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Annuity paid for business deductible by non-resident

The ECJ has held that a non-resident taxpayer must be able to deduct an annuity paid in consideration for a business interest on the same lines as a resident.

It is not uncommon for German family businesses to pass to the next generation by way of “advanced inheritance” in exchange for a pension to be paid to the former proprietors. This pension (annuity) is generally oriented more towards the needs of the recipients than to an arm’s length consideration for the transfer of ownership in the business. Such pensions are deductible for acquirers as “special expenses” defined as costs beyond the ordinary that cannot in the circumstances be avoided. However, a special expense deduction is, as a personal relief, only available to a resident taxpayer.

Two brothers acquired a family business from their parents in exchange for a retirement pension to be paid out of future profits. One brother was resident in Germany and one in another EU member state. The tax office granted the resident his “special expense” relief, but refused to do so for the non-resident. The latter saw this as discrimination restricting his freedom of capital movement.

The ECJ has now held the discrimination to, indeed, be an unjustified restriction on the free movement of capital. The pension payment was in consideration of the business transfer and would not have been made, had the brother not entered into his inheritance. As such and regardless of amount, it was directly connected with the (taxable) income earned from the business. In that regard, the non-resident was in the same position as the resident and should therefore receive identical treatment. The deduction was in neither case dependent upon taxation of the income by the recipient (payment by a resident to a recipient abroad would still be deductible). Thus arguments in support of the discrimination on the basis of the balanced allocation of taxing powers between states or on the coherence of the German tax system necessarily fail.

The ECJ case reference is C-559/13 *Grünewald* judgment of February 24, 2015

Keywords

annuity, family business, inheritance, special expenses