

By PwC Deutschland | 26 September 2022

Attribution of taxable income in fiduciary cases

The Supreme Tax Court decided in the specific case of a Contractual Trust Arrangement that a fiduciary relationship within the meaning of Section 39 (2) No. 1 Sentence 2 of the German Fiscal Code which is recognized for tax purposes may still exist after insolvency proceedings were initiated over the assets of the trustor.

Background

Contractual Trust Arrangement: Double trust arrangements, often also referred to as contractual trust arrangements (CTA), are widespread and recognized models for insolvency protection and liquidity provision to secure entitlements to company pension plans. Thus, if a share or assets are assigned to a creditor as security (collateral) for a claim (i.e., after insolvency proceedings occurred), this is a security trust. In contrast, in the case of a third-party trust (administrative trust), the trustee is bound by the instructions of the trustor.

Sec. 39 (2) No. 1 Sent. 2 Fiscal Code: "In the case of fiduciary relationships, assets shall be attributable to the beneficiary (trustor); in the case of transferred ownerships for security purposes (collateral ownership) to the provider of collateral, and in the case of own property to the owner."

Case of dispute

The plaintiff is a non-profit association which holds, manages, and invests assets in a profitable manner as trustee. The trust assets serve to secure the pension obligations of the companies towards their beneficiaries. In accordance with its articles of association, the plaintiff does not pursue any profit-making interests and acts against reimbursement of his expenses and otherwise free of charge. Insolvency proceedings were later opened against the assets of the trustor.

The tax office took the income of the plaintiff as capital investment income, since, in the case of capital investment income, the limited and lump-sum deduction of income-related expenses meant that the motive to generate profit could be assumed from the outset. The Regional Tax Court of Duesseldorf rejected the claim of the plaintiff as unfounded.

Decision

The Supreme Tax Court granted the appeal and did not see any intention by the plaintiff to generate surplus income under the given circumstances.

The regional tax court's decision to recognize the claims from investments as (operating) income assumes that the claims are attributable to the plaintiff for tax purposes. However, these claims can only be attributed to the plaintiff if he is the owner of the monetary claims. There is no attribution of income if - as in the case in dispute - the income received must be passed on without it being possible to exert any legal influence on the management of the assets.

Regarding specific terms of the fiduciary agreement, the Supreme Tax Court concluded the following:

The fiduciary relationship is to be recognized for tax purposes.

It follows from Sec. 1 of the trust agreement that the transfer of assets is made "for the purpose of management and investment in its own name, but on a fiduciary basis for the trustor and in accordance with his instructions".

Further, it cannot be inferred from the provisions applicable to the case of security (Sec. 5 of the trust agreement) that the trustor's authority to issue instructions and, correspondingly, the trustee's obligation to follow instructions would end in this case.

The sole pursuit of the arrangement by transferring the trust property "exclusively ... for the fulfillment of pension obligations of the trustor and its ... group companies ... and ... to secure the pension entitlements of the beneficiaries", remains fully intact even in the event the situation of collateralization arises.

It is also decisive that the plaintiff, as trustee, acts solely for the account of the trustor when exercising the rights and obligations granted to him under the trust agreement.

A further indication of the existence of a trust relationship in such a manner that it is recognized for tax purposes is that - in the case of dispute - the trustee's own assets and the assets of the trust and its earnings must be held and managed separately.

Source

Supreme Tax Court decision of 4 May 2022 (I R 19/18), published on 22 September 2022.

Keywords

fiduciary, trust