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Extended limited tax liability if income is subject to U.K. tax on remittance basis

A taxpayer who emigrated to the U.K. and who exercised his right under U.K. tax law to pay tax on income not earned in the U.K. on a "remittance basis" is caught by the preferential taxation regime of Sec. 2 (2) No. 2 Foreign Tax Act and subject to extended limited tax liability in Germany.

Background

The taxpayer (plaintiff) is a German national who lived in Germany until 2000 and in London thereafter. He had opted to tax non-UK income on a remittance basis. By using the remittance basis of taxation, one pays UK tax on UK sourced income and gains but only pay UK tax on foreign income and gains if the income/gains are brought (remitted) to the UK. In 2006, the year of dispute, the plaintiff received income from the rental of German real estate and various German source investment income (interest and dividend income). The German tax office included this latter income in the tax assessment. It held that the investment income was subject to the extended limited tax liability regime of Sec. 2 Foreign Tax Act (FTA) and that the tax in the U.K. was reduced by way of “preferential (low) taxation” pursuant to Sec. 2 (2) No. 2 FTA.

Sec. 2 FTA deals with the extended tax liability of individuals who have been resident in Germany for at least five years prior to moving abroad: The individual is subject to a limited tax liability for a period of ten years after the year in which the unlimited tax liability ended and under the following preconditions: First, if the burden of income tax levied in the foreign territory is more than one-third below the burden of German income tax for individuals under otherwise identical conditions (Sec. 2 (2) No. 2, 2nd half-sentence FTA).

Under the UK tax regime, the option to be taxed on a remittance basis is not available to all taxpayers but only to those taxpayers who are "resident" in the UK, but not both "ordinary resident" and "domiciled" at the same time. The term "resident" essentially corresponds to the term "domicile", which is to be determined based on an overall view of the circumstances. "Ordinary resident" roughly relates to the main place of residence (the center of the taxpayer’s vital interests).

The Munich Tax Court as tax court of first instance had dismissed the action.

Decision

The Supreme Tax Court confirmed the view of the court of first instance and rejected the claim brought by the plaintiff.

The UK "remittance basis" taxation applicable (i. a.) for certain "investment income" is a preferential taxation within the meaning of Sec. 2 (2) FTA. Preferential taxation exists where a taxpayer or a group of taxpayers is granted significant tax relief which is not available for UK taxpayers subject to general taxation in that country. The plaintiff opted for the application of the "remittance basis" taxation in the UK. Since the investment income was not transferred to the UK, it was also not included in the UK tax base and thus not taxed. In the opinion of the Supreme Tax Court, this represents a significant reduction compared to general taxation. It went on to say that a preferential tax treatment granted in contrast to the general taxation in the exit state can significantly reduce the tax burden for the taxpayer within the meaning of 2 (2) no. 2 FTA if certain parts of the

generally taxable income are fully tax-exempt.

The Supreme Tax Court did also not share the doubts raised by the plaintiff regarding the constitutionality and compliance with EU law of Section 2 FTA.

First, the application of Sec. 2 FTA does **not lead to a violation of overriding EU law**, i. e. the free movement of capital in Article 63 and the freedom of establishment. The application of Sec. 2 FTA does not put the plaintiff in a worse position, since the tax burden arising under the extended limited tax liability does not exceed the tax which would arise under the unlimited tax liability.

Furthermore, the Supreme Tax Court did not agree with the plaintiff's view that Sec. 2 FTA should be resubmitted to the **Federal Constitutional Court** for review to examine the provision regarding the Ability-to-Pay Principle, the principle of consistency, and the general guarantee of the right to equality.

Note: The current case of dispute referred to the "old" double tax treaty (DTT) which has been replaced by the DTT in force since 2010.

Source:

Supreme Tax Court judgment of 14 January 2025 (IX R 37/21) – published on 20 March 2025.

Schlagwörter

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