TIGHTENING OF THE INTEREST BARRIER

After the Federal Council refused to approve the Growth Opportunities Act on 24 November 2023, some measures were incorporated into the Secondary Credit Market Promotion Act at short notice. With the resolution of the Bundestag on 14 December 2023 and the approval of the Bundesrat on 15 December 2023, the changes to the interest barrier regulation originally contained in the Growth Opportunities Act came into force.

INTEREST BARRIER REGULATION – BASIC APPLICATION

Interest expenses above interest income (net interest expenses) of a partnership or corporation are only deductible as business expenses up to an amount of 30% of taxable EBITDA (offsettable EBITDA). If the net interest expenses in a financial year do not reach the limit of the offsettable EBITDA, the „unused" portion can be carried forward to the following five financial years as an EBITDA carryforward and used there to increase the deductible amount of interest expenses. If, on the other hand, the net interest expenses exceed the offsettable EBITDA, the non-deductible interest expenses can be carried forward to the following financial years (interest carryforward) and, if applicable, deducted there up to the amount of the offsettable EBITDA (Section 4h (1) EStG).

The interest barrier does not apply if one of the following three exceptions applies (Section 4h (2) EStG):

- The net interest expenses amount to less than 3 million Euro (so-called 3 million Euro exemption limit).
- The business falls under the so-called stand-alone clause, which until 2023 required the business to be part of a group or only part of it.
- The equity ratio of a company belonging to a group is equal to, higher or at most two percentage points lower than the equity ratio of the group at the end of the previous reporting date (equity escape).

CHANGES ADOPTED AS OF 1 JANUARY 2024

With the Secondary Credit Market Promotion Act (Federal Law Gazette I 2023, No. 411), the interest barrier regulations were selectively modified. The amendments are to be applied for the first time to financial years that begin after 14 December 2023 and do not end before 1 January 2024, i.e., regularly from the financial year 2024.

The amendments make the necessary adjustments to the EU legal requirements of the Anti Tax Avoidance Directive (ATAD).

In particular, the law provides for the following adjustments:

Modifications to the exemptions

The existing exemptions will be continued in a modified form. However, the application of the exemptions is excluded in the future if interest expenses were increased as a result of an interest carryforward (Section 4h (1) sentence 7 EStG). This means that in the future, the exemption provisions will only be utilized for current interest expenses and interest carried forward can only be deducted if it falls below the offsettable EBITDA.

In future, the stand-alone clause will only apply if the taxpayer is not a related party within the meaning of Section 1 (2) AStG and does not have a permanent establishment outside its country of residence (Section 4h (2) sentence 1 letter b EStG). As the new regulation renders obsolete the provision on the application of the exclusion rule for corporations in the case of harmful external financing by shareholders, Section 8a (2) KStG has been deleted.

Note

A person is deemed to be a related party within the meaning of Section 1 (2) AStG if

- the taxpayer directly or indirectly holds at least 25 % of their capital or participation rights or, conversely, the person holds this level of participation in the taxpayer (significant participation),
- the taxpayer has a claim to at least 25 % of the profit or liquidation proceeds against the person or, conversely, the person has such a claim against the taxpayer,
- the taxpayer can exercise a direct or indirect controlling influence over this person or, conversely, the person has a controlling relationship with the taxpayer,
- a third party has a significant interest in both the person and the taxpayer, has a claim to profits or liquidation proceeds of at least 25 % against them, or can exercise a controlling influence over both, or
- the person or the taxpayer can exert an influence on the other outside of the business relationship and can utilize this when agreeing on business relationships, or if one of them has a vested interest in generating income for the other.

The application of the equity escape is also maintained in principle. However, a company only belongs to a group if it is consolidated with one or more other companies. The mere possibility of consolidation is no longer sufficient (Section 4h (3) sentence 5 EStG). However, a company can be assumed to be part of a group if it determines its financial and business policy uniformly with one or more other companies (Section 4h (3) sentence 6 EStG). Equally unchanged, the equity escape does not apply if there is harmful external shareholder financing. However, contrary to the case law of the Federal Court of Finance (BFH judgement dated 11 November 2015, case no. I R 57/13), Section 8a (3) sentence 1 KStG stipulates that the 10 % limit, according to which no more than 10 % of the interest expenses of the corporation or another legal entity belonging to the group may be paid to related parties, must be examined concerning the respective legal entity as a whole. The BFH is of the opinion that, when examining the 10 % limit, external shareholder financing of the materially involved shareholders must be considered separately.

Interest expenses subject to the interest barrier

According to the legal opinion of the BFH, interest expenses only include remuneration for borrowed capital, but not remuneration for other services provided by the lender (see most recent BFH ruling dated 22 March 2023, case no. XI R 45/19). However, the tax authorities already have a broader understanding of the term interest expenses and include all payments with a remuneration character that are paid to the lender (BMF letter dated 4 July 2008, BStBl. I 2008, p. 718, margin no. 15).

In line with this legal interpretation, from 2024, interest expenses will not only include remuneration for debt capital but also expenses that are economically comparable to interest and other expenses in connection with the procurement of debt capital (Section 4h (3) sentence 2 EStG). This implements the ATAD requirements. The explanatory memorandum to the law points out that although the ATAD contains a catalogue of expenses covered by this, it does not contain an exhaustive list. Correspondingly, the term interest income is extended to include economically equivalent income in connection with capital claims (Section 4h (3) sentence 3 EStG). In contrast, other income – unlike in the case of the extension of the definition of interest expenses – is not included in the extended definition of interest income.

Interest expenses and interest income now explicitly no longer include amounts from the compounding and discounting of low-interest liabilities and capital claims. The provision previously contained in Section 4h (3) sentence 4 EStG no longer applies.

Finally, interest income and interest expenses from loans to finance certain long-term public infrastructure projects are not to be recognized as net interest expenses within the meaning of the interest barrier (Section 4h (6) EStG).

Restrictions on the creation and utilization of an EBITDA or interest carryforward

To date, there has been no EBITDA carryforward that could increase the deductible amount of interest expenses in subsequent years if the interest barrier does not apply due to the applicability of an exemption rule per Section 4h (2) EStG. In addition, in the future, there will be no EBITDA carryforward even if the interest expenses do not exceed the interest income (Section 4h (1) sentence 3 half-sentence 2 EStG).

In addition, the cases in which an existing EBITDA carryforward or an existing interest carryforward can be cancelled will be extended. According to the current legal situation, the cessation or transfer of the business leads to the loss of existing carryforwards. In the future, this will also apply in the event of the cessation or transfer of a part of a business, which will lead to a corresponding pro rata loss of existing carryforwards (Section 4h (5) sentence 4 EStG). According to the explanatory memorandum to the law, the departure of a controlled company from the tax group constitutes such a discontinuation of a business unit. This corresponds to the opinion of the tax authorities regarding the current legal situation and is therefore clearly intended to legally safeguard this position.

CONTACT PERSON

If you have any questions about the tightening of the interest barrier, your advisors at RSM Ebner Stolz will be happy to help. You can also get in touch with our contacts listed here.

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