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By PwC Deutschland | 27 March 2014

Tonnage tax option does not exclude partner’s earnings prior to commissioning

The Supreme Tax Court has held that the exercise of the option for tonnage tax on the profits of a ship sailing in international waters does not preclude regular taxation on the earnings of a partner from services to the partnership prior to the ship’s commissioning.

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Under the tonnage tax provision of the Income Tax Act the option for tonnage tax must be exercised in the year the ship is commissioned and takes effect from the beginning of that year. Profits and losses stemming from the ship in prior periods, e.g. while she is being fitted out or working up, are to be set to zero, if necessary in retrospect. Shipping partnerships allocate their tonnage tax income to the partners in profit-sharing ratio. Charges by partners for their services to the partnership are allocated to them separately as additional elements of partnership income outside the scope of the tonnage tax rules. The Supreme Tax Court has now held that this latter provision also applies to such charges during the pre-commissioning period.

This judgment fell in response to a claim that the rule on partners' services does not specifically mention periods before the option, and the rule setting the results of those periods to zero should therefore apply to the full partnership earnings of each partner. However, the court looked to the purpose of separating partners' services from tonnage tax operations – to close a loophole allowing employees and others with a very minor partnership share to tax their remuneration on a very small portion of the tonnage base. It saw this purpose as equally relevant before and after commissioning and therefore decided that any ambiguity in the wording of the provision should be resolved in favour of a common approach.

Supreme Tax Court judgment IV R 19/10 of February 6, 2014 published on March 26

Keywords

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