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Loan and accumulated interest separate debts

The Supreme Tax Court has held that a refusal to recognise a related party loan write-off, does not preclude the tax office from treating the write-off of the accumulated interest as a further hidden distribution.

A GmbH made a loan at a market rate of interest to relative of its sole shareholder. The interest accumulated on a separate account. No attempt was made to pay the interest or repay the principal and the GmbH wrote off both balances five years after granting the loan. The tax office took the view that the loan had not been granted as a commercial transaction, that repayment had never been seriously intended or expected and that both write-offs were to be disallowed as "hidden distributions". The GmbH accepted the finding in respect of the principal, but disputed it in respect of the interest. If the loan had not been meant seriously, no interest should have been charged and no write-off would have been necessary. However, the Supreme Tax Court has now held in favour of the tax office. The loan agreement was a legally valid document, governing both the loan itself and the interest to be charged thereon. Nevertheless, the two were separate liabilities, so that the tax disallowance of the one did not preclude tax recognition of the other. Thus the interest taken to income before the write-off remained taxable and the subsequent write-off of the accumulated balance remained disallowable as a hidden distribution.

Supreme Tax Court judgment I R 5/14 of November 11, 2015 published on March 30, 2016

Keywords

accumulated interest, debt, write-off