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By PwC Deutschland | 27 May 2024

UPDATE: Dual residence does not exclude German gift tax liability

The Supreme Tax Court reversed three earlier rulings of the Baden-Wuerttemberg Tax Court and decided that Sweden has no right of taxation, even if at the time of the gift the gift tax had been abolished in Sweden (here: as of 1 January 2005). As a result, a gift made by a donor who has his residence both in Germany and Sweden is subject to the provisions of the German Inheritance and Gift Tax Act.

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Background

The plaintiffs are siblings. Their father had given each of them shares in a Swedish limited company in 2005. At the time of the gift, the father was resident in Germany and in Sweden, the center of his vital interests - however - was in Sweden. The German tax office imposed gift tax on all three recipients, due to the fact that the father is resident in Germany and with the abolition of the gift tax in Sweden at the beginning of 2005, Germany had the right of taxation.

The **lower tax Court** of Baden- Wuerttemberg upheld the appeals and ruled in favor of the taxpayers by asserting that Sweden had the sole right of taxation, even if at the time of the gift the gift tax had been abolished in Sweden. According to the double tax treaty between Germany and Sweden, which covers inheritance, gift, income, and wealth tax, the "residence of the persons involved in the gift" is decisive. In case a donor has his residence both in Germany and Sweden, it is important for gift tax purposes where his main place of residence (the center of the taxpayer's vital interests) at the time of the gift is.

Decision of the Supreme Tax Court

The gift of the shares by the father to the plaintiffs is subject to gift tax in Germany. Article 4 (1) a of the double tax treaty between Germany and Sweden does not preclude taxation in Germany by providing that "*for the purposes of this Agreement, the term "a resident of a Contracting State" means (…) for income tax and capital tax purposes, any person who, under the laws of that State, is liable to tax therein by reason of his domicile, permanent residence, place of management or any other criterion of a similar nature*".

In the case in dispute, the gift would as such have been taxable in Sweden alone, as the donor had the center of his vital interests in Sweden at the time of the gift. However, since the abolition of inheritance and gift tax in Sweden in 2005, there is no longer any "residence" in Sweden within the meaning of Art. 4 (1) (b), (2) (a) of the tax treaty concluded between German and Sweden. According to the Supreme Tax Court, this provision refers to domestic law ("*under the laws of that State") to determine the "residency".* If - as in the case of dispute - Sweden does no longer levy the tax, there is also no "double residency" and no reason to assign the right of taxation to one of the two states. Thus, for determining the residency under treaty law, an existing national provision ("according to the law of that state") is required which draws a connection between the (unlimited) tax liability of the gift and the domicile or a similar stationary location of the donor.

In its contested decisions of 5 August 2020, the lower tax court had cited the case law of the Supreme Tax Court, according to which the "tax liability" referred to in the definition of residence under treaty law does not require that the income concerned in the individual case be actually subject to taxation in the state of residence. Rather, the abstract ("virtual") tax liability should be sufficient in this respect (Supreme Tax Court decision of 6 June 2012 case I R 52/22 regarding the tax exemption for distributions of a Luxembourg SICAV). However, according to the opinion of the Supreme Tax Court the difference to the case in dispute is that in the case decided at the time, a law had continued to exist under which the income of corporations resident in France was in principle subject to (unlimited) tax liability. If, however, the specific tax is abolished completely and without replacement in a contracting state, then there is neither an actual nor a notional or

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virtual tax liability in that state.

Update (27 May 2024)

A further constitutional complaint has been launched against the Supreme Tax Court decision **II R 27/20**, the proceedings are currently pending before the Constitutional Court under case no. 1 BvR 211/24.

Update (24 April 2024)

In the meantime, constitutional complaints have been filed against the rulings **II R 29/20** and **II R 28/20** of the Supreme Tax Court (pending under file no. 1 BvR 136/24 and 1 BvR 142/24 at the Federal Constitutional Court).

Source:

Supreme Tax Court, judgments of 24 May 2023 in cases II R 27/20, II R 28/20 and II R 29/20 – published on 12 October 2023.

Keywords

dual residence, gift tax