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By PwC Deutschland | 16 April 2014

Interest limitation unconstitutional?

The Supreme Tax Court has granted a stay of execution because of doubt as to whether the interest limitation rule meets the constitutional requirement of equal treatment of like matters.

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A family-owned GmbH with a network of 13 foreign subsidiaries objected to the interest limitation rule as being in breach of the constitutional requirement for equality of taxation in like circumstances. This rule essentially disallows net interest expense in excess of 30% of EBITDA. However, it does not apply to businesses that are not members of groups and it also does not apply where the annual net interest expense is under €3 m. According to the official explanation at the time, it was introduced to replace the “thin capital” rule rejected by the ECJ in order to meet the same objective of countering the perceived abusive practice of shifting taxable income abroad through interest expense. However, it cannot openly discriminate against payments to institutions in other EU member states and thus applies to all interest payments regardless of the location of the recipient.

The Supreme Tax Court has confirmed in a resolution granting a stay of execution pending a final court decision that there is doubt as whether the interest limitation meets the constitutional requirement of equality of taxation. It applies indiscriminately, regardless of any suspicion, or even possibility, of abuse, and thus goes beyond what is necessary to achieve its legitimate object. Start-ups, companies in financial difficulties and interest paid to German lenders were quoted as examples. On the other hand, it does not apply to companies with a total interest expense of (now) less than €3 m or to businesses that are not members of groups. It therefore does not “catch” all possible abuses and may therefore be an unsuitable tool in respect of its stated object. The court also pointed out that its total revenue is only minor in relation to tax revenue as a whole and that only relatively few taxpayers are affected. Hence possible overriding considerations in the public interest lose their significance.

Supreme Tax Court resolution I B 85/13 of December 18, 2013 published on April 16, 2014

Keywords

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