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Impact of tax treaty definitions on domestic law

The Supreme Tax Court held, in a decision published on 19 October 2016, that the term “permanent establishment” set out in Section 9 No. 3 of the Trade Tax Act should follow the domestic law definition and not the tax treaty definition.

The taxpayer, a GmbH, carried on business as an import agent; specifically it acted as the agent for another GmbH, sourcing all its goods from Turkey. The company had no other income source save for the provisions received. For this purpose, the taxpayer kept a purchasing office in Turkey.

In its trade tax returns for the years 2004 to 2008, the taxpayer deducted the income arising from the Turkish purchasing office from the trade tax base according to Section 9 No. 3 of the Trade Tax Act (TTA). This provision provides for the deduction of that part of the trade tax base, which emanates from a permanent establishment located outside Germany (as defined by the TTA). The tax office initially followed this treatment, but revised its view at a subsequent tax audit.

The basis for the tax office's revision was that under the terms of the German/Turkish tax treaty, a purchasing office was excluded expressly from the definition of a permanent establishment.

The taxpayer argued, however, that the treaty did not apply in these circumstances and the relevant definition was the domestic one.

The Supreme Tax Court held that the domestic definition should be applied to the term as set out in Sec. 9 No. 3 TTA.

The Court stated that it was settled case law that tax treaties merely determined the extent to which the liability to tax under domestic law should be restricted. The definition of "permanent establishment" as set out in the individual tax treaties is, thus, generally only applicable within the framework of the tax treaty. This view is confirmed by the wording of the German/Turkish tax treaty itself, with such phrases as "*For the application of this Treaty the following applies*…" or (in Article 3 (1)) "*Within the meaning of this Treaty…the expression … shall mean*". In contrast questions such as whether earnings from abroad should be deducted when calculating income or to which cases such a deduction should apply, are ones of domestic law.

The concept of the "coexistence" of bilateral agreements as it concerns tax treaties and domestic tax rules presupposes a coexistence of the factual prerequisites with the result that terms defined in the treaty, which differ to the definition in domestic law, must be interpreted on a stand-alone basis according to treaty.

It is open to the legislator to set aside this coexistence of the separate sets of rules but it has chosen not to in this case. No connection with treaty law is evident in the case of Section 9 No. 3 TTA.

Supreme Tax Court decision of 20 July 2016 (I R 50/15)

Schlagwörter

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