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By PwC Deutschland | 24 May 2019

State of Lower Saxony Tax Authorities issue directive announcing deviation from the rule of discounting certain liabilities during low- /negative-interest phases for banks

According to Section 6(1) no. 3 Income Tax Act, non-interest-bearing liabilities with terms of at least 12 months, which do not constitute a deposit or advance payment, are to be discounted, i.e. a fictitious interest component (interest rate 5.5%) is initially deducted from profits and added back to profits in subsequent years as notional interest over the term of the loan.

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The directive states that, for certain liabilities of banks, no discounting within the meaning of Section 6(1) no. 3 Income Tax Act should occur.

The reasoning given in the directive – with reference to the circular of the Ministry of Finance dated 26 May 2005 (BStBl. I 2005 S. 699) - is that during a phase of low or negative interest rates, the banks are subject to certain other economic disadvantages, which are comparable to a charge to interest.

This deviation from the general rule should apply to the following liabilities:

1. Loans received by banks from the central bank

For banks, loans received from the Central Bank are from an economic point of view equivalent to interest-bearing loans, because, inter alia, the credit institutions must provide collateral in the form of securities, which then can no longer be used elsewhere. The zero interest rate was imposed by the European Central Bank (ECB), so cannot be avoided by the banks, if they want to participate in the Euro-system. The low interest rate is passed on to the customers.

2. Onward-lending provided by the banks for selected investment projects (e.g. residential construction) received from development banks

The low-interest advantage is also passed on to the customers in the case of development loans.

3. Customer deposits

For customer deposits, the respective bank must hold a so-called minimum reserve with the central bank, thereby currently paying a negative interest rate.

The German banking industry has been informed accordingly.

Source:

Federal State Tax Authorities of the Lower Saxony, Directive of 02.05.2019 – published on 17 May 2019 (DB1305111)

Keywords

banks, discounts, fictitious interest, liabilities