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By PwC Deutschland | 17. November 2020

No trade tax add-back of rental costs allocated to production costs of current assets

Rental and lease payments for the use of movable fixed assets are not to be added back to trading profits in accordance with Section 8 No. 1 Letter d Trade Tax Act (TTA), insofar as they are to be attributed to the costs for the production/manufacture of current assets.

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This will also be the case in situations where the rent and lease payments would have been capitalized as production costs, had the asset still been included in the business' assets as at the balance sheet date and therefore had to have been capitalized. This was decided by the Supreme Tax Court in a ruling published on 12 November 2020.

Background

The dispute centred on whether rental and lease payments had to be added to the profits on a pro rata basis pursuant to Section 8 No. 1 Letter d TTA if they constituted costs for the production of current assets which had been divested from the business assets before the balance sheet date (i.e. during the year).

The appellant was a construction company operating in the legal form of a GmbH (limited liability company), which, in the year of dispute 2008, regularly leased equipment for its construction site facilities (concrete pumps, concrete equipment, system formwork, construction fences, magazines, accommodation, toilets, cranes, lifting equipment and scaffolding). The fees paid for this in the relevant year amounted to around € 925,000.

On the basis of a tax audit carried out in 2012, the tax office came to the conclusion that the financing fees contained in the rental/lease payments should be added back to the profits according to Section 8 No. 1 Letter d TTA.

The appellant appealed to the Tax Court of Schleswig-Holstein without success.

Decision

The Supreme Tax Court allowed the appeal and overturned the decision of the lower instance.

The Tax Court had wrongly assumed that the expenses incurred in 2008 for the rental of equipment for the construction site facilities constituted rental payments which had to be added back according to Section 8 No. 1 Letter d TTA.

According to the introductory sentence of Section 8 TTA, rental and lease payments were only to be added back to the above-mentioned expenses to the extent that they had been deducted when determining the profits.

The rental payments incurred for the rental of equipment for construction site facilities will not have been deducted in the determination of the profit in the sense of the introductory sentence of Section 8 TTA to the extent that they are direct costs of the building site constituting part of the costs for the production of a current asset. This would also apply where the product had already been completed during the assessment period and had been disposed of. The expenses incurred lose their original character as rental payments when they are reclassified as costs of production.

Rental and lease payments are no longer included in the add-back if they have been included in the production cost of an asset. This is because they only have an impact on profits from being included in the production/ manufacturing costs, so they are neither conceptually nor economically "a reduction in profit due

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to rent and lease payments” within the meaning of Section 8 No. 1 Letter d TTA.

The reclassification does not depend on whether it relates to the production costs of fixed assets or of current assets. If rental or lease payments are to be allocated to the production costs of current assets, they can only lead to a reduction in profits as production costs.

Contrary to the opinion of the tax court and the tax office, an add-back is not to be made even if the related current assets have not been capitalized as at the balance sheet date. It is solely the reclassification of the rent as production costs that is relevant and not the reporting of the rent on the balance sheet date and its postponement to another period. In accordance with the Supreme Tax Court judgement of 30 April 2003 (I R 19/02), the extent to which the respective expenses meet the definition of production/manufacturing costs under commercial law is therefore decisive.

Accordingly, the appellants therefore assumed by mutual agreement and with good reason that the rental payments made for equipment for the construction site facilities (concrete pumps, concrete equipment, system formwork, construction fences, magazines, accommodation, toilets, cranes, lifting equipment and scaffolding) represent the cost of production of the unfinished construction work capitalized at the balance sheet reporting date to the extent that they can be allocated to these as construction site direct costs.

This view accords with the principle of equality (Article 3 (1) of the German Constitution.

Source:

Supreme Tax Court ruling of 30 July 2020 (III R 24/18), published on 12 November 2020.

Schlagwörter

current assets, rental expense, trade tax addback