

BFH rules on constitutionality of discount rate for non-interest-bearing liabilities

BFH considers 5.5% discount rate for long-term liabilities in 2010 to be in line with constitutional principles.

In a decision dated 22 May 2019 and published on 10 October 2019, Germany's federal tax court (BFH) ruled that the 5.5% statutory discount rate applied to long-term non-interest-bearing liabilities in 2010 is in line with constitutional principles. The application of a discount factor to such liabilities results in taxable income for the debtor at the time the liability comes into existence, and (tax-deductible) deemed interest expense in the subsequent years over the term of the liability/loan.

In the case before the BFH, the taxpayer had argued that, based on the prevailing low market rates in 2010, the 5.5% discount rate applied by the German tax authorities on a long-term loan he had obtained in 2010 on a non-interest-bearing basis was not in line with the German constitution. The taxpayer had filed an objection against tax assessment notices, also arguing that a 1% rate should be applied instead of the statutory 5.5% discount rate because the terms and conditions of the loan agreement had been changed with retroactive effect for the relevant year.

The German tax authorities and the lower tax court of Cologne rejected the taxpayer's objection against the 2010 tax assessment notices, with the lower court pointing out that an amendment of underlying terms and conditions of a loan agreement cannot be made on a retroactive basis, but only for future tax years. The case was then brought before the BFH.

The BFH ruled that the annual 5.5% discount rate is compatible with market rates for 2010, which, according to the court's view of the relevant market rates, amounted to approximately 4%. Therefore, the BFH determined that the 5.5% rate is constitutional for 2010.

It should be noted that the BFH did not issue a final decision on whether the 5.5% discount rate for long-term non-interest-bearing loans during 2010 is constitutional, but referred the case back to the lower court for further examination of another issue. However, it is likely that the lower court, or ultimately the Federal Constitutional Court (BVerfG), will have to rule on the constitutionality of the annual 5.5% discount rate applied to long-term non-interest-bearing liabilities in the near future.

The BFH and lower tax courts have ruled on the constitutionality of statutory interest rates in previous cases. In a 2014 decision on the 6% annual interest rate on additional tax payments, the BFH confirmed that the rate was constitutional for the period at issue (the period up through March 2011). However, the BFH indicated that the legislature may need to adjust the rate if the market rate has changed significantly and there is no indication that the rate will return to the level that prevailed when the rate was introduced into the tax code in 1961 (see [GTLN dated 11/10/2016](#) and [GTLN dated 08/10/2014](#)).

In a decision dated 9 November 2017 concerning the annual 6% interest rate applied to additional tax payments in 2013 (see [GTLN dated 03/06/2018](#)), the BFH took the position that the 6% rate was compatible with market rates, which, according to the court's view of the relevant rates, ranged between 0.15% and 14.70% for that year. Therefore, the BFH determined that the 6% rate was constitutional for 2013 (see [GTLN dated 06/03/2018](#)). The BFH's May 2019 decision on the 5.5% discount rate for long-term non-interest-bearing loans during 2010 seems in accordance with the November 2017 decision.

However, it should be noted that in a decision dated 25 April 2018 with respect to a more recent period, the BFH took a different view. It determined that the 6% interest rate on tax

payments is no longer realistic and equitable for the period from 2015-2017, given the structural and solidified low interest market rates during more recent years (see also [GTLN dated 05/18/2018](#)). In the decision, the BFH considered the interest rate an unsubstantiated surcharge on tax payments. However, the BFH did not issue a final decision on whether the interest rate is unconstitutional because that is the responsibility of the BVerfG. In light of several other cases referred to the BVerfG, it is likely that the court will have to rule on the constitutionality of the annual 6% interest rate on tax payments in the near future as well.

In addition to the decisions of the BFH concerning the 6% interest rate applied on tax payments, the lower tax court of Cologne held that the 6% interest rate used to calculate pension liabilities, which generally results in a low recognition of pension accruals for German tax purposes, violates constitutional principles (see [GTLN dated 10/26/2017](#)). The tax court, therefore, initiated a procedure before the BVerfG on the constitutionality of the 6% interest rate applied to pension accruals, and the case is currently pending before the BVerfG.

Affected taxpayers should monitor these developments and analyze in more detail whether relevant tax assessments should be kept open.

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