Downloaded from Blogs on 08.11.2026 19:27

By PwC Deutschland | 23 June 2025

Compensation payment in connection with interest rate swap not deductible as business expense

In a most recent judgment, the Supreme Tax Court clarified that compensation (settlement) payments in connection with an interest rate swap may be deducted as business expenses if they are used to hedge an operational interest rate risk. However, this requires that the business loan and the interest swap transaction are exactly or at least approximately matched in respect of their content (portfolio, volume, term and amount).

Downloaded from Blogs on 08.11.2026 19:27

Background

The tax courts had to decide whether expenses incurred in connection with financial futures transactions are deductible as operating expenses when determining the taxable income from agriculture and forestry in 2012 (the year of dispute).

The plaintiff intended to significantly expand his successfully managed winery. The financing was to be provided mainly through borrowed capital. To secure the existing interest rate level for the costly expansion of the business, the plaintiff concluded two (forward) swap agreements with two banks in 2011 and in 2012, which involved the exchange of a fixed interest rate (payable by the plaintiff) for a variable interest rate (payable by the bank) and based on a fixed capital amount. The second forward transaction was guaranteed by a third bank.

The plaintiff paid the costs from the swap contracts from his private account. He had not recorded the quarterly compensation payments from the swap agreements and the guarantee commissions in his current accounts. The corresponding payments were only later recorded as a business contribution while setting up the annual financial statements (in 2013 and 2015).

Due to circumstances beyond the plaintiff's control, the construction of the new business premises could only start in 2015. At this time, however, the market interest rates had fallen contrary to the previous forecast prompting the plaintiff to cover its financing requirements - without recourse to the swap agreements - by taking out low-interest loans from other banks. The plaintiff claimed the quarterly compensation payments to be made under the swap contracts and the guarantee fee as business expenses from his income from agriculture and forestry.

However, the tax office saw the swap contracts as not being connected with the plaintiff’s business and instead attributed the results of the forward transactions to income from capital investments (capital gains). As a result, the expenses (losses) had no tax effect in the year in dispute, as they could only have been offset against gains from the same type of income. Taxable capital investment income had not been incurred by the plaintiff in the year in question.

The plaintiff's appeal before the tax court of first instance (Tax Court of Rhineland-Palatinate) was not granted. The tax court concluded that there was no direct close economic connection between the swap payments and the loans. Due to the large time lag between the conclusion of the transactions (several years) and because of the lack of sufficient correlation between the transactions it was not possible to establish with enough certainty that the compensation payments and the guarantee commissions were made for predominantly business reasons.

Decision

The appeal of the plaintiff was also dismissed by the Supreme Tax Court, albeit for

Downloaded from Blogs on 08.11.2026 19:27

different reasons.

According to the Supreme Tax Court it could be left open whether the interpretation of the tax court regarding the time gap which could not be established beyond doubt and the incongruence between the (forward) swap contracts and the loans taken out later stood up to further examination or whether the court's interpretation here was too restrictive.

The deduction oft he compensation payments as business expenses was in any case not possible because the plaintiff had not recognized the current swap payments as operating expenses in the current accounts in a timely manner,- i.e. already upon preparation of the annual financial accounts during the year. This applies in particular if - as in the case of dispute - the underlying loan transaction took place some considerable time after the interest rate hedging transactions (i. e. in 2015 and 2016).

Therefore, it could not be precluded that the interest rate swaps were initially intended for private speculation or gambling ("interest rate bets") and were only assigned to the business sphere to „optimize the tax situation". The expenses from the swap contracts were initially paid from the client's private account and only later recorded as a business contribution.

The Supreme Tax Court also took the opportunity to comment in general on the deductibility of compensation payments in case of interest swaps.

The Supreme Tax Court, first, clarified that compensation payments to settle interest rate swaps may be deducted as business expenses if they are used to hedge an operational interest rate risk. However, this requires that the business loan and the interest-hedging swap transaction are exactly or at least approximately matched in respect of their content (portfolio, volume, term and amount).

If, as in the case of dispute, payments for a forward swap are intended to secure a (supposedly) favorable interest rate for a loan that will only be required later, it is sufficient that the interest rate hedge and the subsequent loan agreement are credibly based on a uniform financing concept because in such a case - unlike with contracts which are concluded at the same time - the (current) interest rate hedge and the (subsequent) loan cannot, by their very nature, be precisely tailored to each other in terms of their content. It cannot be ruled out that the initial economic situation and the financing requirements may change after the conclusion of the swap transaction due to circumstances that cannot be influenced until the time the loan is taken out. To ensure that a swap transaction has not been concluded for speculative and therefore non-business reasons, it is necessary that it is treated by the taxpayer as a business transaction from the outset.

Source:

Supreme Tax Court decision of 10 April 2025 VI R 11/22 - published on 20 June 2025.

Downloaded from Blogs on 08.11.2026 19:27

Keywords

compensation payment, interest swap