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Costs associated with mutual agreement proceeding are not costs of earning income

The Supreme Tax Court has held that the costs incurred by a taxpayer in connection with a tax treaty mutual agreement proceeding are not costs of earning the relevant income, but has left open a possible deduction as “unusual expenses”.

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A US resident realised a gain on the sale of a share in a GmbH. The German tax office sought to tax the gain, but the taxpayer objected on the grounds that it was taxable in the US under the double tax treaty. This tax office did not accept this objection, so he requested a mutual agreement proceeding in an effort to clear the issue. Ultimately, the two governments agreed to split the taxing right in the ratio 60:40 in favour of Germany. However, the taxpayer had incurred various consultancy and legal costs in the course of the process and these should, he claimed, be deducted from the taxable gain, as they would not have arisen without it. The tax office refused this, too.

The Supreme Tax Court has now held that the costs at issue were not direct costs of making the gain. They were incurred in the course of resolving a dispute over the right to tax it and thus did not arise until after it had been made. Admittedly, without the gain, they would not have been incurred at all, although this connection was too remote to allow classification as direct costs. The court explicitly left the question open as to whether they might have been allowable against total income as “unusual expenses”, as that deduction is only available to German residents.

Supreme Tax Court judgment IX R 25/12 of October 9, 2013 published on December 4

Keywords

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