Convenience Translation -
Ruling by the Federal Ministry of Finance published 16 May 2011

Subj.: Rental Income pursuant to sec. 49 para. 1 no. 2 lit. f) aa) and sec. 49 para. 1 no. 6 Income Tax Act

Re: Federal Finance Ministry Circular dated 5 May 2011
IV C 3 – S 2300/08/10014

With reference to the results of the negotiations with the supreme tax authorities of the Federal States, the following rules are applicable for the tax assessment period 2009 for purposes of income determination within the meaning of sec. 49 para. 1 no. 2 lit. f) aa) Income Tax Act (ITA):

Accounting Obligations

1. Taxpayers subject to German limited tax liability, who lease out, rent out or sell immovable assets located in Germany, aggregates of things (*Sachinbegriffe*) or rights registered in a domestic public record or utilized in a domestic permanent establishment or other facility as part of their commercial activities, also generate business income from these activities within the meaning of sec. 49 para. 1 no. 2 lit. f) ITA, even if they do not maintain a domestic permanent establishment or have appointed a domestic permanent representative. For corporations subject to limited tax liability, which are comparable to domestic corporations or other legal persons within the meaning of sec. 1 para. 1 no. 1 to no. 3 Corporate Income Tax Act (CITA), the existence of relevant business income according to sec. 49 para. 1 no. 2 lit. f) sent. 2 ITA is assumed. Individuals subject to limited tax liability, who lease out or rent out immovable assets located in Germany, aggregates of things or rights registered in a domestic public record or utilized in a domestic permanent establishment or other facility as part of their non-business activities, generate income within the meaning of sec. 49 para. 1 no. 6 ITA.

2. According to sec. 138 para. 1 General Tax Code (GTC), the relevant local municipality is to be informed of the acquisition of an asset causing a tax liability pursuant to sec. 49 para. 1 no. 2 lit. f) ITA within one month after the acquisition (transfer of economic ownership). If the rental activities were already performed before the year 2009, the requalification of the previously non-business income into business income as of 1 January 2009 does not constitute a deliberate entrepreneurial decision. Thus, the continuation of the rental activities does not cause an additional (retrospective) notification obligation pursuant to sec. 138 para. 1 GTC.

3. The obligation for keeping accounts is based on sec. 140 and sec. 141 GTC. According to sec. 140 GTC, the keeping of accounts is required for taxation purposes, if the keeping of accounts is already required according to “legal provisions other than tax law”, whereas foreign legal rules may also cause the obligation for keeping accounts according to sec. 140 GTC.

   In case the taxpayer subject to limited tax liability exceeds one the thresholds stated in sec. 141 GTC, the tax authority in charge is to notify the taxpayer about the obligation for keeping accounts according to sec. 141 GTC. This notification must be issued at least one month before the beginning of the fiscal year as of which the accounting obligation is to be fulfilled (GTC Application Decree, no. 4 re sec. 141). This notification may occur by way of tax assessment or notice of assessment or in a separate administrative decision.

4. Further, the obligation for keeping accounts and other records according to sections 145 et seq. GTC as well as according to sec. 22 Value Added Tax Act (VAT Act) also have to be adhered to. The taxpayer's obligations to cooperate in this context are based on the general provisions of sec. 90 GTC.

5. The books and other records required must be kept and preserved in Germany (sec. 146 para. 2 GTC). Alternatively, the keeping and preservation of electronic accounts and other essential electronic records in another state may be approved under the requirements set out in sec. 146 para. 2 lit. a) GTC. For details with regard to the obligation of submitting books, records, deeds and other business papers see sec. 97 and sec. 200 GTC.

Profit Determination

6. If there is no obligation to keep accounts and if there is thus no actual keeping of accounts, pursuant to sec. 4 para 3 ITA, the profit maybe determined as excess cash of the business income above the business expenses.

7. In all other cases, according to sec. 4 para 1 ITA, the profit is uniformly determined as difference between the value of the net business assets at the end of the fiscal year and at the end of the previous fiscal year, increased by the value of the withdrawals and reduced by the value of the contributions. The fiscal year equals the calendar year, this also applies, if the taxpayer subject to limited tax liability should have abroad a business year deviating from the calendar year.

8. If, as a consequence of the change in tax law as of the assessment period 2009, the profit is determined according to the principles set out in ann. 7, an opening balance sheet has to be drawn-up. With regard to relevant assets and evaluation, see ann. 11. In such opening balance sheet, on the asset side only the assets mentioned in sec. 49 para 1 no. 2 lit. f) ITA, and on the passive side the liabilities linked to those assets are to be shown. Income and expenses economically allocable to assessment periods before 2009 are to be declared as rental income according to sec. 49 para 1 no. 6 ITA when actually earned or paid, provided this does not relate to a case of sec. 49 para 1 no. 2 lit. f) ITA in the version effective before the new rule (sale) entered into force.

