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*German Tax and Legal News*

## **Munich court rules on taxation of pilots flying in national and international air traffic**

The tax court of Munich had to decide whether a pilot's foreign income can be exempt under progression or if a tax credit for taxes paid in Austria should be granted for German tax purposes.

In a decision dated 3 June 2014, the tax court Munich had to rule on whether a German pilot's foreign income qualifies for exemption with progression (i.e. the income is exempt but included for purposes of calculating the tax rates on the non-exempt income) or whether a credit for tax paid in Austria should be granted for German tax purposes.

### **Facts**

The plaintiff (pilot) in the case is a German national living in Germany, but employed by an Austrian airline. The plaintiff reported all of his employment income in his 2008 German income tax return as tax-free income. His income from the Austrian employment had been subject to tax in Austria. The German tax authorities took the position, however, that the income was fully taxable in Germany and issued a tax assessment notice.

The plaintiff filed an appeal with the tax authorities and applied for a tax exemption for all of his income in Germany. The German tax authorities initially received information from the airline that the pilot was flying in international air space, but ultimately it came to light that he also flew in Austrian air space. The tax authorities then issued an amended tax assessment that took the Austrian tax into account, but the appeal was rejected.

In an appeal to the Munich tax court the plaintiff took the position that only articles 15(1) and 23(1)(a) (dependent personal services and elimination of double taxation, respectively) of the Germany-Austria tax treaty were applicable because article 15(5) (the international traffic clause) would lead to unacceptable disadvantages, such as double taxation of the income (see discussion below).

He also emphasized that, under some of Germany's other tax treaties, the income of pilots residing in Germany who are employed by Belgian, British, Dutch and Swiss airlines is exempt from German taxation. To avoid the double taxation in his case, the German pilot would be forced to move to Austria. Furthermore, he argued that, in the reverse situation, income earned by pilots residing in Austria and working for a German airline would be tax-free in Austria and only considered for purposes of the progression clause.

The German tax authorities argued that article 15(5) is applicable to the extent the employment is exercised in international air traffic. They also pointed out that an allocation of income would be necessary on the basis of the flight times, and they calculated the portion of flight time in international air traffic as 76.6% of the pilot's total flight time. The authorities issued another amended 2008 tax assessment notice and considered 24.4% of the income as exempt with progression. A foreign tax credit was granted for 75.6% of the income.

### **Decision**

The tax court of Munich confirmed the tax authorities' approach.

According to article 15(1) of the Germany-Austria treaty, taxation rights are allocated to the country of residence, unless the work is performed in the other country. As a special rule, article 15(5) provides that income received for work performed on an aircraft operating in international air traffic may be taxed in the country in which the airline's registered office is located.

In the present case, Austria has the right to tax the employment income related to work performed in Austria (article 15(1)). Since the registered office of the airline is located in Austria, Austria also has the right to tax income related to work performed in international air traffic (article 15(5)). However, according to the wording of the treaty, Austria does not have the exclusive right of taxation of income related to work performed in international air

traffic.

To avoid the double taxation of income, the tax court of Munich referred to article 23(1)(b) (ee), under which taxes paid in Austria and that are related to income that can be taxed in Austria under article 15(5) may be credited against German taxes. If article 23(1)(b) is not applicable, the income is tax-free in Germany and can only be considered in determining the tax rate (i.e. exemption with progression).

The result in the case was that flight times, including ancillary activities such as briefings, ground times and closing operations after landing that relate to international air traffic, are taxable in Germany and a foreign tax credit for Austrian tax paid is available. Income allocated to flight times in Austrian domestic flights can be treated tax-free under the progression clause.

The tax court stated there was no unacceptable tax discrimination in the present case, and the fact that the tax exemption method may result in lower taxes in other cases is not relevant in the instant case and is a consequence of different tax rates applying in Austria and Germany. Additionally, since the provisions in a tax treaty are binding only on the contracting countries, it is irrelevant that Germany uses the tax exemption method to avoid a double taxation in its other treaties.

The tax court, therefore, held that the German tax authorities correctly issued an assessment notice by exempting the income related to domestic flights and granting a tax credit in Germany for the income related to international flights.

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