Downloaded from Blogs on 30.10.2026 09:48h

By PwC Deutschland | 05. Januar 2011

Disallowance of 5% of tax-free investment income constitutional

The Constitutional Court has held the blanket disallowance of 5% of dividends and capital gains realised by companies to be constitutionally acceptable.

Downloaded from Blogs on 30.10.2026 09:48h

Dividends and capital gains on the sale of shares are tax-free income in the hands of companies. The corresponding non-deductible expenses have been arbitrarily set at 5 per cent of the total receipt. Effectively, therefore, 5 per cent of the tax-free investment income is added back to accounting income in the tax computation as a non-deductible expense item. The Constitutional Court has now rejected a claim by a taxpayer to be allowed to reduce this add-back to the lower amount of directly connected expense actually incurred.

The court saw various legal supports for the present rule. At 5 per cent, the add-back was too low to sustain a charge that it threatened a taxpayer's ability to pay. There was no evidence that it was unrealistic as an average amount. As a simplification measure, it fell within the licence enjoyed by the statute setter to lay down lump sums and flat rates without regard to individual circumstances. The refusal to grant an option for individual taxpayers to revert to actual was constitutionally justified by the need for legal certainty, given that the actual allocation of, say, interest expense between tax-free and taxable income earning activities was not always clear. The fixed add-back also invalidated avoidance strategies, such as "ballooning", that is the accumulation of income of a subsidiary for years for later distribution in a single amount and so preserving the full expense deduction in the years in which no dividend was received. (AM)

Constitutional Court resolution 1 BvL of October 12, 2010 published on November 18

Schlagwörter

Tax-free investment income, add-back, blanket disallowance, non-deductible expenses