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## **Can anticipated income-related tax expenses of a student who is not subject to tax in Germany be claimed for a later employed activity carried out in Germany?**

by

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**Germany is trying to attract qualified foreign workers. But if such qualified employees then actually move to Germany and if they have previously completed a second study abroad, the question regularly arises as to whether these costs can still be claimed in Germany as (anticipated) income-related tax expenses?**

### **1. Starting position**

The initial case is not uncommon: Foreign students come to Germany to study here, often only after completing a initial Bachelor degree and subsequent employment in their previous home country. These students then often remain in Germany after completing their studies to pursue employment here. If the degree is a second degree, i.e. a master's degree that is subject to a fee, (anticipated) income-related tax expenses can regularly be claimed as part of (future) income from employed work.<sup>2</sup> If no or only little income is then achieved in the respective academic years, there is often a surplus of income-related expenses and thus a loss carried forward, which is used up in the first year of employment and leads to a corresponding tax refund.<sup>3</sup>

But what applies in comparable cases in which (foreign) students first complete a second course of study in a (European) foreign country and only take up domestic employment and thus a place of residence in Germany after completing their studies? Can anticipated income-related expenses also be claimed in Germany in these cases?

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<sup>2</sup> Section 9 (6) EstG, cf. on the master's degree as a second degree, BFH judgment of February 12, 2020, VI R 17/20, BStBl II 20, 719. In general, all educational measures that are acquired after completing initial training for a job or a first degree are training costs and lead to tax deductions if they are professionally required. This applies both to training costs for a second (new) job and to the costs of a second degree. This takes into account the changed labor market situation (keyword "lifelong learning"), which the Federal Tax Court took as an opportunity to change its case law (cf. BFH VI R 120/01 of December 4th, 2002, BStBl II 2003, 403).

<sup>3</sup> If it is only about a first training for a job / first study, expenses of up to EUR 6,000 can be claimed annually as tax deduction (Sonderausgaben), but the possibility of a loss carry-forward is not possible, compare Section 10 (1) No. 7 German Income Tax Code.



## 2. Anticipated income-related expenses under limited tax liability

Income-related tax expenses are to be deducted in the year in which they are paid. If costs for a second degree were incurred before the year of immigration to Germany, it should be checked whether an income tax assessment should be carried out for the academic years in which the income-related expenses were paid. As it is assumed that there was no domicile (“Wohnsitz”) or habitual abode (“gewöhnlicher Aufenthalt”) in Germany during these academic years and therefore no unlimited tax liability, it will have to be checked whether the income-related expenses can be claimed within the framework of the limited tax liability in Germany. Since there is no employer obliged to deduct salary taxes from the anticipated income-related expenses, the income will have to be assessed on application in accordance with Section 46 (1) No. 8 German Income Tax Code.

To this end, it will first have to be checked to what extent domestic income within the meaning of Section 49 (1) of the Germany Income Tax Act existed at all during the period of study and thus before the years of immigration to Germany. In most cases, it should be checked whether there is domestic income from employment at the respective payment date in the academic years, which also includes negative income.

Domestic income exists to the extent that, based on the year of expenditure, the activity is or has been carried out or realized in Germany. According to the interpretation of the German Federal Tax Court (“Bundesfinanzhof – BFH”)⁴, the provision could only affect income that is related to work that has been (physically) performed or utilized in Germany in the present or in the past, i.e. with an existing or past domestic employment relationship. This would not be the case since the anticipated income-related tax expenses relate to future employment in Germany. Although this treatment has so far only been indicated by the BFH, this view could already lead to the exclusion of the deduction of income-related expenses for years prior to moving to Germany.

However, even if one considers such a connection to be possible, the anticipated income-related tax expenses would have to be economically related to the subsequent domestic income. Case law⁵ regularly requires a specific link of the anticipated income to a specific (subsequent) activity in Germany. A sufficient connection is only likely to exist if, at the time the income-related expenses are incurred, there are already demonstrable efforts to find employment in Germany.⁶

## 3. Fictitious unlimited tax liability in Germany as a lifeline?

However, reference should be made to the possibility of fictitious unlimited tax liability upon application according to Section 1 (3) German Income Tax Code. In the context of unlimited tax liability, the world income principle apply, with the result that also all income-related tax

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⁴ BFH Urteil vom 27.04.2005, I R 112/04, BFH/NV 2005, 1756

⁵ BFH Urteil vom 27.04.2005, I R 112/04, BFH/NV 2005, 1756 (here also a discussion of the place of habitual abode); BFH Urteil vom 24.02.2010, IX R 57/09, BStBl II 2011, 405, FG München Urteil vom 27.07.2007, 8 K 3952/05, DStRE 2008, 601 (concerning a study in the USA after leaving Germany and return to Germany some years later after the studies were finished); FG Hamburg Urteil vom 09.03.2007, 6 K 96/05, EFG 2007, 1440 (concerning training as a pilot outside Germany which later worked in Germany); FG Hamburg Urteil vom 28.02.2006, VI 351/03, DStRE 2007, 204 (concerning a study in the USA with later work in Germany, room at German mother in Germany not sufficient for unlimited tax liability)

