By PwC Deutschland | 12 May 2011

Trade tax interest add-back not banned by directive?

An ECJ advocated general has suggested the court rule that the German trade tax interest disallowance is not a "withholding tax" banned by the Interest and Royalties Directive.

A German subsidiary borrowed from its Dutch parent. The loan remained outstanding for more than one year, leading to trade tax disallowance of 50% of the interest paid (the current rule is disallowance of one-quarter of all interest paid over €100,000). The subsidiary saw the additional burden arising from this disallowance as equivalent to a charge on loan interest paid to a parent, prohibited under the Interest and Royalties Directive. The advocate general on the case has now called upon the court to reject this plea, stressing that the Interest and Royalties Directive is solely concerned with exempting the income of the lender from withholding tax in the country of the borrower. Its object is to avoid legal double taxation from taxing the same income in both member states, and not to avoid the economic double taxation arising from a charge on the income of the recipient whilst disallowing the expense of the payer. It thus serves a different purpose than the Parent/Subsidiary Directive and the rulings on the provisions of that directive cannot be directly applied to the present case.

In the meantime, Germany has replaced her thin capitalisation rule with a disallowance of related-party interest in excess of 30% of EBITDA. This corporation tax disallowance has parallels to the trade tax disallowance here in dispute, although there are important distinctions. Thus, the final outcome of this case will be relevant to, though not necessarily decisive for, the corporation tax consequences of intra-group finance.

The ECJ case reference is C-397/09 *Scheuten* opinion of May 12, 2011

Keywords

interest, thin capitalisation, trade tax disallowance