Treaty Relief at Source for German Partnerships: Courts Adopt Different Positions in India and Korea (Rep.)

In this article, the author analyses the entitlement to treaty relief of German partnerships against the background of decisions in India and Korea (Rep.), and concludes that the Korean decision is in line with the prevailing opinion in Germany.

1. Introduction

In contrast to many other countries, German partnerships are widely used to do business and this practice is not restricted to small businesses. For instance, the German chemical and pharmaceutical Merck group was organized as a German general partnership until 1995. Although there is no German equivalent to a UK or a US limited liability partnership (LLP), a German partnership’s liability can effectively be limited, if a company, such as a Gesellschaft mit beschränkter Haftung (the equivalent to a UK limited liability company, GmbH) becomes the sole general partner of a Kommanditgesellschaft (a limited partnership, KG). Such an entity is referred to then as a GmbH & Co KG.

From a purely German perspective, the use of partnerships has a number of advantages. Although partnerships act on account of their partners, they can acquire assets and rights in their own name and can be sued. This is known as limited legal capacity and permits partnerships to do business like a company. On the other hand, partnership contracts can be structured flexibly, so that the entrepreneurial influence within a family can be balanced, and this makes the legal form of a partnership very interesting for family-owned businesses in Germany. This situation applies because various family members can become partners in the partnership, but typically the senior family member is the general partner or owns the company that is the general partner. In this way, the senior family member is entitled legally to manage and represent the partnership. If the partnership is to be transferred to the next family generation, the senior family member changes his or her status from general to limited partner and a more junior family member can become the new general partner.

In addition, under certain circumstances, employee co-determination rights in respect of partnerships are less onerous than for companies. This position applies specifically to the rights of employees to determine members of a supervisory board.

For income and corporation tax purposes, partnerships are transparent, and the tax losses generated by a partnership can be transferred to the partners by virtue of the general tax principles in Germany.1 This situation also applies to limited partners, as long as they are at risk of losing the contribution made or must make further contributions, i.e. at-risk rules.2 If partnership losses are not transferable to limited partners under the at-risk rules, they remain at partnership level and are carried forward indefinitely on the account of the limited partner. Moreover, profits not withdrawn from the partnership benefit from a reduced income tax rate of 28.25%.3

Where, however, a partnership established in Germany does business abroad, it is often difficult to obtain treaty relief outside the country. This situation may be because the tax authorities of other countries are not used to dealing with German partnerships or qualify partnerships as non-tax-transparent. Against this background, it is interesting to investigate how non-German tax courts deal with this question and, specifically, to analyse conflicting two decisions in India4 and Korea (Rep.).5

Conflicting foreign cases on treaty relief at source for German partnerships may arise as a result of how foreign courts understand the German trade tax. Consequently, it is necessary to start with an analysis of the nature of the trade tax (see section 2.).

2. The Nature of the German Trade Tax

The German trade tax is a non-personal tax levied on a stehender Gewerbebetrieb (standing trade or business), to the extent that it is run in Germany.6 Personal elements, such as a taxpayer’s ability to pay tax or a taxpayer’s tax residence, are irrelevant for trade tax purposes. Similar to rates, i.e. property taxes, trade tax is levied on a taxable object, namely, the trade or business, and no personal allowances are available. Although, currently, German trade tax has a number of income elements, it is not a tradi-

1. DE: Abgabenordnung (General Tax Code, AO), sec. 39 subsec. 2, no. 2; for trading partnerships together with the specific rule in DE: Einkommensteuergesetz (Income Tax Law, EStG), sec. 15, subsec. 1, no. 2.
2. Sec. 15a EStG.
3. Id., at sec. 34a.
4. See the decision of the Bombay High Court (BHC) in IN: BHC, 8 Jan. 2013, Director of Income Tax (International Taxation) v M/S Chiron Behring GmbH & Co., ITA No. 2273 of 2010, (2013), 15 ITLR 475, Case IBFD.
5. See the decision of the Korean Supreme Court (KSC) in KR: KSC, 26 Mar. 2015, Tiger Securitization Specialty Co Ltd v Chief of Yeoksam District Tax Office, 18 ITLR 2016, p. 543.

