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By PwC Deutschland | 20 July 2011

Discount of restoration provisions confirmed

The Supreme Tax Court has confirmed the validity of an Income Tax Act provision requiring that restoration and rebuilding provisions be discounted.

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Long term, interest free liabilities must be discounted at 5.5% p.a. until their anticipated maturity date. The same applies to provisions for long term obligations (with special rules for pensions). The Supreme Tax Court has now confirmed this rule in respect of the restoration provisions recorded by the operator of a rubbish dump.

The dump was expected to be full during 2015, at which time it would be closed to new intakes. Its operating company was under obligations on closure to recultivate the land on which the dump was situated and to restore an adjacent harbour and canal to their original condition. It set up provisions for the cost of meeting these obligations. The basis was full cost at current balance sheet date prices and the accrual period was set to end in 2015. The recultivation provision was accrued by use of the dump (rubbish intake) on the basis that the recultivation necessary was dependent on the amount of rubbish accepted. The harbour and canal restoration obligations were independent of, and unaffected by, dump usage and were therefore accrued straight-line over the dump's remaining useful life expected to end in 2015. The company then discounted its provisions in accordance with the Income Tax Act rule and at tax office insistence. However, it is not satisfied of the legal validity of the provision, largely in view of previous tax authority claims and court rulings that the then lack of a discount requirement was based on the need to avoid a current under-provision in the face of rising prices.

The Supreme Tax court has now confirmed the provisions as taken up. The accrual period – the expected period of active usage – was acceptable as was the basis of allocation – by usage for the usage dependent recultivation provision and straight-line for the rebuilding provisions. The court, though, added that the basis for calculating the expected future costs – current prices at balance sheet date – was also correct. Future price rises were future events and could not be taken up in accounts based on historical cost. From that point of view, the previous future price increase argument in justification of the then lack of a provision discount requirement was a fallacy and could no longer be regarded as valid. Rather, the court accepted the official explanation of the discount requirement when enacted – the need to avoid the creation of hidden reserves through over-provisions.

Supreme Tax Court judgment IV R 32/07 of May 5, 2011 published on July 20

Keywords

discounts, long term, provision