By PwC Deutschland | 18. August 2021

Statutory interest rate levied on late payment or refund of taxes unconstitutional

In a decision on two joint cases published today the Constitutional Court decided that interest incurred on late payment of taxes (back taxes) and the interest paid for tax refunds pursuant to Sections 233a and 238(1) sentence 1 of the German Fiscal Code is not in line with the German Constitution insofar as the interest rate is set at 0.5% per month and for interest periods from 1 January 2014.

Background

Interest at a rate of 6 per cent per annum or a half per cent for every month is levied on tax amounts paid late and in cases of a tax refund. The interest period does not start until 15 months after the end of the year of assessment (grace period).

The constitutional complaints relate to the assessment of late payment interest on trade tax following an external tax audit. The subject of the constitutional review is the interest period from 1 January 2010 through 14 July 2014.

Decision

Interest levied pursuant to Sections 233a, 238(1) sentence 1 Fiscal Code was initially constitutional. However, the provision is no longer compatible with the principle of equality under Art. 3(1) of the Basic Statute (*Grundgesetz*) insofar as an interest rate of 0.5% per month is applied to interest periods in 2014.

The Constitutional Court points out that under current law, taxpayers whose taxes are assessed after the expiry of the grace period of 15 months are treated different to taxpayers whose taxes are assessed within the grace period.

The assumption of the lawmakers at the time (i. e. when passing the Tax Reform Act 1990) that the interest rate of 6% p.a. reflects the potential advantage for the taxpayer from a late tax assessment was correct. The interest rate applied roughly corresponded to the relevant benchmark conditions on the money and capital markets.

However, despite the legislator's right to evaluate and estimate the applicable rate, interest at a rate of 0.5% per month can no longer be justified if the interest rate set in a standardized manner proves to be clearly unrealistic over the course of time and under changed market conditions and factual circumstances. In the opinion of the court this has been the case at least since 2014.

Following the financial crisis in 2008, an environment of structurally low interest rates has emerged which is no longer suitable to reflect usual interest rate fluctuations. This is foremost evident in the development of the base interest rate. While it was still over 3% in 2008, it fell rapidly to 0.12% in the course of 2009. Since January 2013, it has been in the negative range. Also, the discount rate varied between 2.5% and 8.75% during the fifty years of its existence and the base rate prior to 2009 ranged from 1.13% and 3.32%. This development indicates a low interest rate level that no longer reflects normal interest rate fluctuations but has been of a structural and sustainable nature since 2014 at the least.

The development of interest rates on the capital market shows a similar trend. In 2014, the annual 6% interest rate had already deviated and moved away from the actual market rate and was already roughly twice the highest credit interest rate that could still be achieved on the market.

For **interest periods up to 2013**, the statutory interest rate is increasingly less able to reflect the intended purpose of imposing late payment interest. However, for these periods, the interest rate is not obviously excessive in its effects. Nor does it violate the principle of proportionality in a narrow sense. The court concludes that, up to 2013, the low interest rate environment had not yet been so firmly established and manifested to assume that – as a rule - the statutory interest rate would appear to be obviously unrealistic.

Court provides guidelines for future course of action

The provision continues to apply to interest periods from 1 January 2014 through 31 December 2018 as otherwise - according to the court - considerable budgetary uncertainties would have to be expected. The legislator is not obliged to enact a constitutional provision retroactively. However, the provision remains inapplicable for interest periods 2019 onwards. The legislator is now required to introduce new provisions by 31 July 2022 which will then apply retroactively to all interest periods from 2019 onwards.

Takeaway

Assessments on late payment interest that have already been issued and are not final as being "subject to re-examination" (that is, subject to a future tax audit) with respect to interest periods from 1 January 2019 should be kept open by means of an appeal (either with the tax office or, as the case may be, with the competent regional tax court), provided that the interest assessment has not already been given a provisional notice with respect to the specific issue at hand, i. e. the interest rate on late tax payments.

Source:

Constitutional Court, decision of 8 July 2021 (in the joint cases 1 BvR 2237/14 and 1 BvR 2422/17), published on 18 August 2021; **press release** No. 77/2021 of 18 August 2021

Schlagwörter

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