By PwC Deutschland | 19 August 2016

Subject-to-tax clause - Section 50d (8) ITA in the case of double tax residence

The Supreme Tax Court refused leave to appeal on a case involving the double tax residence of a German unlimited taxpayer.

The individual involved had a place of residence in Germany, an apartment in Hong Kong and accommodation in China. During the year in question he received a pension and rental income in Germany and he was employed by a Hong Kong firm. Under the terms of his employment contract he was responsible for a factory in China; further his employer agreed to pay all the tax on his employment income. No evidence was available to show that tax was actually paid in China and Hong Kong. During the year in question he was present in Germany for 31 days, in Thailand for 27 days, in Hong Kong for 91 days and in China for 216 days.

The tax authorities in Germany took the view that the employment income for the work performed in China was taxable in Germany as part of his worldwide income. After the tax court both refused his appeal and leave to appeal, the individual appealed to the Supreme Tax Court, requesting leave to appeal.

Leave to appeal was refused. The Supreme Tax Court held that the case was not one of fundamental significance, which required clarification by the Court. The appellant had asked the Court to rule on the question whether Section 50d (8) of the Income Tax Act ("ITA") permitted a reversion of taxing rights to Germany, where, in the case of a double tax residency in Germany and China, not only were the activities under the employment contact performed in China but also the centre of vital interests was also in China, so that for the purposes of the German/Chinese tax treaty, China was both the state of residence and the state in which the activities were performed. The Court held that this question did not require clarification as the answer could be immediately discerned from the wording and meaning of the legislation.

Section 50d (8) ITA provides that where employment income of a unlimited taxpayer is to be excluded from the tax base for German tax under the terms of a tax treaty, the exemption will only granted – regardless of the treaty – where the taxpayer proves that the tax is actually paid on the relevant income in the state with the taxing rights under the treaty or that the state in question has waived its right of taxation.

It was a matter of settled case law that a domestic place of residence gave rise to an unlimited tax liability (i.e. a liability to tax on worldwide income), even where the centre of vital interests was located abroad.

Further it was clear from the wording, that for its application, Section 50d (8) ITA merely required that the unlimited taxpayer *had* employment income, which was to be excluded from the German tax base according to a tax treaty, so that in the instant case the conditions were met. Section 50d (8) ITA does not require tax residence in Germany under the terms of the treaty, only the existence of an unlimited tax liability is decisive. Such an unlimited tax liability can clearly exist even if the tax residence is attributed to the other state under the tie-breaker clause of the OECD Model Treaty (Art. 4 (2) in the German/Chinese treaty).

Supreme Tax Court Ruling from 25 May 2016, I B 139/11

Keywords

Double tax residence, Tax Treaties, subject to tax