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By PwC Deutschland | 15 February 2023

Supreme Tax Court: Full trade tax add-back of remuneration for third-party partnership management

The remuneration paid to managing directors for the management of a partnership limited by shares (KGaA) must be added back for trade tax purposes even where the KGaA concluded an employment contract directly with the managing directors who each are limited partners of a limited partnership (GmbH & Co. KG), which itself is the general partner of KGaA (the plaintiff). According to the Supreme Tax Court, such "third-party employment" does not reduce the amount of add-back when determining the KGaA's trading income if the KG is entitled to a corresponding claim for compensation by its articles of association.

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Background

The plaintiff is a partnership limited by shares (KGaA) with a GmbH & Co. KG (limited partnership - KG) as its general partner. The general partner of KG is S, a private limited company (GmbH). The KG in turn holds a 100% interest in S GmbH. The managing directors of S GmbH were natural persons K, R and H and later L. In the case of dispute, GmbH & Co. KG, the general partner of KGaA, was responsible for the management of the latter and was entitled to claim reimbursement of expenses incurred in this connection. However, the plaintiff concluded a management agreement with K, R and H and later L, who were also managing directors of the GmbH. These managing directors received the remuneration for their management activities directly from KGaA. In essence, K, R, H and L were appointed to manage and represent the plaintiff under company law as managing directors of S GmbH (general partner of the KG).

The managing directors' fees were initially only partially added back to the trading profit for trade tax purposes. Following a tax audit, the local tax office was of the opinion that the add-back pursuant to Sec. 8 No. 4 Trade TaxAct (TTA) must include the entire remuneration paid to the general partners. It was irrelevant whether the persons entrusted with the management were themselves shareholders in the managing KG or not.

Relevant trade tax provisions with add-back and deduction for partnerships limited by shares

According to *Sec. 9(1) No. 1 Corporation Tax Act (CTA)* part of the profit paid to the general partner of a partnership limited by shares (Kommanditgesellschaft auf Aktien - KGaA) or similar companies with personal liability as **remuneration for managing the business is deductible** *for corporation profits tax purposes*. On the other hand, *Sec. 8 No. 4 TTA* requires that **the remuneration (fees) paid to the general partners** of a partnership limited by shares for management **are to be added back to the trading profit** subject to trade income tax.

§ Sec. 8 No. 4 TTA corresponds with Sec. 9(1) Sentence 1 No. 1 CTA. The purpose of the deductions mentioned in Sec. 9(1) No. 1 CTA is to avoid a double taxation (e.g. corporation tax for the KGaA and income tax for the partners). If therefore the remuneration for the management is not subject to corporation tax at the level of the KGaA, Sec. 8 No. 4 TTA ensures in return that this share of profits is nevertheless subject to trade tax.

Decision of the Supreme Tax Court

The Supreme Tax Court confirmed the view of the tax office. If the general partner of a KGaA (here: the GmbH & Co. KG) holds a 100% interest in a GmbH, which is also its general partner, and if both the limited partners of the KG and also persons without a share in the KG are managing directors of the GmbH, the transfer of the management of the business of the KGaA to these persons by means of a separate employment contract (so-called third-party employment) does not result in the reduction of the add-back of the remuneration paid to the general partners of a partnership pursuant to Sec. 8 No. 4 TTA. This applies if the limited partnership is entitled to a corresponding claim for compensation by virtue of its articles of association. The managing directors of the KGaA then effectively and economically carry out their activities

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on account of the KG.

The Supreme Tax Court went on to say that the add-back provision is to be applied irrespective of whether the general partner is itself subject to trade tax with its income from the KGaA. It is also undisputed that expenses incurred by a GmbH as general partner because it had assigned the management to outside managing directors would also have to be added back pursuant to Sec. 8 No. 4 TTA. In this respect - as in the case of dispute - the situation cannot be any different if the general partner of a KGaA is a GmbH & Co. KG whose general partner is a GmbH authorized to manage the company. Otherwise, the purpose of Sec. 8 No. 4 TTA, which is to ensure that the other profit share is also subject to trade tax, would be undermined. To avoid double taxation at the trade tax level, Section 9 No. 2b TTA provides in turn for a deduction of the profit shares added to the trade income of a KGaA under Section 8 No. 4 TTA at the level of the general partner if they have been recognised in the determination of the profit.

Source:

Supreme Tax Court, decision of 14 September 2022 (I R 13/20) published on 9 February 2023.

Keywords

management agreement, trade tax addback