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tional income tax. This is evidenced by various disallowed business expenses, mainly related to the trade's financing. Furthermore, in the past, German trade tax also provided for the taxation of capital and wage elements. Consequently, the German standard official trade tax forms do not note a trade taxpayer's tax residence.

3. Entities Liable to Trade Tax

A trade or business is not a person, so no tax assessment can be issued to it. As a result, the legislation provides for a definition of a "taxpayer". This taxpayer is the entrepreneur who undertakes the trade or business. In the case of a partnership, the (co-)entrepreneurs would be the partners in the partnership. As, in practical terms, it may be difficult to issue tax assessments to all of the partners in a partnership with a trade or business, as an exception, the legislation provides that the partnership should be regarded as the taxpayer in respect of the trade tax.

Where a German general partnership and a German resident European Economic Interest Grouping (EEIG) derive income from overseas, their eligibility to treaty relief cannot depend on the person who coincidently must pay the partnership's trade tax. In addition, not all German partnerships pay trade tax. Where a partnership does not maintain a trade or business, but say, earns rental income or income from agriculture, in general, it is not subject to trade tax, unless it is deemed to have a trade or business. This topic is not dealt with in this article.

4. Foreign Tax Cases

4.1. The Indian case

In the Indian case, the Bombay High Court (BHC) in Mumbai had to deal with a German partnership that received royalty and technical services fees from India. The case was silent on the question as to where the partnership's partners were tax resident. A potential entitlement of the partnership's partners to treaty relief was not discussed either by the BHC.

The Indian tax authorities argued that the German partnership was not entitled to treaty relief, as a German partnership was not liable to tax in Germany. They did not distinguish between income tax and trade tax. The taxpayer argued that a German partnership had to pay trade tax.

The BHC concluded that the German partnership was entitled to treaty relief, as it paid trade tax in Germany because trade tax was covered by the Germany-India Income Tax Treaty (1995) and because the partnership was a German treaty resident person given its German trade tax liability. The German tax certificate provided by the partnership was regarded as evidence of the partnership's trade tax liability.

4.2. The Korean case

In the Korean case, the Korean Supreme Court (KSC) had to deal with a German partnership that owned all of the shares in a Korean company by way of a fully owned interposed German company. The Korean company paid a dividend to the German company and applied for a reduction of the dividend withholding tax to 5% under the Germany-Korea (Rep.) Income Tax Treaty (2000). The partners in the German partnership were resident in Austria, Germany and Luxembourg.

The Korean tax authorities argued that, under domestic Korean legislation, the German company was not the beneficial owner of the shares in the Korean company. This situation arose, as the German company was not capable of controlling and managing the shares in the Korean company. Effectively, the company was controlled and managed by the German partnership, as the only shareholder of the interposed German company.

The KSC took the view that the interposed German company did not have sufficient substance and, therefore, must be disregarded for the purposes of treaty relief. Then, the dividend was deemed to be paid to the German partnership as the 100% shareholder of the German company. Although the German partnership qualified as a corporation for Korean tax purposes under domestic Korean legislation, the withholding tax could not be reduced to 5%. In the opinion of the KSC, this position applied, as the partnership was transparent for German income and corporation tax purposes and its income was taxable in the hands of its Austrian, German and Luxembourg partners. Although the partnership paid local German trade tax, the KSC held that this state of affairs did not make the partnership a German resident person under article 4(1) of the Germany-Korea (Rep.) Income and Capital Tax Treaty (2000).

