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By PwC Deutschland | 10.02.2016

Interest limitation unconstitutional?

The Supreme Tax Court has requested the Constitutional Court to rule on the conformity of the interest limitation with the constitutional requirement to tax like circumstances alike.

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The interest limitation disallows net interest expense in excess of 30% of EBITDA. However, the rule does not apply to companies with a total net annual interest cost of no more than €3 m or to those that are not part of a group. There are also a number of other exemptions, but the overall effect is to render the actual impact somewhat arbitrary. In particular, the asserted purpose of the rule – prevention of profit shifts abroad through deliberate under-capitalisation of the German operation – seemed somewhat illusory to the Supreme Tax Court in the light of the relatively high threshold and of the indiscriminate application to cases without foreign connotations. The court also pointed out that interest, as such, is a legitimate business expense and that the limitation rule can penalise financing arrangements generally seen as reasonable. Start-ups and crisis management were quoted as examples.

Overall, the court found that the interest limitation rule does not meet the constitutional requirements of equal treatment and consistency of application. It has laid the question before the Constitutional Court for a ruling, together with a detailed explanation of its objections. These are a mixture of doubts on the legitimacy of some of the stated aims of the rule and on its suitability as an instrument in meeting others that are legitimate.

Supreme Tax Court decision I R 20/15 of October 14, 2015 published on February 10, 2016

Keywords

EBITDA, interest expense, interest limitation