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Double tax treaties: recognition of losses from a Belgian permanent establishment.

Section 50d (9) Income Tax Act (ITA) excludes a tax exemption in Germany under a double tax treaty where, inter alia, the income is not taxed in the other treaty state.

In a decision of the Supreme Tax Court published on 19 December 2018, the Court held that the term "income" in this context applied to both positive and negative income. Thus, provided that the other conditions set out in Section 50d (9) have been met, losses, which were originally excluded as tax-free treaty income, could, be deducted from domestic taxable income, regardless of the treaty.

Recognition of losses by reason of a conflict of qualification

The German-resident law firm of the appellant, an unlimited German taxpayer, rented offices in Brussels from 1991 to 2010 and from October 1992 onwards, a lawyer was to some extent present in the offices constantly, offering various services, including the provision of advice, information or opinions, which could be invoiced under the federal fee regulations for legal services. Between 1994 and 2004, a lawyer was employed, who also used the office for representative activities.

Following a tax audit, the Belgian tax authorities issued certificates, which stated, inter alia, that the law firm was not regarded as a Belgian tax resident for the purposes of the Belgian/German tax treaty, was not liable to income tax for the fiscal years 1991 to 2007, and that for these periods no loss carry-forward was available. The appellant applied to set off the Belgian losses against his taxable income in Germany.

The question before the Court revolved around whether the expenses incurred by the law firm for the rental of an office in Brussels were to be recognised for German tax purposes in the hands of the appellant. Were the costs deductible as business expenses or were they merely to be considered for the purposes of calculating the tax rate under the progression provisions?

Section 50d (9) No.1 ITA deals with the situation where income is not taxed as a result of a conflict as to how the provisions of a tax treaty are applied/interpreted by the participating treaty states. This may be the case where the designation as to the type of income conflicts, or where facts and circumstances are interpreted differently or where the domestic legislation of the different states leads to a divergent interpretation of the treaty provisions. In these circumstances, Section 50d (9) No.1 ITA allows Germany to tax the income, in that it prohibits the treaty tax exemption.

According to the decision of the Supreme Tax Court published on 19 December 2018, this prohibition applies not only to income/profits but also to losses incurred, so that not only income untaxed in the other state will be taxable in Germany but also losses not recognised in the other state will be available for set off in Germany.

In the circumstances before the Court, Article 14 of the Belgian/German treaty gave the right to tax the income (both positive and negative) of the Brussels office to Belgium. The Supreme Tax Court referred the matter back to the local tax court to decide whether the requirements of Section 50d (9) ITA had been actually met in the circumstances and whether there was an actual conflict of qualification.

The local tax court had allowed the appellant's appeal and confirmed that that the appellant could deduct the Belgian losses. However, this decision had solely been based on the fact that the Belgian tax authorities

had issued the above-mentioned certificates. The Supreme Tax Court held that it was necessary to look into the matter in greater detail and establish whether the income/losses were excluded from taxable income in Belgium because of Belgian domestic tax legislation or whether this exclusion was a result of a conflict of qualification in tax treaty law.

According to the Supreme Tax Court, if it is subsequently established that the exclusion of the income from the Belgian tax base results from Belgian domestic tax legislation, Section 50d (9) No. 1 ITA will not be applicable.

Source: Supreme Tax Court judgment of 11 July 2018 (I R 52/16), published on 19 December 2018

Schlagwörter

Income Tax Act, International Tax, anti-avoidance, loss recognition