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No tax savings from rental of luxury properties

If a property with more than 250 square meters of living space is rented, losses incurred as a result of the rental cannot necessarily be offset against taxable income of the taxpayer. This was decided by the Supreme Tax Court in a case of rentals within the family.

Background

In the case of dispute, the married couple (plaintiffs) had acquired three residential mansions with a living space of more than 250 square meters each. They let the properties to their adult children for an indefinite period. The scheme gave rise to substantial annual losses of between €172,000 and €216,000. These losses were initially offset against the plaintiff's other taxable income. This resulted in considerable income tax savings. Following a tax audit, the tax office did not accept the losses. In the absence of an intention to generate income, the surplus income-related expenses claimed for the three properties in dispute were not to be taken into account.

The Baden-Württemberg Tax Court as court of first instance had dismissed the appeal as unfounded. The court saw no consistent intention to generate a surplus income.

Decision

In principle, the Supreme Tax Court agreed with the overall conclusion of the court of first instance.

A tax saving effect by offsetting of the losses from the rentals against other taxable income is not possible. If a property with a living space of more than 250 square meters is rented, the taxpayer must prove his intention to generate a financial surplus. If the taxpayer - due to the losses incurred over a longer period - fails to produce the necessary evidence, the rental activity is regarded as a private activity in which profits - and losses - have no tax effect.

With this decision, the Supreme Tax Court confirms its previous case law, according to which the letting of extravagantly designed or furnished premises (e.g., size of more than 250 square meters of living space; indoor swimming pool) cannot from the outset and automatically be assumed to be a taxable field of activity. These are properties for which the current market rent does not adequately reflect the special residential value and which could not recover the underlying costs associated with maintaining and letting of the object. Therefore, it must be regularly demonstrated that positive earnings can be achieved in the long-term and regularly over a 30-year forecast period.

As the specific assessment by the Baden-Württemberg Tax Court of the plaintiff's intent to generate income based on a total surplus forecast did not fully satisfy the requirements set by previous case law of the Supreme Tax Court the case had to be set aside and referred to the tax court for further investigations and final decision.

Source:

Supreme Tax Court judgment of 20 June 2023 (IX R 17/21), published on 16 November 2023.

Keywords

losses, property rental