
Tax High Court considers Interest Capping Rules unconstitutional; now pending at the Constitutional Court

February 2016

In brief

The German Fiscal High Court (BFH) held in a decision that the interest capping rules could be unconstitutional and has referred this question to the Constitutional Court (BVerfG). The decision will take probably another 2-3 years and may or may not lead to a non-applicability of interest capping rules (and the related limitations in interest expense deductions) either retroactively or only for future years. For the time being the rules remain applicable but taxpayers should ensure to keep tax assessment notices open.

Court decision

In a decision dated 14 October 2015 (BFH I R 20/15), which was published on 10 February 2016, the German Fiscal High Court stated that the interest capping rules could infringe the German constitution in various instances and referred this question to the Constitutional Court (which is the only court that can decide upon whether a law is in line with the German constitution).

What does this mean?

Generally, interest capping rules limit the tax deductibility of net interest expenses to 30% of the taxable EBITDA with certain exemptions (i.e., EUR 3m de-minimis rule, stand-alone and equity escape clause). The various other limitations on the deductibility of interest expenses are not affected by this decision.

The Constitutional Court now needs to decide on whether the interest capping rules are in line with the constitution. A decision of this Court is expected to take another two to three or even more years. The outcome remains open at this stage. Even if the Constitutional Court should decide that the interest capping rules are unconstitutional it depends on the exact verdict whether the rules are retroactively not applicable at all,

or to be amended or whether the Court only requests the legislator to revise the laws with future effect within a certain time frame.

From our experience in the past, the Constitutional Court however rarely considers a tax law completely unconstitutional with retroactive effect (in which case the limitations on the interest deductibility under these rules would be overturned) but rather grants a certain time period to revise the laws.

What to do?

The current version of interest capping rules remain applicable for the time being. A taxpayer who is affected by current interest capping limitations should however ensure that the respective tax assessment notices can still be amended in the future: This could be due to the fact that the assessment notice has been issued as a preliminary one anyway ("Vorbehalt der Nachprüfung") or due to an appeal to be raised by the taxpayer (together with a request for a suspension of enforcement) in respect of the pending decision at the Constitutional Court; details to be discussed with your tax advisor.

For any questions, please do not hesitate to contact anyone listed below.

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