

## **Federal tax court confirms constitutionality of interest rate applicable to tax payments/refunds**

On 1 July 2014, the Federal Tax Court (BFH) confirmed that the 0.5% monthly interest rate that is applied on tax refunds/payments does not violate German constitutional principles. The taxpayer argued that the interest rate imposed on him while the tax payment was suspended during a court proceeding is not in line with economic reality and that the legislator should be required to adjust the rate to (lower) market rates.

Under German tax law, interest on tax payments and refunds apply in certain cases. The interest rate, which is prescribed by law, is 0.5% per month. The rate has remained unchanged since it was introduced in 1961.

The taxpayer argued that the interest rate should be adjusted periodically to reflect market rates. Based on earlier BFH decisions, the taxpayer argued that the purpose of the interest applied in his case (interest on tax payments that are suspended while a court proceeding is pending) is to siphon off any benefits that are obtained from using funds that belong to the tax authorities while the court proceeding is pending. As a result of the low market rates, the taxpayer was never able to achieve such benefits (by investing the amount of the tax finally owed) and, therefore, the application of a "fixed" interest rate as prescribed in the code is not in line with constitutional principles.

The federal tax court disagreed, concluding that the tax legislator is free to treat different fact patterns on a standardized basis and that the legislator is not required to take into account the particular facts of each case. For practical purposes, the legislator can set an interest rate without having to constantly adjust the rate to market rates.

In its decision, the BFH noted that the legislator may be required to adjust the interest rate if the market rate has changed significantly and there is no indication that the rate will return to the level that was in place when the prescribed rate was introduced into the tax code. However, the BFH stated that was not the case for the period at issue (the period up through March 2011), but the court left it open whether such a situation subsequently arose due to the consistently low market interest rates.

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