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Embezzled funds not taxable income

The Supreme Tax Court has held that a lawyer did not earn taxable income through misappropriation of funds held on behalf of clients.

A lawyer regularly collected debts on behalf of clients. However, he did not forward the proceeds to the owners immediately and did not credit them to a separate bank account for cash held on behalf of clients. Rather, he paid them to his general business bank account and used them for his own, business and private, purposes. A tax auditor discovered this regular embezzlement of clients' money and the tax office viewed the proceeds as business income when received, the lawyer having accounted on a cash basis.

The Supreme Tax Court has now rejected the view of the tax office. Paying money belonging to clients onto his own business bank account did not release the lawyer from the obligation to meet the claims of the true owners. The money remained a transitory item of "cash collected on behalf of others" and was not part of the lawyer's professional earnings. This was still true even where he had never intended to pass the money on, as in such cases his benefit was the proceeds from a privately committed criminal act, rather than from his business activity. The court contrasted this with the taxable income of a partner from the diversion of partnership earnings to his private bank account and with the fraudulent trading by a bank's employee in the name of the bank but for his own account if successful. In both the latter cases, the income was taxable *per se*; the fraud merely changed the person of the taxpayer.

Supreme Tax Court judgment VIII R 19/12 of December 16, 2014 published on June 17, 2015

Schlagwörter

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