

Ruling Clarifies Taxation of Rental Income Earned by Nonresidents

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On May 16 the German Federal Ministry of Finance published a public ruling on income from immovable assets, which is subject to nonresident taxation under section 49, para. 1 no. 2 lit. (f) of the German Income Tax Act.

Under the new rule, as of 2009 that income is deemed to be business income if it is earned by foreign corporations. The ruling explains the MOF's position on questions regarding the new income qualification.

German-source (deemed) business income can be determined using either the balance sheet (accrual) method or the cash method. The cash method is permitted only if the income or earnings don't exceed thresholds and the tax administration hasn't requested an accrual method profit determination. Once a taxpayer receives such a request, it must apply the accrual method as of the following year (ann. 3-7 of the ruling).

When the accrual method is first applied, an opening balance sheet must be prepared that shows the properties and allocable liabilities (ann. 8 of the ruling). The requirement to state "liabilities allocable to the properties" implies that the German tax administration also wants to tax gains generated by the waiver of debt. However, it is doubtful that Germany has a right to tax those gains when a tax treaty applies.

The last paragraph of the ruling states that the qualification as business income doesn't result in the assumption of a permanent establishment under the

German Trade Tax Act. Without such a PE, no German trade tax will be triggered.

A foreign corporation earning income from German properties will be regarded as having only one "business" under the interest barrier rule (ann. 9 of the ruling). Thus, the German interest barrier rule applies at the level of the foreign corporation.

The properties must generally be recorded on the opening balance sheet at their original acquisition or construction cost reduced by regular depreciation taken through 2008. As of 2009, the basis for the regular depreciation (generally 3 percent) should be only the original acquisition or construction costs (ann. 10, 11 of the ruling).

In determining accrual profits, extraordinary write-downs can be taken as of 2009 (last sentence of ann. 11 of the ruling) if requirements are met (for example, regarding fixed depreciable assets, the fair market value must be below 50 percent of the tax book value).

Rather than assess via tax prepayments the lessor's tax arising from its limited German tax liability, the tax administration may require the lessee to withhold the tax owed by the foreign lessor if it believes its tax claim against the lessor is at risk (ann. 14 of the ruling).

If the property was acquired before 2009, there is no obligation to notify the municipality (Gemeinde) under section 138, para. 1 of the General Tax Act, because a business or business income source has been established (ann. 2 of the ruling). ♦

♦ *Hardy Fischer, P+P Pöllath + Partners, Berlin*