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By PwC Deutschland | 31 October 2013

Exclusion of deduction for private pension paid by non-resident in breach of community law?

The Supreme Tax Court has referred a question to the ECJ as to whether the exclusion of deduction for a private pension paid by a non-resident in return for the transfer of ownership rights in a business is in breach of community law.

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A father transferred the family business to his two sons in equal shares, receiving in return a small pension. One of the sons was resident in Germany, but the other was a non-resident, taxable in Germany on his German source income only, but with only restricted rights to personal allowances and relief for non-business expenses. Accordingly, the resident son was able to deduct the pension paid to the father as a privately incurred “unusual” cost, whereas the non-resident was not. On the other hand, the pension received by the father was taxable in his hands only to the extent it had been deducted by the payer. The non-resident son has claimed that his exclusion from deduction is a discrimination restricting his freedom of capital movement under the TFEU and has cited the ECJ *Schröder* judgment (case C-450/09, judgment of March 31, 2011 holding the exclusion of deduction for a non-resident paying a pension in return for a let property to be, indeed, discriminatory) in support of his argument. However, the Supreme Tax Court is unsure as to whether *Schröder* is a precedent for the present case and has turned to the ECJ for clarification.

As the court explained in its referral decision, there are various arguments in support of the taxpayer’s contention based on the link between the pension expense paid and the profits of the business. However, under the Income Tax Act, the pension is not deductible as a business expense but as the cost of meeting a personal obligation. Under this logic, the relevant link is to the income tax charge on the pension in hands of the recipient. Here, though, the situation is less clear, as allowing a non-resident a deduction could lead to a systematic loss of tax revenue, such as where the recipient was also non-resident, the pension then being taxable under the laws of his country of residence.

Supreme Tax Court decision I R 49/12 of May 14, 2013 published on October 30

Keywords

non-residents, pension