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By PwC Deutschland | 30. September 2021

Statutory interest rate unconstitutional: Ministerial circular with guidelines for transitional period

The Federal Finance Ministry has issued a circular on the implementation of the decision of the Federal Constitutional Court of July 8, 2021 regarding the inappropriate statutory interest rate on late payment and refund taxes. The ministerial notice will have to be applied for the transitional period until retroactive new provisions on the interest rate pursuant to sections 233a, 238 (1) sentence 1 of the German Fiscal Code (AO) for interest periods starting on or after January 1, 2019 are in place.

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The decision of the Constitutional Court - Key points:

In a decision on two joint cases the Constitutional Court decided that interest at a rate of 0.5% per month and for interest periods from 1 January 2014 incurred on late payment or refund of taxes of taxes is not in line with the German Constitution.

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.

The **present provisions in Sec. 233a, 238 (1) Fiscal Code** with respect to the amount and calculation of interest **continue 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 provisions remain 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.

Interest levied on tax deferrals, tax evasion and suspension of enforcement is not affected by the decision. The same applies to litigation interest on reimbursement amounts, i. e. where an assessed tax is reduced, or a tax rebate granted by final and binding judicial ruling or because of such a ruling.

For a more detailed summary of the decision of the Constitutional Court we refer to our post in **Tax & Legal from 18 August 2021**.

Details of the ministerial circular – a brief overview:

According to the circular all first-time assessments of interest on back taxes and tax refunds for interest periods from 01 January 2019 are to be issued on a preliminary basis in accordance with Sec. 165 (1) sent. 4 Fiscal Code in conjunction with Sec. 239 (1) sent. 1 Fiscal Code. Scope and reason for the preliminary assessment shall be indicated (here: the pending legislative process as a result of the guidelines and standards set by the Constitutional Court).

After retroactive amendment of the law, as ordered by the Constitutional Court, the interest assessment shall be amended or declared final, as the case may be. The tax offices must proceed accordingly if interest assessments are amended or corrected based on Section 164 (2) Fiscal Code (“tax assessment subject to review”).

First interest assessments according to Sec. 233a Fiscal Code

All initial (first-time) assessments of interest on back taxes and tax refunds for interest periods beginning on or after January 1, 2019, shall be suspended.

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As a result of the suspension, interest on arrears or refunds accruing from January 1, 2019 will not be assessed. The suspended interest assessment must be issued later, i. e. as soon as the uncertainty has been eliminated by retroactive introduction of new provisions which are commensurate with the guidelines set by the Constitutional Court.

Assessments for interest on late payments or tax refunds due for interest periods up to December 31, 2018 shall be declared final. "*Interest periods up to December 31, 2018*" is meant to include any full month ending before January 1, 2019 at the latest.

Furthermore, the tax administration comments in more detail on various alternative scenarios such as:

In case of **amendments or adjustments of interest assessments** in accordance with section 164(2) Fiscal Code or if the proviso for review is withdrawn in accordance with Sec. 164(3) Fiscal Code, the amended or corrected assessment of interest shall be suspended for *interest periods from January 1, 2019* and in the amount of the reassessed interest.

As regards *interest periods up to and including 31 December 2018* the proviso of interest assessment will be withdrawn and the assessment declared final.

Out-of-court proceedings (objections, appeals): In cases of objections (appeals) against an interest assessment which the plaintiff claims to be unconstitutional with respect to the statutory interest rate the following shall apply:

Interest periods up to and including December 31, 2018: The appeal must be rejected as being unfounded.

Interest periods beginning January 1, 2019: Where the interest assessment has not been suspended or issued on a preliminary basis, the appeal will be suspended. Enforcement of the interest assessment shall also be suspended. Once the retroactive amendments, as specified by the Constitutional Court, are announced in the Federal Law Gazette, the out-of-court proceedings will continue.

Cases pending in court: If, at the time of publication of this circular, legal proceedings re. the question of the constitutionality of the interest rate are already in progress and pending before a regional tax court or the Supreme Tax Court, it will be up to the courts to suspend the proceedings and the enforcement of the interest assessment for interest periods from January 1, 2019.

Other interest

Interest on deferrals, interest on evaded taxes, litigation interest on amounts reimbursed or other interest calculated at the statutory rate of 0.5 % per month: If those interest amounts were assessed on a preliminary basis, they may only be declared final if requested by the debtor of the interest or if the interest assessment is to be withdrawn or amended for other reasons. If an appeal has been raised against such an interest assessment, the appeal shall be rejected as being unfounded.

The principles of this circular are to be applied with immediate effect.

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Source:

Federal Ministry of Finance circular dated 17 September 2021 (IV A 3 - S 0338/19/10004 :005), published on 28 September 2021.

Notes:

(1) *It remains to be seen if and to what extent the decision of the Constitutional Court has similar effects to other provisions of the tax codes where an interest rate of 6 % p.a. is used. One example might be the* ***tax accrual of pension provisions****. For tax accounting purposes pension provisions must be valued and taken up while using the standard actuarial interest rate of 6 %. The Cologne Tax Court considers the standard actuarial interest rate of 6 % applied for the calculation of pension provisions under Section 6a of the Income Tax Act in 2015 to be unconstitutional (decision of 12 October 2017, case ref.* ***10 K 977/17****). It has suspended the appeal and referred the matter to the Constitutional Court for that court to consider the constitutionality of the standard rate. The case is currently still pending before the Constitutional Court (case ref. 2BvL 22/17). A successful complaint would result in higher amounts being tax deductible, thus generating lower tax revenues.*

(2) *As far as* ***VAT*** *is concerned, the question is to what extent (and based on yet further conditions) the assessment of late payment interest is compatible with EU law. The ECJ has stated in several cases that - in the absence of relevant EU provisions - the assessment of late payment interest is a matter for the member states to decide. However, the principles of neutrality of VAT and effectiveness must be observed. Violations of these principles have not gone unchallenged in the past. For example, in its judgment of 15 September 2016 (****C-518/14****, "Senatex"), the ECJ has held that the levy of interest on arrears was not compatible with the principle of neutrality. Specifically, the case related to interest on an input tax deduction that had been claimed too early, because, in the opinion of the tax authorities, it was not possible to correct the invoice retroactively. The ECJ went on to say that correction of a formal error later must not lead to an interest charge or other burden, since there has been no loss to the state.*

Apparently, the ECJ has not yet had a chance to deal with the question whether the assessment of late payment interest as reprimanded by the Constitutional Court might be contestable under EU law. It cannot be ruled out, though, that based on the "Senatax" judgment and on other case law of the past he could certainly take this view.

Schlagwörter

late payment interest, statutory interest rate, tax refunds