The KSC appeared to regard the partner's tax liability as irrelevant because trade tax is levied by the municipalities at non-uniform tax rates assessed by each municipality independently. According to the KSC, the German partnership was:

not liable to pay corporate tax pursuant to German corporate tax law and... only liable to pay trade tax under German Trade Tax Law (Gewerbesteuergesetz) based on the locational relation

7. Although the determination of the taxable income for trade tax purposes starts with the income determined for income or corporation tax purposes (section 7 of the GewStG), this starting base is adjusted by a number of add-backs and reduced by a number of items (sections 8 and 9 of the GewStG). These adjustments should result in taxable income for trade tax purposes independent of foreign income elements and individual factors, such as financing expenses.

8. Sec. 5 GewStG.

9. Apart from partnerships established under German commercial law, such as a limited or a general partnership, an EEIG can be established in Germany under EU rules to support the business of its members. From a German perspective, an EEIG is treated for legal purposes as a German general partnership. As the European rules provide that no taxes may be levied on an EEIG, as an exception to this exception, the members, i.e. the partners, of the EEIG are liable jointly and severally for the trade tax on the EEIG's trade or business.


12. Tiger Securitization Specialty Co Ltd (2013), supra n. 3.

such as address, which cannot be regarded as general tax payment liability, instead its partners are directly liable for general tax payment.14

The decision confirmed that treaty relief could be claimed to the extent the partnership’s partners were tax resident in Germany, though the decision was silent on the position of the Austrian and Luxembourg partners. Consequently, the Korean dividend withholding tax could be reduced to at least 15%15 for some of the partners.

This decision has already been analysed from the perspective of the concept of beneficial ownership under Korean law.16 However, in order to conclude ultimately whether a German partnership is entitled to treaty relief any analysis of these decisions should take into account the nature of the German trade tax.

5. German Tax Residence Certificate of Partnerships

The Indian BHC based its decision on a German tax residence certificate presented by the partnership (see section 4.1.). The official database of the German tax authorities permits applications for tax residence certificates to be made by individuals or corporations, but not by German partnerships. Nevertheless, in relation to an application for a tax residence certificate application, reference can be made to a specific partnership, if the German tax resident individual or corporation is a partner in the partnership.

It is not clear from the facts of the Indian decision how a German tax residence certificate could be presented by the partnership and what certificate was presented. Unfortunately, this certificate appeared to be one of the main decisive factors for the BHC’s opinion.


The decision of the KSC is in line with the prevailing view in Germany.17 The BHC was correct in saying that the partnership had to pay trade tax, but did not take into consideration the fact that this trade tax liability did not emanate from personal factors, such as personal allowances reflecting the specific situation of the taxpayer with regard to the family status and unusual obligations.18 As the Indian decision stands, it would result in an equivalent treatment of a personal and a non-personal tax liability, which is contrary to the clear wording of the Germany-India Income Tax Treaty (1995).19 However, both aspects cannot be mixed.20 This situation arises as the non-personal elements of the trade tax indicate that this tax is not comparable to a general income tax. The operation of a trade or business leads to a liability to trade tax. This position contrasts with treaty entitlement that attaches to certain persons by virtue of them, in their capacity as persons, being liable to tax. In other words, a liability to trade tax does not justify the treaty residence of an entrepreneur or a taxpayer.21

Unless specifically provided for in the relevant tax treaty, a German partnership is not entitled to treaty relief. A German partnership is not a person, which, under German law, is liable to trade tax in Germany by reason of its domicile, residence, place of management or any other criterion of a similar nature. However, it is liable to German trade tax, as with any other German or non-German entrepreneur, by reason of its German trade or business. A partnership cannot be a person resident in Germany for purposes of treaty relief. The reference to trade tax in article 2(3) (a) of the Germany-India Income Tax Treaty (1995) and the Germany-Korea (Rep.) Income and Capital Tax Treaty (2000) may be misleading. The clear wording in article 4 of both of these tax treaties should exclude German partnerships from treaty relief, as that article 4 requires that a tax liability arises by reason of personal factors that are irrelevant for German trade tax as a non-personal tax. As a result, the correctness of the Indian decision can be questioned. It may have led ultimately to the application of the correct tax rate, provided that all of the partners were treaty resident in Germany, despite the fact that, in general, India does not grant treaty relief to the partners of a fiscally transparent entity.

