COMMENTARY

The judgment is remarkable because it is the first expression of the Federal Fiscal Court's view on the international taxation of a private equity fund.

The case involves an outbound situation of two companies incorporated in Germany which were partners of an English limited partnership (E-LP). Yet, the assessment given by the court with regard to this structure is significant for inbound constellations, too.

Paragraphs [12]–[22] of the grounds for the judgment may seem confusing to international readers. The court clarifies in this passage that the limited partnership made commercial profits in the sense of art III(1) of the 1964/1970 German-UK DTT (which corresponds to art 7(1) of the OECD model treaty). This can be seen as undoubted from an international perspective. It is not crystal clear from a German point of view, though, because the German version of the treaty uses the term 'gewerbliche Gewinne' for 'industrial or commercial profits'. Under German national law this expression excludes profits from mere asset management (*Vermögensverwaltung*). Therefore, it is necessary for the court to decide that the activities of the limited partnership were not restricted to asset management but were commercial in the sense of the treaty. The court founds its opinion on the facts that the private equity fund was managed by very experienced persons who had been authorised to do financial transactions by the UK Financial Services Authority. Moreover, they got actively involved in the management of companies owned by the fund, which never held participations in companies longer than four years and had professional investors only.

At para [23] the Federal Fiscal Court explains that the limited partnership had a permanent establishment in the UK, because its management was operated by its only general partner GP-Ltd whose managing directors worked in the London office of EV-Ltd, a company which belonged to the same group as E-LP. Pursuant to art III(1) of the 1964/1970 German-UK DTT the UK as the source state had the right to tax commercial profits to the extent that they were attributable to the permanent establishment situated in the UK. According to the court's reasons at para [24] the UK taxing right extends to all profits received by the German partners through their interest in E-LP, because the specific articles of the treaty dealing with these types of income give priority to art III if the income is attributable to a permanent establishment in the source state (art VI(5) of the 1964/1971 German-UK DTT for dividends, art VII(5) for interest and art VIII(2) for capital gains from the alienation of movable property).

At paras [25]–[27] the court illustrates that Germany must observe the priority of art III over arts VI, VII and VIII, too, when it applies the methods for the elimination of double taxation. It has to apply the

a exemption method pursuant to art XVIII(2)(a) of the 1964/1970 German-UK DTT if the UK taxes commercial profits as the source state pursuant to art III(1). I shall refrain from commenting on the details of this passage because it refers to a controversy between German tax scholars and practitioners which is of minor interest for international readers.

b The tax court of Baden-Württemberg being the court of first instance in this case had decided on 11 May 2010 that Germany was not obliged to apply the exemption method because the income derived by the German partners of E-LP had not been taxed in the UK. However, at para [28] the Federal Fiscal Court set aside these reasons and re-established the principle c that the exemption method does not only prevent double taxation that effectively exists but also 'virtual' double taxation unless it is provided otherwise in the treaty (see no 34 of the OECD Commentary on arts 23A and 23B). In the 1964/1970 German-UK DTT Germany's application of d the exemption method only depended on UK taxation if income in the sense of art VIII(1) was concerned (ie capital gains from the alienation of immovable property). Since the partners in this case had not received such income, the Federal Fiscal Court holds that Germany is obliged to apply the exemption method notwithstanding the non-taxation in the UK. It e should be noted in this context that the new German-UK DTT which has been in force since 30 December 2010 contains an extensive 'subject to tax clause' requiring effective taxation in the UK for an application of the exemption method by Germany (art 23(1)(a) of the 2010 German-UK DTT).

f The final paragraphs refer to a subject to tax clause in German national law (s 50d(9) of the German Income Tax Act) which denies the application of the exemption method by Germany as the state of residence if the source state construes the treaty to exclude source taxation or to allow g reduced source taxation only. Since in the case at hand, the non-taxation in the UK was not caused by the UK's interpretation of the treaty but rather by tax benefits for the private equity sector that were granted by national law, the German subject to tax rule cannot be not applied.

Although the case at hand is about an outbound situation from a h German perspective, the implications of the court's verdict on inbound structures are being vividly discussed among German tax experts. If non-residents have an interest in a German private equity fund organised in the legal form of a partnership, it is likely given the court's statements that they have a permanent establishment in Germany. Therefore, they will i be subject to source-based income taxation which cannot be mitigated by a tax treaty because Germany has the right to tax profits attributable to the permanent establishment under art 7(1) of the OECD Model Treaty. Moreover, the fund itself will be liable to municipal trade tax which amounts to nearly 15% in many cities. Such rather heavy tax burden can

be significantly reduced if the fund carries out asset management only. Yet, since the Federal Fiscal Court made clear in its decision that it considers a typical private equity fund to make commercial profits it is obvious that sophisticated tax planning is necessary for the fund to remain within the borders of asset management.

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24 August 2011. The following judgment was delivered.

JUDGMENT

LEITSÄTZE

[1] Eine i.S. von § 15 Abs. 3 Nr. 2 EStG 1997 gewerblich geprägte Personengesellschaft erzielt nicht allein wegen der Prägung gewerbliche Gewinne i.S. von Art. III Abs. 1 Satz 1 DBA-Großbritannien 1964/1970 (Anschluss an die ständige Spruchpraxis des Senats).

[2] Ein in der Rechtsform einer britischen Limited Partnership geführter sog. Private Equity/Venture Capital Fonds kann nach § 15 Abs. 2 EStG 1997 gewerblich tätig sein und gewerbliche Gewinne i.S. von Art. III Abs. 1 Satz 1 DBA-Großbritannien 1964/1970 erzielen.

[3] Räumlichkeiten können auch dann eigene Betriebsstätten sein, wenn es sich hierbei um solche einer eingeschalteten Managementgesellschaft handelt und hierüber kein vertraglich eingeräumtes eigenes Nutzungsrecht besteht (Bestätigung des Senatsurteils vom 23. Februar 2011 I R 52/10, BFH/NV 2011, 1354).

[4] Einkünfte aus einer britischen Betriebsstätte sind auch dann nach Art. XVIII Abs. 2 Buchst. a i.V.m. Art. III Abs. 1 Satz 1 DBA-Großbritannien 1964/1970 von der inländischen Bemessungsgrundlage auszunehmen, wenn sie in Großbritannien aufgrund dortiger steuerlicher Subventionsmaßnahmen tatsächlich unbesteuert bleiben. Aus demselben Grund entfällt ein Besteuerungsrückfall nach Maßgabe von § 50d Abs. 9 Satz 1 Nr. 1 EStG 2002.

[5] Die Freistellung von der inländischen Besteuerung nach Art. XVIII Abs. 2 Buchst. a i.V.m. Art. III Abs. 1 Satz 1 DBA-Großbritannien 1964/1970 erfasst auch Dividenden, die aufgrund des sog. Betriebsstättenvorbehalts nach Art. VI Abs. 5 DBA-Großbritannien 1964/1970 im Quellenstaat als gewerbliche Einkünfte zu behandeln sind (Abgrenzung zum Senatsurteil vom 7. August 2002 I R 10/01, BFHE 199, 547, BStBl II 2002, 848).

TATBESTAND

[6] Es wird darum gestritten, ob die gesondert und einheitlich festgestellten Einkünfte der Klägerinnen und Revisionsklägerinnen