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German Tax and Legal News

BFH allows limited offsetting of interest expense and income in cash pool arrangements for trade tax purposes

Negative cash balances cannot be offset by future positive cash balances.

Germany's federal tax court (BFH) issued a decision dated 11 October 2018 that was published on 6 March 2019 in a case where a German company participated in a cash pooling arrangement with its foreign parent company, under which cash balances were recorded on a daily basis as either receivables or liabilities against the cash pool leader. Interest at a rate of 5.5% was calculated on the cash balances and booked on a monthly net basis, either as income or an expense. The BFH overruled a decision of the lower tax court of Lower Saxony (dated 14 September 2017), holding that the German trade tax rules generally do not prohibit the netting of interest income and interest expenses under a cash pooling arrangement, although there are some limitations.

German trade tax rules require the addback of 25% of interest expenses incurred in excess of EUR 100,000 to the trade tax basis. The municipal trade tax applies in addition to the federal corporate income tax (which is 15.825%, including the solidarity surcharge) and ranges between 7% and 17%, depending on the municipality. As a result, the trade tax can account for more than half of the overall tax on corporate profits. If interest expense can be netted against interest income, this could reduce the amount of the addback and, consequently, the amount of a taxpayer's trade tax liability.

The BFH, in general, upheld its long-standing jurisprudence, under which the netting of receivables and payables for trade tax purposes is possible only in cases where the receivables and payables are similar, they serve the same purpose and they are offset against each other on a regular basis.

The BFH confirmed that these principles apply to all sort of loan arrangements in general, and to cash pooling arrangements in particular. In its decision, the BFH explained that the cash pool receivables/payables were similar, as they triggered the same interest rates and were granted based on the same terms and conditions. They also served the same purpose, as the purpose of the arrangement was to provide liquidity to the group and optimize interest and financing conditions. The court confirmed that, based on the specifics of the case, the payables and receivables resulting from the cash pooling arrangement actually were offset against each other at the end of the company's fiscal year.

In its decision, however, the BFH ruled out the possibility of netting a negative daily cash balance against positive cash balances recorded in the future; in contrast, netting a positive daily cash balance against negative cash balances recorded in the future should be possible. A negative daily balance may be netted against a positive balance accumulated in the past, but it should not be possible to offset a negative balance with retroactive effect by a positive balance recorded in the future. This can be of relevance, e.g. in a situation where a taxpayer has a positive balance for the calendar year overall, but this positive balance is a result of a negative balance as of a date in the first half of the year and an excess positive balance by the end of the year. In such a case, it should not be possible to offset the positive and negative balances and to disregard the negative balance of interest expense in the first half of the year for trade tax purposes.

Taxpayers that want to take advantage of the tax court decision would need to carefully monitor their overall balance resulting from cash-pooling arrangements.

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