Although the inclusion of the German trade tax in German tax treaties does not entitle a German partnership to treaty relief, from a German perspective, nevertheless, this inclusion is important to ensure that Germany applies the tax treaty not only to income and corporation tax, but also to trade tax. This situation applies to both inbound and outbound cases. For instance, a foreign entity that has a representative office in Germany has no German trade tax liability, as such an office does not qualify as a permanent establishment (PE) under the tax treaty in ques-

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17. Disagreeing with the decision of the BHC, see W. Oepen & S. Münch, Die Gewerbesteuer als Türöffner zum DRA-Schutz? Zur Abkommensberechtigung deutscher Personengesellschaften unter dem DBA Indien, 18 Internationales Steuerrecht p. 55 (2009). The former president judge of the I. Senate of the German Bundesfinanzhof (Federal Fiscal Court, BFH), which is the Senate that deals with all international tax questions, described the treaty entitlement of German partnerships as an “advantageous thesis.” (See D. Gosch, Außensteuerliche Aspekte der Gewerbesteuer, Hefte zur Internationalen Besteuerung, Universität Hamburg, p. 3 (2013)).
18. For instance, the ESTG provides for child allowances (in section 32), allowances for disabled persons (in section 33b) and extraordinary expenses not incurring for the wide majority of other taxpayers (in section 33).
However, it would qualify as a German PE subject to German trade tax under domestic German legislation. On the other hand, the income of a German resident would also be tax exempt for trade tax purposes if exempt under the tax treaty.

The decision of the KSC is in line with the wording and the purpose of the Germany-Korea (Rep.) Income and Capital Tax Treaty (2000). It is also agreed that relief can be claimed under the Germany-Korea (Rep.) Income and Capital Tax Treaty (2000), to the extent the partnership’s partners are treaty resident in Germany.

An interesting follow-up question would be the extent to which reduced treaty dividend withholding tax rates could be claimed. Generally, dividend withholding tax is reduced to 15%. However, the rate is reduced to 5% under the Germany-Korea (Rep.) Income and Capital Tax Treaty (2000), where a German company owns at least 25% of the shareholding in the Korean company directly. So if in the Korean case, the German partnership had had a corporate partner owning at least 25% of the Korean company via the partnership, it would have to be decided whether this would qualify as a direct ownership in terms of the tax treaty. The KSC’s decision is silent on this question. The German tax authorities generally take the view that the interposition of a fiscally transparent partnership would make the shareholding an indirect shareholding. However, under article 1(b) of the Protocol to the Germany-Switzerland Income and Capital Tax Treaty (1971), as negotiated by the German tax authorities, there is an interesting, and conflicting, statement saying that, for the sake of clarity, it is noted that the participation in a company by way of a partnership does not preclude the assumption of a direct shareholding.

In contrast to the German tax authorities, the US Internal Revenue Service (IRS) do not regard the interposition of a fiscally transparent entity as harmful to a direct ownership as required under the Germany-United States Income and Capital Tax Treaty (1989) so as to be entitled to a lower dividend withholding tax rate:

Companies holding shares through fiscally transparent entities such as partnerships are considered…to hold their proportionate interest in the shares held by the intermediate entity. As a result, companies holding shares through such entities may be able to claim the benefits of subparagraph (a).

Consequently, it would have been of interest to learn the views of the KSC regarding this question.

\[\text{26. Convention between the German Federal Republic and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital ( unofficial translation) (11 Aug. 1971) (as amended through 2010), Treaties & Models IBFD.}\]


\[\text{22. OECD Model Tax Convention on Income and on Capital art. 5(4)(d) (21 Nov. 2017), Treaties & Models IBFD.}\]

\[\text{23. Sec. 12 AO.}\]


\[\text{25. Id., at art. 10(2)(a).}\]