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By PwC Deutschland | 25 September 2014

Trade tax rental disallowance constitutional

The Supreme Tax Court has held that there is no constitutional objection to the partial disallowance of rental costs for trade tax, even if the tenant has sublet the premises.

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A wholesaler effectively controlled a semi-independent network of retail franchisees. It leased the retail premises from each owner for a fixed rental and sublet them to the individual retailers for a rental-based on turnover. It objected to the trade tax disallowance of (now) one-eighth of the rental expense on the grounds that having sublet the premises to retailers it was not effectively using them for its own business purposes. Since the tenants would also face the same disallowance, the same expense was in practice disallowed twice. This and the fact that the disallowance only affected specific costs, leaving other business expenses fully deductible, conflicted with the provisions of the constitution guaranteeing non-confiscatory taxation and equality of treatment of like circumstances.

The Supreme Tax Court has now rejected these contentions. The legislative had a wide freedom in the design of the trade tax system, provided its decisions were not arbitrary. It was therefore free to disallow a portion of the financing costs of a business, given that the trade tax object was the business and not the trader. It was also free to include a portion of the rental costs in its definition of financing costs and therefore in the disallowance (currently, one-quarter of all interest costs are disallowed and own-half of rental expense is deemed to be interest). That the actual calculation was general did not invalidate the court's conclusion. The legislative was entitled to make general assumptions in the interests of simplicity and practicality. The sub-tenancy of the premises was irrelevant, as two different taxpayers were involved. Also a fixed rental paid to the landlord against a turnover-based sub-rental meant that the tenant was "using" the premises for its own business purpose. It was the head tenant in its own interests, and not merely acting as the agent for the sub-tenants. All in all there was no constitutional objection to the trade tax add-back in its then form. Since the add-back has, in the meantime been reduced the court's conclusion presumably holds good under present law.

Supreme Tax Court judgment I R 70/12 of June 4, 2014 published on September 24

Keywords

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