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Pension payment for early inheritance deductible for non-resident?

An ECJ advocate general has suggested the court hold for a second time that Germany must allow a non-resident a deduction on the same terms as a resident for a pension paid to his father in consideration of his early assumption of joint ownership in the family business.

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It is not unusual for the owners of family businesses to pass the ownership rights to the next generation in exchange for a pension sufficient for them to retire. This system of “early inheritance” is founded in German inheritance law. The Income Tax Act reflects it by allowing the heir a deduction for the pension outlay as a “special cost” whilst treating it as taxable income in the hands of the recipient. However, a deduction for “special costs” – unusual outgoings that a taxpayer is legally or morally obliged to bear – is only available to resident taxpayers. On March 31, 2011, the ECJ held that this denial of a deduction to a non-resident heir to property was an unjustified hindrance on the freedom of capital movement – C-450/09 *Schröder*. Its main argument was that neither the pension obligation nor the inheritance would have occurred in isolation, so that if a resident heir was able to deduct the pension paid from his taxable income, there was no reason for denying this right to the non-resident earning taxable income from the assets he had inherited. The Supreme Tax Court accepted that judgment for the case decided, but then repeated its question with a second, directly comparable case of two brothers, only one of whom was resident in Germany, assuming joint proprietorship over a German business from their resident father against a life pension. The Supreme Tax Court justified its second submission with contentions that it was unsure that the two cases were directly comparable and that it felt it had not adequately emphasised the conceptual link between the deduction of the expense for the payer with the tax charge on the recipient.

The ECJ advocate general on the second case has now suggested the court follow its ruling in the first. The disallowance of the pension payment deduction for the non-resident whilst granting it to a resident is discrimination hindering the freedom of capital movement. It makes the “deal” within the family relatively less attractive to the non-resident heir. The first case involved the transfer of rented property, whilst the second concerned the transfer of a business operation. In both, the pension paid to the donor – the father – was oriented more to the needs of the recipient than to the income to be earned from the assets transferred, although the income from the first transfer was considerably more stable than that from the second. However, the advocate general suggests that this distinction is irrelevant. Important is merely that in neither case would the assets have been transferred without the pension promise. He goes on to point out that the conceptual link between the tax deduction for the pension payer and the tax obligation of the recipient is irrelevant to the distinction between two payers. If the concern is that the non-resident payer might attempt to claim a deduction in both countries for the same payment, it is open to the German tax authorities to inform the country of residence of the German claim. This then leaves it to the country of residence to prevent the “double dip”.

The ECJ case reference is C-559/13 *Grünewald* opinion of November 18, 2014.

Schlagwörter

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