

TAX INFO

Aktuelle Entwicklungen im deutschen Unternehmenssteuerrecht

Recent Developments in German Business Taxation



No. 34 | July 30, 2014

Prohibition of deduction of Trade Tax is constitutional

The legislative concept of the Corporate Tax Reform of 2008 justifies fiscally motivated individual provisions.

The first senate of the Federal Fiscal Court (*Bundesfinanzhof*, BFH) dealt with the consequences of the far reaching Corporate Tax Reform Act of 2008 in a judgment dated 17 January 2014 (I R 21/12) and declared the amended concurrence between trade tax, income tax and corporate income tax as compliant with the constitution. The Court's decision proves the broad tax legislative discretion of the German legislative body.

The Corporate Tax Reform aimed at making Germany more attractive to foreign direct investments and to reduce fiscal incentives to shift profits generated by German companies abroad. For this purpose, the corporate income tax rate as well as the trade tax base were reduced in order to allow for a nominal tax burden of business profits in an amount of approximately 30 %. With respect to partnerships, which are not eligible to profit from the tax rate reduction introduced by the Corporate Tax Reform, the Corporate Tax Reform provided for the possibility to credit almost the entire amount of trade tax paid against the income tax of the entrepreneurs. However, the reduction of the nominal tax rates was accompanied by a broadening of the tax assessment base: Apart from the introduction of the so-called interest stripping rules and add-back provisions, amendments were made to the concurrence of the income taxes. While the trade tax paid could originally be deducted as business expense and accordingly also reduced the tax assessment base for

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Should further analysis or explanation of the subject matter be required, please contact a member of our Tax team or the lawyer with whom you normally consult.

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income tax respectively corporate income tax, the Corporate Tax Reform introduced a prohibition of deduction of trade tax in Sec. 4 (5b) Income Tax Act (ITA).

Pursuant to the BFH, no constitutional doubts arise if trade tax is levied besides income tax or corporate income tax even if the tax burden stemming from one tax is not taken into account in assessing the other. Accordingly, the BFH stated that the crediting of trade tax granted previously was not constitutionally required but was rather a concession of the legislative body, which could be amended or even repealed.

Although the prohibition of deduction in Sec. 4 (5b) ITA results in a restriction of the so-called objective net principle, according to which only the difference between income and income related expenses may be subject to taxation, this restriction was held to be constitutionally justified. The reduction of the nominal tax rates accompanied by a broadening of the tax assessment base constitutes a legislative concept which allows for individual burdensome provisions for the taxpayer as, per example, the prohibition of deduction of trade tax. Furthermore, the prohibition of deduction of trade tax cannot be held unconstitutional just because some enterprises are subject to a very high trade tax burden – in the underlying case, the taxpayer claimed an effective tax burden of nearly 80%.

The trade tax continues to be of high relevance in practice. Often, the trade tax burden is even higher than the corporate income tax.

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