

By PwC Deutschland | 17. April 2023

# Waiver of exit tax upon return to Germany

**According to a decision of the Supreme Tax Court the exception from the exit taxation due to an "only temporary absence" must be granted if the taxpayer again becomes subject to unlimited income tax within five years after leaving Germany and irrespective of the question whether he had from the outset the intention to return.**

## Background

According to Section 6 (1) of the Foreign Tax Act (FTA), where a taxpayer's unlimited tax liability ceases through the taxpayer giving up his German residence/habitual abode, any material shareholdings held in his private property will be deemed as disposed of even without a sale and any capital gain on the deemed disposal will be taxable under Section 17 (1) of the Income Tax Act (ITA). Section 6 (3) FTA provides for this so-called exit tax to be subsequently waived in certain circumstances (which are described in more detail further below).

The plaintiff had moved to Dubai in the United Arab Emirates and had given up his domestic domicile and habitual residence in Germany in March 2014. At the time of his relocation, the plaintiff held interests in several German-resident corporations. In December 2015 the plaintiff informed the tax office of his intention to return to Germany. Two years after the move, the plaintiff re-established his habitual residence in Germany.

In the plaintiff's income tax assessment for the year of departure (2014), the tax office recognized capital gains pursuant to Sec. 6 (1) FTA in conjunction with Sec. § Sec. 17 ITA. The plaintiff objected, arguing that, because of his eventual return to Germany, taxation would have to be retroactively waived. The tax office did not agree on the grounds that the plaintiff had not made clear his intention to return when he left the country.

### **The Muenster Tax Court (of first instance) refused the plaintiff's appeal...**

The plaintiff had not credibly shown that at the time of his departure he had had the intention to become tax resident again in Germany at a later point in time. For the exit tax to be waived, Section 6 (3) Sentence 1 FTA requires not only that the taxpayer becomes subject to unlimited tax liability again within a five-year period but also that the cessation of the unlimited tax liability was based solely upon a temporary absence. This was to be regarded as a subjective element of the constituent requirement that the intention to return existed at the time of departure. § 6 (3) FTA did not apply to failed or "aborted" emigrations. The taxpayer had to be able to show credibly upon his return, that he had always intended the emigration to be temporary. According to the Muenster Tax Court, however, the plaintiff had not succeeded in establishing this on a prima facie basis.

### **...whereas the Supreme Tax Court ruled in favor of the plaintiff**

The taxation of the income from the fictitious increase (step-up) in the value of the plaintiff's shareholding as capital gain has no sufficient legal basis and is therefore not justified. There is merely a "temporary absence" which is of no relevance here.

In the opinion of the tax authorities, Sec. 6 (3) FTA is to be interpreted in such a way that the taxpayer must already have the will to return at the time of departure and that this must be plausibly substantiated. The Supreme Tax Court, however, decided that the requirement of "only temporary absence" is met if the taxpayer becomes liable to unlimited taxation again within the legally determined period of 5 years following

departure. It is not necessary that the intention to return to Germany must be established early on, i. e. at the time of departure.

The Supreme Tax Court went on to say that the wording of Sec. 6 (3) FTA does not indicate when or if at all the taxpayer must establish and prove his intention to return. This special situation is only dealt with in the “reverse exception” in Sec. 6 (3) Sentence 2 FTA which provides for an extension of the initial five-year period if it can be substantiated that "an intention to return continues unchanged". The intention to return may therefore be shown at any time during the first 5-year period, be it through notification of the tax authorities or relocation of domicile to Germany.

With respect to the ambiguous wording of the law, it is for the Supreme Tax Court a matter of giving due effect of the intention of Sec. 6 FTA which is aimed at preserving the national right of taxation regarding the hidden reserves in the German shareholdings (capital gain on a deemed disposal) which has accrued during the time of German residence. This is met in any case if the taxpayer returns to Germany within the initial 5-year period.

**Source:**

Supreme Tax Court decision of 21 December 2022 (I R 55/19), published on 13 April 2023.

**Schlagwörter**

exit tax, unlimited tax liability