013 published on April 2, 2014 following the ECJ judgment C-168/11 *Breker and Breker* of February 28, 2013

**Schlagwörter**

foreign income, foreign tax credit, per country limitation