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 05.09.2016

German Tax and Legal News

BFH confirms relationship between tax treaty provisions and tax treaty override rule in domestic tax law

In a decision dated May 25, 2016, Germany's federal tax court (BFH) confirmed that the domestic tax treaty override provisions in section 50d (8) of the income tax code (ITC) that aim to secure Germany's taxation rights must be applied even if the relevant tax treaty entered into force after the domestic treaty override provision became effective. Although the BFH's opinion appears to be in line with a decision of the Constitutional Court issued on December 15, 2015 (see [Deloitte Tax-News dated February 19, 2016](#)), the BFH decision goes beyond the Constitutional Court's ruling.

The case involved a German resident individual who earned income from employment carried out in Germany and in Azerbaijan. Based on the relevant provision in the Germany-Azerbaijan tax treaty, the individual filed a tax return that granted an exemption from German tax on the employment income earned in Azerbaijan (taking the income into account only for purposes of determining the applicable German tax rate). The German tax authorities, however, applied section 50d (8) ITC, which includes an additional condition to qualify for an exemption from German tax under a treaty: the individual must produce evidence that the other state has waived its right to tax the income or that tax actually has been paid on the income in that other state. In the case before the BFH, the taxpayer did not provide such evidence and, therefore, the tax authorities treated the employment income earned in Azerbaijan as being fully taxable in Germany, despite the provisions in the Germany-Azerbaijan tax treaty.

The taxpayer took the position that the Germany-Azerbaijan tax treaty entered into force after section 50d (8) ITC was introduced into German tax law and that the domestic provision, therefore, does not apply to the treaty. The fact that the treaty does not include a specific subject-to-tax clause comparable to section 50d (8) ITC must be respected when considering the intention of the parties to a treaty entering into force after the domestic rule.

The lower tax court (decision of the lower tax court of Hamburg dated August 21, 2013) ruled in favor of the taxpayer and did not apply the domestic treaty-override.

The BFH, however, rejected the taxpayer's arguments and overruled the decision of the lower tax court. The BFH based its decision mainly on the grounds that the treaty override provision does not include any limitation regarding the application of the rule from a timing perspective. The statutory language explicitly provides that the provision must be applied irrespective of the provisions in a tax treaty. The fact that not all of Germany's treaties that entered into force after the domestic treaty override provision include specific subject-to-tax clauses cannot lead to a different conclusion.

The BFH notes that the general principle "lex posterior derogat legi priori" principle (a later law repeals the former law) that applies to ordinary domestic law does not apply in the case because no such intention of the legislator can be presumed when transposing the treaty into domestic law.

Although the case decided by the Constitutional Court concerned a tax treaty that entered into force before section 50d (8) ITC was introduced, the BFH decision now makes it clear that the domestic treaty override provision applies even to treaties that enter into force after the introduction of section 50d (8). The decisive factor for the BFH was that the German legislator included clear and unambiguous wording in section 50d (8) that the provision applies "notwithstanding any treaty provisions." This language does not allow scope for any limit on the application of the rule to treaties that entered into force before the treaty override provision was introduced.

The BFH decision highlights the need to analyze both the provisions of an applicable treaty and the domestic tax law of tax treaty partners.

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