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By PwC Deutschland | 22 March 2019

Unlimited tax liability with dual residency

The fact that a taxpayer has both a residence in Germany and a residence abroad does not, according to a ruling by the Supreme Tax Court, preclude the existence if an unlimited tax liability even when the foreign residence constitutes the centre of the taxpayer’s vital interests

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The taxpayer was resident both in Germany and in Romania and had had his main place of residence had been Romania since 2002. In his German income tax returns for the years 2003 to 2009, he declared himself to be subject to limited taxation and included the income earned in Germany from business operations, self-employment and income from renting and leasing various properties. The Tax Court also accepted the limited tax liability. As a result, his income earned in Romania was not included in the tax base.

The Supreme Tax Court took a different view of the case in two essential respects and has referred the case back to the tax court for a second hearing and decision.

In the opinion of the Supreme Tax Court, the assumption of the tax court that the taxpayer had a residence in Germany during the years in dispute had not been properly reviewed.

Furthermore, the tax court had wrongly reached the conclusion that a taxpayer with residences both in Germany and abroad could not be subject to unlimited income tax if his main place of residence was abroad.

Appeal admissible

The assessment, as to whether the residence is maintained and used, is in essence a question of fact. In this respect, the Supreme Tax Court, as a court of appeal pursuant to the Code for Tax Courts, is bound by the facts established by the tax court and their evaluation of the same. The higher court can, as a matter of settled case law, only review the conclusions of the tax court where these can be considered to illogical or in breach of general principles of common experience.

In the current case the tax court’s conclusion that the taxpayer had a domestic residence did not involve sufficient findings of fact. The tax court just assumed that the taxpayer's domestic residence existed in all the years under review on the grounds that the apartment maintained there was suitable for permanent living and was at least occasionally visited by the taxpayer. However, the findings were made regarding the furnishing of the apartment in question, its actual occupancy, its availability or the taxpayer’s intention to use the property. Accordingly, the case was returned to the tax court for a proper review and evaluation of the facts.

Dual residence does not exclude unlimited tax liability

According to the Supreme Tax Court, the fact that the taxpayer was resident in Romania did not exclude an unlimited tax liability. Section 8 of the General Tax Code allows a taxpayer to have several residences simultaneously. These can be located inland and/or abroad. In this respect, the provision recognisably assumes the equivalence of all residences of a person, since it only requires the existence of "a" residence without any further distinction. Section 8 of the General Tax Code does not differentiate between "principal residence" and a "secondary residence”. The only decisive factor is whether it can be shown objectively that the taxpayer maintains the dwelling for the purposes of his own habitation.

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Furthermore, so the Court, it cannot be inferred from the wording of Section 1 (1) 1st sentence of the Income Tax Act that only the residence which represents the centre of the vital interests can give rise to an unlimited tax liability. In this respect, the Supreme Tax Court referred to its earlier rulings on this subject (e.g. judgment of 25 May 2016 - I B 139/11), according to which a domestic residence leads to an unlimited income tax liability of a taxpayer even if the centre of his vital interests is abroad.

There was also no general principle of international tax law according to which every person may only be treated as subject to unlimited taxation by the state in which he holds the centre of his vital interests. In this respect, the question of whether there is unlimited tax liability in Germany must be distinguished from the question of where a person is deemed to be resident within the meaning of a double tax treaty (“DTT”). If an individual is resident both in Germany and abroad, he has a permanent residence in both states, rather than being resident only in the state with which he has closer personal and economic relations (centre of vital interests).

The Court noted that *Article 4 (2) (a*) DTT Germany/Romania, clearly only defines the term” residence” for the purposes of the application of the DTT itself. It state that residence "for the purposes of this treaty" means "a person resident in a Contracting State" and "a person resident in a Contracting State" means "a person resident in a Contracting State", inter alia, who, under the law of that State, is liable to tax there on account of his place of residence.

Source: Supreme Tax Court decision of 23 October 2018 (I R 74/16), published on 20 March 2019.

Keywords

centre of vital interests, dual residence, limited taxpayer, unlimited tax liability