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By PwC Deutschland | 03. Februar 2025

Administrative and consolidated group costs of a holding company not fully deductible

The Supreme Tax Court decided that a commercial partnership holding a share in a corporation as its sole activity in order to generate dividend income which is partially tax-exempt in accordance with Section 3 No. 40 Income Tax Act can deduct its ongoing administrative and consolidated group costs only in part because they are economically related to the partially tax-exempt income as defined in Section 3c (2) Sentence 1 Income Tax Act.

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Background

Section 3 No. 40 Income Tax Act (ITA) provides that certain type of capital investment income (including dividends) may be taxed under the partial income method whereby 40% of the dividends are tax exempt and the remaining 60% is subject to income tax. Correspondingly, only 60 % of the expenses that are economically connected with the with the exempt income is tax-deductible (Section 3c (2) ITA).

The plaintiff is a GmbH & Co. KG (limited partnership with no natural person bearing unlimited liability). Its limited partners in the year in dispute were siblings A and B, C and D. The general partner of the plaintiff was L GmbH without a share in the company's assets. The plaintiff owns 100% of the shares in V GmbH, which in turn holds shares in several other companies. In the year of dispute, the plaintiff only received dividend income from its shareholding in V GmbH which was subject to income tax under the partial income method. The tax office only recognized 60% of the plaintiff‘s costs for closing and auditing work, legal advice and monetary transactions as well as membership fees to the Chamber of Industry and Commerce as deductible operating expenses in accordance with Section 3c (2) ITA. The plaintiff claimed full deduction of said costs.

Decision

The Supreme Tax Court decided that the business expenses were also economically related to the plaintiff's 40% tax-exempt income from its shareholding in a GmbH according to Section 3 No. 40 Sentence 1 letter d ITA. Accordingly, these operating expenses were only partially deductible (60%) contrary to the plaintiff's claim.

The Supreme Tax Court pointed out that, first, it is evident and not in dispute that the plaintiff's expenses are **economically connected** to its business income pursuant to Section 15 (3) no. 2 ITA. This is because the income of the plaintiff as a GmbH & Co. KG with at least one corporation bearing unlimited liability ranked as trading income per se, even if the partnership itself did not operate a trading facility (due to the so called“trading hallmark”-principle).

The expenses for its financial statements and auditing work, legal advice, Chamber of Industry and Commerce membership and monetary transactions were borne by the plaintiff due to its commercial activity pursuant to § 15 (3) no. 2 ITA, the ownership in V GmbH and the generation of investment income. Even more so, as the investment in V GmbH was the plaintiff's sole business activity in the year of dispute.

The plaintiff also fulfilled a **legal obligation** imposed on it in each case with the business expenses, in particular the costs for the financial statements and audit work with regard to the consolidated balance sheet and with the payment of the Chamber of Commerce membership fees. However, the driving force and the overriding motive behind these obligations in each case was the plaintiff's own fundamental entrepreneurial decision. It is not relevant whether the expenses are incurred to fulfill **a legal obligation** (e.g. costs for financial statements and audits or Chamber of Industry and Commerce fees) or **a private-law contractual obligation** (e.g. legal and consulting costs or costs of monetary transactions). These obligations and the associated expenses are also the result of the plaintiff’s intention through a

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commercial partnership (whose income ranked as trading income per se due to the so called “trading hallmark”-principle) to own shares in other companies with the sole purpose to generate investment income.

With regard to the nature of the connection between the expenditure and the tax-exempt income, the Supreme Tax Court went on to say that a legal correlation whatsoever is not required and that a mere indirect economic connection is sufficient.

Source:

Supreme Tax Court judgment of 27 November 2024 (IV R 25/22) – published on 30 January 2025.

Schlagwörter

directly connected expenses, expense deduction, tax exemption