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No economic ownership of lessee in case of a sale-and-lease back

A mere put option by the lessor at a favorable price does not necessarily lead to the attribution of economic ownership of the assets to the lessee. In its judgment the Supreme Tax Court once more confirms that economic ownership must be determined on a case-by-case basis.

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Generally, a sale and lease-back is a sale by the customer to the leasing company followed by a service by the leasing company (lessor) to the customer (the monthly rentals). The lessor records the assets in his balance sheet and claims depreciation and also possible refinancing costs while on the other hand recording the rent as taxable income. The distinction depends on the circumstances of the case, namely on the economic ownership of the underlying assets. Economic ownership presupposes that the owner exercises effective control over the asset whereby excluding others (i. e. the legal owner) from affecting the economic good during the normal period of its useful life (Section 39 sub-section 2 No. 1 sentence 1 of the German Fiscal Code).

In the case before the Supreme Tax Court a limited partnership (KG) purchased electronic information systems from the manufacturer (seller) which the latter had developed and also specific automatic dispensing machines for bacterial cultures. The KG in turn leased back the assets to the seller (lessee) over a base lease period of 48 months. The KG (lessor) had a put option whereby lessee was obliged to “re-purchase” the assets at an unreasonable high price at the end of the lease term. For that reason, the tax office did not accept that the KG was the economic owner of the leased assets.

First and foremost, the Supreme Tax Court held that the seller of the automatic dispensing machines retained economic ownership at all times since the assets were specially fitted for his needs. In the case of electronic information systems the court reached quite an interest conclusion: The useful life of the asset being longer than the base lease period together with the KGs favorable put option at the end of the base lease term does not necessarily assume transfer of economic ownership to the lessee. Quite so, the lessee could not - for the rest of the asset’s useful life – legally exclude the KG from having an influence whatsoever or affecting the assets in any way. A mere put option of the lessor is alone not sufficient. Rather, the lessee (seller) must have been in a situation which ensures economic exclusion of the KG at all times, e.g. also by way of an extension option or purchase option.

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