9. A corporation within the meaning of sec. 2 no. 1 CITA, which is comparable with a corporation or other legal entity within the meaning of sec. 1 para 1 no. 1 to no. 3 CITA, only has one "business" within the meaning of sec. 4h para. 1 ITA. For equity ratio comparison test purposes according to sec. 4h para 2 sent. 1 lit. c) ITA the business comprises both the domestic as well as foreign business units of the corporation. For purposes of determination of the income (sec. 8a para 1 CITA), the entire scope of income according to sec. 49 para 1 no. 1 to no. 3 ITA has to be taken into account.

Assessment of Depreciation, Asset Evaluation

10. For purposes of assessing the depreciation as well as for the evaluation of the assets which generate rental income before 1 January 2009 according to sec. 49 para 1 no. 6 ITA and after 31 December 2008 income according to sec. 49 para 1 no. 2 lit. f) aa) ITA, the following rules are applicable:

11. Domestic immovable assets, aggregates of things (*Sachinbegriffe*) or rights registered in a domestic public record or utilized in a domestic permanent establishment or other facility, which were acquired or constructed after 31 December 1993 and before 1 January 2009 are to be evaluated pursuant to sec. 6 para. 1 no. 1, no. 1 lit. 1 a) and no. 2 ITA irrespective of the profit determination method with their acquisition or construction costs, reduced by the substance-related asset depreciation actually taken pursuant to sec. 49 para 1 no. 6 ITA. For assets within the meaning of sent. 1, which were acquired or constructed before 1 January 1994, instead of acquisition or construction costs, the fair market value (*Teilwert*) on 1 January 1994, reduced by asset depreciation taken in the period from 1 January 1994 until 31 December 2008 pursuant to sec. 49 para. 1 no. 6 ITA has to be used. Also after 31 December 2008, the initial acquisition or construction costs or the fair market value (*Teilwert*) on 1 January 1994 determine the base for the depreciation; due to the lack of a true contribution sec. 7 para 1 sent. 5 ITA is not applicable. Sec. 6 lit. b) ITA is not applicable due to the lack of a domestic permanent establishment (sec. 6 lit. b) para 4 ITA). Extraordinary write-downs according to sec. 6 para 1 no. 1 sent. 2 and no. 2 sent. 2 ITA are permitted in case of a profit determination pursuant to sec. 4 para 1, sec. 5 ITA.

12. As of the fiscal year 2009, depreciation on buildings has to be taken with 3 % p.a. (sec. 7 para. 4 sent. 1 no. 1 ITA), provided the other requirements of sec. 7 para. 4 sent. 1 no. 1 ITA are fulfilled (e.g. no residential use).

Taxation Procedure

13. The tax authority in charge of the region where the assets are located is responsible of the tax assessment (or rather, the assessment of withholding tax according to sec. 50 lit. a) para. 7 ITA). If the requirements according to sent. 1 are fulfilled by several tax authorities, the tax authority is in charge in whose region the most valuable portion of the property is located (sec. 19 and sec. 20 GTC).

    If in case of sec. 49 para. 1 no. 2 lit. f) ITA and sec. 49 para. 1 no. 6 ITA there is a central competence regarding the VAT assessment with respect to a foreign-based enterprise pursuant to sec. 21 para. 1 sent. 2 GTC in conjunction with sec. 1 of VAT competence regulation (*Umsatzsteuerzuständigkeitsverordnung)*, in order to avoid a differing competence for income and VAT taxation, an agreement pursuant sec. 27 GTC is generally to be aimed at, pursuant to which the tax authority in charge of income tax is also in charge for VAT (see GTC Application Decree re sec. 21 and sec. 27).

14. To insure taxation, the tax authority may, instead of assessing the tax prepayments, demand withholding tax according to sec. 50 lit. a) para. 7 ITA, to the extent the tax claim is deemed to be endangered.

15. The fulfillment of the requirements according to sec. 49 para. 1 no. 2 lit. f) ITA as such does not lead to the assumption of a domestic permanent establishment within the meaning of sec. 2 para. 1 sent. 3 Trade Tax Act (TTA). Thus, there is no trade tax liability of this income.

This ruling will be published in the Federal Tax Gazette, part I.

By order