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German Tax and Legal News

Constitutional court rules treaty override provision in line with the constitution

Legislature can introduce treaty override provisions that secure German taxation rights

In a decision dated 15 December 2015 (and published on 12 February 2016), Germany's constitutional court confirmed that the legislature can enact tax treaty override provisions that aim to secure Germany's taxation rights, despite treaty provisions to the contrary. The federal tax court (BFH) referred the case to the constitutional court in 2014.

Tax treaties in Germany are not "self-executing." For a tax treaty to become applicable, it must be transposed into German domestic law, which requires the consent of both the upper and lower houses of parliament. Once transposed, a treaty will have equal status with "ordinary" domestic tax law; in other words, the treaty will not supersede ordinary domestic law, or vice versa. Because of this equality of status, the prevailing opinion has been that the German legislature has the power to subsequently enact rules that override the provisions in Germany's existing tax treaties.

The BFH noted in its decision referring the case to the constitutional court that the interaction between tax treaty law and domestic tax law needs to be refined. According to the BFH, although a treaty and German domestic law rank equally, the negotiated provisions in a treaty limit the legislature's latitude to introduce measures that deviate from the treaty.

The case involved a German resident individual who earned income from employment exercised in Germany and in Turkey. Based on the relevant provision in the Germany-Turkey tax treaty that was in effect at the time, Germany granted the individual an exemption from German tax for the employment income earned in Turkey (such income could be taken into account only for purposes of determining the applicable German tax rate). Section 50d (8) of the German income tax code (which still applies) 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 Constitutional Court, the taxpayer did not provide such evidence and, therefore, the tax authorities treated the employment income earned in Turkey as being fully taxable in Germany despite the provisions in the Germany-Turkey tax treaty.

In its decision, the constitutional court makes a detailed analysis of the relationship between tax treaties and ordinary domestic law and concludes that tax treaties do not rank superior to ordinary domestic law. For ordinary domestic law, however, the "lex posterior derogat legi priori" principle (a later law repeals the former law) applies, which means that the legislator can unilaterally introduce rules that deviate from earlier provisions in a tax treaty.

It should be noted that one of the judges of the constitutional court disagreed with the other judges and published her dissenting opinion (although this opinion does not have any practical implications). According to the dissenting judge, the majority decision did not take into account that in today's globalized world relationships between states have become increasingly important and, therefore, the importance of agreements based on international law has increased significantly. Consequently, it no longer should be possible for single states to simply rely on domestic law to change or deviate from binding international agreements. Deviating from the terms of an international agreement simply by enacting conflicting provisions under domestic law should be unconstitutional.

The constitutional court's decision likely will impact several other similar pending cases in which the treaty-override provisions are at issue. The court is likely to reach the same conclusions in these cases.

The decision highlights the need to analyze both the provisions of an applicable treaty, as well as the domestic tax law of treaty partners.

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