

# GMS Flash Alert



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## Germany – Constitutional Court: 6% Interest on Back Taxes, Refunds Unconstitutional

The German Constitutional Court announced its decision<sup>1</sup> that the current statutory **interest rate of 6 percent on back taxes and tax refunds has been found to be unconstitutional** in a press release on 18 August, 2021<sup>2</sup>.

The underlying decision affects the calculation of interest on income tax as well as corporate tax, VAT, and trade tax. For interest periods as of 2019, the interest rate must be adjusted.

### WHY THIS MATTERS

The assessment of interest rates can be both to the benefit and to the disadvantage of the taxpayer. Where a tax assessment leads to the taxpayer owing final taxes (back taxes), it can potentially lead to additional interest costs depending on the underlying interest period and outstanding tax liability (e.g., due to under-withholding or insufficient prepayment). Particularly in cases where a net salary agreement is in place, the reimbursement of interest constitutes a cost factor for companies. Correspondingly, the assessment of interest on tax refunds in net salary scenarios leads to cost saving opportunities for employers.

Since the German Constitutional Court decided that the recent regulation is no longer applicable as of 2019, it may be worthwhile to examine the decision and its practical implications for employers and employees.

### Background

Under current legislation, when a German tax assessment leads either to a tax refund or a final tax payment, per annum interest of 6 percent (i.e., 0.50 percent per full calendar month) is assessed. However, the underlying interest period does not start immediately with the end of the respective fiscal year, but only after the expiry of an “interest-free grace period” of generally 15 months.<sup>3</sup> In other words, the imposition of such interest only relates to taxpayers whose tax assessments take place after a long period, or the assessment is amended<sup>4</sup> after a rather long period of time. In this context, it is important to

mention that Germany does not run a self-assessment system (unlike the system in the United States). Instead, each tax return filed is followed by a formal tax assessment notice issued by the tax authorities. Hence, it is not the taxpayer but the tax authorities who determine the timing of when a tax assessment notice is issued.

The imposing (or granting) of interest of 0.5 percent per month was originally designed to determine a taxpayer's advantage (or disadvantage) that arises from a late tax assessment. For simplification purposes, the German legislature is allowed to apply a typification approach<sup>5</sup> in order to determine the interest rate. However, the interest rate to be applied must be realistic. Looking at the development of the capital market and the downward trend of lending rates, the Constitutional Court decided that an interest rate of 6 percent per annum has been "obviously unrealistic" at least since 2014 and was therefore found unconstitutional.

Although the German Constitutional Court ruled that the fixed interest rate of 0.5 percent per month is unconstitutional for periods as of 1 January 2014, the existing provisions are still allowed to be applied for interest periods until 31 December 2018. For interest periods beginning in 2019, the interest rate must be (retroactively) adjusted. By 31 July 2022, German legislators must have enacted provisions that are compatible with the German constitution.

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## KPMG NOTE

### Actions

It is recommended that all taxpayers and practitioners verify whether interest payments of 6 percent were imposed as of January 2019 or after.

All interest notices issued as of May 2019<sup>6</sup> formally should have been assessed as "preliminary" and will be amended automatically once the German legislature has enacted new provisions.

A review of these amended interest notices becomes necessary.

All other interest notices that are not assessed as "preliminary" (i.e., between January 2019 and May 2019) should be reviewed as to whether an adjustment can be applied for in another way.

Particular attention should be given to cases where a net salary/tax equalisation between employer and employee was agreed. Where an employer has already settled an outstanding German tax liability including interest payments for periods as of January 2019, it will need to be discussed, administered, and determined that the expected refund of interest will actually be forwarded to the employer.

At this stage though, no further information is available yet on when and how the German legislature will amend the interest rates as of 2019.<sup>7</sup> It also remains to be seen whether – in case of a tax refund – interest notices will be amended to the detriment of taxpayers.

KPMG in Germany will provide further guidance once new information becomes available.

## FOOTNOTES:

1 Order of 8 July 2021 (file number 1 BvR 2237/14 and 1 BvR 2422/17), for detailed justification of the judgement, (in German) see:

[https://www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/DE/2021/07/rs20210708\\_1bvr223714.html](https://www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/DE/2021/07/rs20210708_1bvr223714.html) .

2 Press Release No. 77/2021 (in German), see:

<https://www.bundesverfassungsgericht.de/SharedDocs/Pressemitteilungen/EN/2021/bvg21-077.html> .

3 For example: the interest calculation period for the German fiscal year 2017 (equals calendar year) starts on 1 April 2019.

4 For instance, a tax assessment can be amended after a tax audit or after filing a successful appeal against the initial tax assessment notice.

5 The “typification approach” means that the German government can assume that taxpayers face one fixed interest rate on the market. No distinction is made between lender and borrower on the market, short-term vs. long-term loan, higher loan vs. lower loan, secured loan vs. non-secured loan, or high credit rating vs. low credit rating. Whatever the underlying circumstances are, taxpayers deal with one interest rate only.

6 Circular from the German authorities dated 2 May 2019 (in German), see:

[https://www.bundesfinanzministerium.de/Content/DE/Downloads/BMF\\_Schreiben/Weitere\\_Steuerthemen/Abgabenordnung/2019-05-02-vorlaeufige-Festsetzung-Zinsen-Verfassungsmaessigkeit-Zinssatz.pdf?\\_\\_blob=publicationFile&v=2](https://www.bundesfinanzministerium.de/Content/DE/Downloads/BMF_Schreiben/Weitere_Steuerthemen/Abgabenordnung/2019-05-02-vorlaeufige-Festsetzung-Zinsen-Verfassungsmaessigkeit-Zinssatz.pdf?__blob=publicationFile&v=2) .

7 At the time of writing, the German general elections had not yet been held which could possibly impact both the content and timing of the necessary adjustments.

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## Contact us

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