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By PwC Deutschland | 12 April 2012

Retroactive taxation of interest on refunds of non-deductible taxes unconstitutional?

In 2010 the Supreme Tax Court changed its position and ruled that interest on refunds of non-deductible taxes to be tax-free. In the meantime the court has again been invited to decide whether the subsequent retroactive change in law by the German tax administration to restore the old situation is in line with the constitution.

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In 2010 the Supreme Tax Court has revised its existing case law by holding the interest received on a tax refund to be tax free, if the underlying tax was not a deductible item. These are income and corporation taxes, and the VAT charge arising from the input tax on non-deductible business expenses or from drawings in kind. The interest received on refunds of these taxes continues to be regarded as investment income; however - according to the Supreme Tax Court - it is to be considered as falling under the specific Income Tax Act exclusion for the parallel expense item and therefore to be exempt.

As a result of this judgment the German tax administration amended the relevant sections in the Income Tax Act thus restoring the status quo prior to the court decision: Interest received on refunds of non-deductible taxes remains taxable as investment income with retroactive effect, as the subsequent adjustment of the statutes should apply to all open cases. This retrospective legislation was widely felt to be unfair. The principal issue has meanwhile been brought forward by taxpayers in two cases and is currently pending before the Supreme Tax Court. It is now with the court to decide if the retroactive change is in breach of constitutional law. In several resolutions the Supreme Tax Court has already granted taxpayers a stay of execution of the income tax due on the grounds of the retroactive amendment of the Income Tax Act, which it views as debatable. (mh)

Supreme Tax Court resolution VIII B 190/11 of December 22, 2011- published on February 15, 2012

Keywords

Retroactive taxation, interest, non-deductible taxes, refund