⁶ It could be sufficient to receive a concrete offer for future employment in Germany during your studies or, even better, to have concluded an employment contract for the period after completing your studies during your studies.

expenses are to be considered as a tax deduction.<sup>7</sup> If the students have little or no further foreign income during their studies abroad,<sup>8</sup> the route via fictitious unlimited tax liability appears to be a possible, albeit difficult,<sup>9</sup> way of taking losses into account, at least if the anticipated income-related tax expenses are to be treated as domestic income, because without the existence of any domestic income, the fictitious unlimited tax liability cannot be applied. As already explained before, this question has not been finally clarified if the anticipated income-related tax expenses to the later domestic income can be considered as domestic income in the respective years of payment.

It is therefore only sobering to state as an interim conclusion: In the clear majority of cases, the consideration of study costs as anticipated income-related tax expenses within the framework of limited tax liability or fictitious unlimited tax liability in Germany will fail due to the high hurdles formulated by case law. This is also because in practice the foreign students may not know during their academic years where and with whom they will ultimately find their first job.<sup>10</sup>

#### 4. Options to improve the tax deduction

Ultimately, the only option that remains is to point out that it could be advantageous for foreign students - for example as part of a (paid) internship during their studies<sup>11</sup> - to also work in Germany while at the same time establishing a German place of residence and paying any tuition fees preferably during this period of unlimited tax liability (or making a prepayment of their tuition fees at this time).<sup>12</sup> Alternatively, if payment is not possible during the unlimited tax liability period, the tuition fees should not be paid before but after the (interims) unlimited tax liability period. On the one hand, because at least in the calendar year of the temporary unlimited tax liability, the income from the period of limited tax liability must be included in the assessment, on the other hand, the argument of a link with domestic income from a past employment now also arises. This argument should be all the stronger if the student manages to receive an offer from the domestic employer for later employment in Germany after completing the domestic internship, so that payments may still be made during the time of the then limited tax liability up to the renewed unlimited tax liability. In general, it can also be said that at least a temporarily unlimited tax liability in Germany during the times of studies should be the best way to claim anticipated income-related tax expenses.<sup>13</sup> The situation is likely to be similar for German students who take a second degree abroad.

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<sup>7</sup> BFH Urteil vom 19.12.2001, I R 63/00, BStBl II 2003, 302

<sup>8</sup> In concrete terms, this means that the foreign income does not amount to more than the basic allowance (in calendar year 2023 EUR 10,908 for single person), which may have to be reduced according to the country group classification. Most relevant, for example, if the course is financed by a student loan and no income is generated during the course.

<sup>9</sup> A formal certificate from the competent foreign tax authority on the amount of foreign income is regularly required, i.e. a so-called zero certificate if no income was received

<sup>10</sup> But you may check if a loss carry forward is possible in the state of study similar to Germany, compare under Section 5

<sup>11</sup> Even better with an internship before starting your studies. It would also be conceivable – as far as possible – to pay the tuition fees in advance at the time of unlimited tax liability.

<sup>12</sup> The loss carry forward can then be utilized during the first years of unlimited tax liability and can be carried forward through the limited tax liability period by filing a limited tax liability tax return each year in order to ultimately use the loss carry forward during the second unlimited tax liability period, cf. Section 56 sentence 2 EStDV in conjunction with Section 10d (4) EStG.

<sup>13</sup> So a domicile (§8 AO) or habitual residence (§ 9 AO) in Germany, whereby this should only be unproblematic in cases in which no further (foreign) income is obtained worldwide, because of the fact that unlimited tax payors are taxable in Germany with their worldwide income if no tax treaty applies



## 5. The opposite case

Students who are pursuing a second course of study, such as a Master course, in Germany that is subject to a fee but who decide to pursue a professional activity outside of Germany after completing their studies<sup>14</sup> should apply for the determination of a loss carry-forward for the study period based on the above statements.<sup>15</sup> Although this loss carryforward initially has no further tax benefit, the loss carryforward can in principle be carried forward indefinitely and can then also be used to be set off against income from (much) later professional activity in Germany.

## 6. Conclusion

Germany is trying to attract qualified foreign workers. However, if (foreign) students do not come to Germany immediately for their second-degree studies, but first study at a (fee-based) university abroad to then pursue employment in Germany after finishing the studies, the deduction of anticipated income-related tax expenses for the time abroad, will in most cases fail. Although a (partial) deduction is possible through appropriate planning (creation of (partial) unlimited tax liability in Germany during the academic period), this will usually fail in practice because the vast majority of jobs after completing a degree abroad are more likely the products of a coincidence, rather than a career path that was planned from the outset.

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<sup>14</sup> And at best without a specific link during your studies to later employment abroad.

<sup>15</sup> It is necessary to submit a tax return every year in Germany for the period of limited tax liability, which, if no other domestic income is available, is ultimately only the declaration of the loss carry forward from the respective previous year in order to achieve another loss carry forward into the next year.