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Pensions paid abroad subject to limited tax liability

A limited tax liability on payments by the German State pension fund to a resident of Canada is not nullified by the tax treaty.

The Supreme Tax Court took the view that in such a case Germany held a competing right to tax.

Where a resident of Canada receives pension payments from a domestic – here German pension fund, it was necessary to examine whether the payments were subject to a limited tax liability in Germany and if this was the case whether the tax treaty with Canada prevented Germany from taxing the income.

The Court had to consider the impact of the tax treaty in two separate cases. The appellants, who had lived in Canada for many years, received a life annuity from the German State pension fund, which the tax office considered partially taxable. The lower tax court allowed the appellants' appeals to treat the pension payments as exempt from German tax, on the basis that the taxation by Germany of domestic state scheme pension payments to recipients in Canada was excluded by No. 5b of the Tax Treaty Protocol which provides for a limitation on tax at source. According to that provision German tax could only be levied on pension payments arising from a German source, where those payments were made by the German State itself, or by one of its federal states or by a regional/local authority. In addition a tax deduction at source was only possible in relation to pensions paid to public servants; this did not include state pensions paid by the German State pension fund.

In both cases the Supreme Tax Court allowed the appeals of the tax office.

The fact that the appellants were limited tax payers for German tax purposes was not in dispute, as they realised domestic source income in the form of a German state pension without being resident or having a regular place of abode in Germany. The Supreme Tax Court took a different view, however, in relation to the impact of the tax treaty, namely that the treaty with Canada did not stop Germany from taxing the pensions. This view was based on the competing right to tax given to the country of source (Germany) by Article 18 (1) 2nd Sentence of the German/Canadian treaty. According to this, state scheme pensions fall within the term "pensions and similar allowances" applied in the Article, so that Germany was (also) entitled to taxation pensions paid to the plaintiff.

The Supreme Tax Court did not see the provision in the protocol mentioned by the local tax court as an obstacle. That wording only covered "pensions" and in doing so, merely complemented Article 19 which regulated "active benefits" received by public servants.

Source:

Supreme Tax Court decision of 20 December 2017 (I R 9/16 und I R 8/16 NV), published on 16 May 2018.

Keywords

Income Tax Act, Tax Treaties, limited taxpayer, pensions