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By PwC Deutschland | 03 January 2013

No write-down of interest-free loan asset

The Supreme Tax Court has refused a company a write-down to current market value of an interest-free long-term loan asset on the grounds that ultimate repayment was not in doubt and that the value impairment was therefore only temporary.

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A company granted an interest-free loan to its subsidiary for a fixed term of nine years. It took up the asset as an investment at a discount of 5.5% over the agreed term. It saw this discount as a write-down to the current market value of an asset without earnings potential. The tax office refused to allow the discount as an expense, because the loan had not been granted at arm's length.

The Supreme Tax Court has confirmed the refusal of the expense, albeit for a different reason. It took the view that the loan could only be written down if the impairment in value was likely to be permanent. In the present case, though, there was no reason to doubt that the subsidiary would be able to fulfil its contractual repayment obligation at par on expiry of the loan term. Thus, any write-down at the start of the loan period would be followed by progressive write-backs in subsequent periods and there was ultimately no apparent risk of loss.

The company also failed with its call for parallel treatment with the required annual discount of 5.5% off non-interest bearing liabilities. The court held that that discount requirement was specific to liabilities and there was no legal requirement for similar treatment of assets. There was also no requirement for congruent treatment of the same item in the books of debtor and creditor.

The court did not examine the circumstances of the loan grant – arm's length or as a substitute for share capital – in view of its finding that temporary value impairment did not justify a write-down in any event. It should, however, be noted that the law has been changed in the meantime to exclude all bad debt losses on related-party debt of this nature. However, the finding holds good for third-party interest-free assets, such as in the field of customer finance.

Supreme Tax Court judgment I R 43/11 of October 24, 2012, published on January 2, 2013

Keywords

interest-free, loan, value impairment