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By PwC Deutschland | 16. Oktober 2014

Treaty override unconstitutional?

The Supreme Tax Court has held that the treaty override provision making tax exemption of foreign income dependent on tax compliance in the other state is, unless mirrored in the treaty, in breach of international law and therefore unconstitutional. It has referred to the Constitutional Court for a ruling.

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A German resident pilot of an Irish airline earned his salary practically tax-free over the years 2007-10. Under the German/Irish double tax treaty then in force, the earnings of aircrew were taxable in the country of establishment of the airline. Ireland, however, exempted the salaries of non-residents except to the extent the work was actually performed in Ireland. Thus, the pilot earned most of his salary tax-free. At the time, the treaty contained no switch-over or other provision designed to ensure that all income was actually taxed in one of the two signatory states. The treaty override provision of German law substituted the foreign tax credit for the “standard” exemption of employment income unless the taxpayer could demonstrate payment of the tax in the other state or that the other state had waived its right to tax. The pilot met this demonstration requirement with the repayment of the PAYE (salary withholding tax) by the Irish tax office. In 2013 the override provision in the Income Tax Act was tightened to also exclude from treaty exemption cases where the other state did not exercise its right to taxation because it did not regard the taxpayer as its own resident. Because this amendment was depicted as a “clarification” rather than a substantive change, it was applied retroactively to all cases still open.

The Supreme Tax Court has now taken issue with the override provision of the Income Tax Act on two counts. Firstly, the override, itself, is in breach of the treaty – unless specifically agreed with the other state. As such, it is in conflict with international law and – as is apparent from recent Constitutional Court cases – therefore unconstitutional. It cannot therefore be applied in the present case. Secondly, the court sees the 2013 amendment as a substantive change to a clear provision on which a taxpayer was entitled to rely. Retroactive application is thus excluded under the constitution. It has now referred both questions to the Constitutional Court for a final ruling.

Note: this case is no longer relevant to the future taxation of German resident aircrew of Irish airlines, as a new treaty has been concluded with an override clause. In any case Ireland has changed her law to tax the remuneration of non-resident aircrew (as permitted under the relevant treaty).

Supreme Tax Court decision of August 20, 2014 published on October 15

Schlagwörter

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