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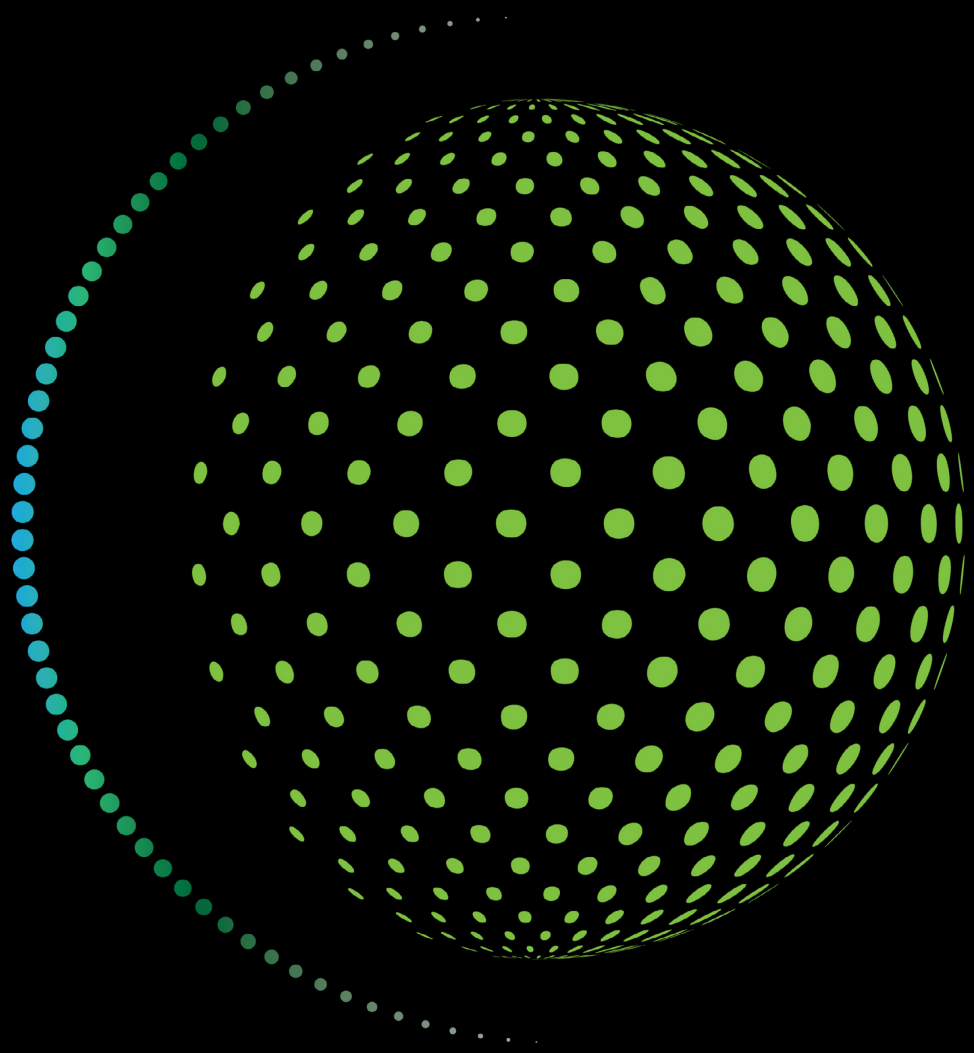

EU Anti-Tax Avoidance Directive

Implementation of interest expense limitation rule

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March 2021

This document provides insights on the impact and implementation of the interest expense limitation rule in the EU Anti-Tax Avoidance Directive 2016/1164 (ATAD) into the domestic legislation of the EU member states.

This slide deck is a high level overview of the rules and should not be relied on as tax advice. The surveys used to prepare this deck included certain assumptions, so the actual facts and circumstances should be evaluated on a case-by-case basis.

The survey questions were framed in the context of the choices individual EU member states are expected to make, and responses are based on developments known as of March 2021. The responses reflect the views of Deloitte colleagues to the extent they are aware of relevant developments in their jurisdictions.

Contents

Introduction

Interest expense limitation rule

- The ATAD is part of the Anti-Tax Avoidance Package presented by the European Commission in January 2016. The directive, formally adopted by the Economic and Financial Affairs Council of the EU on 12 July 2016, aims to provide a minimum level of protection for the internal market and ensure a harmonized and coordinated approach in the EU to the implementation of some of the recommendations under the OECD BEPS project. The ATAD provides for the minimum harmonization of rules in the areas of CFCs, hybrid mismatches, and interest deductions, and requires the introduction of a corporate general anti-abuse rule (GAAR) and an exit tax (the latter two measures are not part of the BEPS project).

- The ATAD targets situations where companies arrange intercompany loans so that the debt is based in a high-tax country where interest payments can be deducted, but the interest on the debt is paid to the group lender company that is based in a country where interest is taxed at a low rate (or not at all), thus allowing the group to reduce its overall tax burden. To discourage companies from artificially shifting their debt, the ATAD requires member states to implement measures limiting the tax deductibility of interest on debt. Member states are required at least to disallow the deductibility of such interest expense based on a fixed percentage (see below), but they are permitted to apply more targeted rules to address abuses in intragroup debt financing (e.g., thin capitalization rules), as well as the interest expense deduction limitation.

- Various options are available to member states in implementing the interest expense limitation rule in the ATAD, e.g., a de minimis threshold, an "escape clause" and a grandfathering provision.

- The ATAD defines "net borrowing costs" as the amount of a taxpayer's deductible borrowing costs under domestic law that exceeds the taxable interest income and other economically equivalent taxable income received by the taxpayer. The definition of borrowing costs is broader than just "interest"--such costs also include costs that are economically equivalent to interest (e.g., finance leases, derivative instruments related to borrowings, certain foreign exchange gains and losses, and guarantee or arrangement fees). Under article 4(1) of the ATAD, "excess borrowing costs" are deductible only up to 30% of a taxpayer's earnings before interest, tax, depreciation, and amortization (EBITDA); any excess borrowing costs are nondeductible, subject to the introduction of the following rules:
  - Member states may allow standalone entities (i.e., those not part of a group) to fully deduct borrowing costs (on the grounds that such entities cannot use debt to shift profits).
  - Member states may allow taxpayers to deduct excess borrowing costs up to a EUR 3 million threshold, which will be determined for the entire group. It also is possible for a lower (or no) threshold to apply.
  - Grandfather loans concluded before 17 June 2016 and not subsequently modified, refinanced, etc.
  - Exclude third-party loans used to fund qualifying long-term public infrastructure projects where the project operator, borrowing costs, assets, and income are in the EU;
  - Exclude certain (regulated) financial undertakings from the new provisions; and
  - Carryforward current year nondeductible excess borrowing costs to future years and potentially carry back such costs.

- The ATAD contains two escape clauses that member states can opt to introduce: (i) an "equity/total assets" ratio test, whereby a taxpayer will be able to deduct borrowing costs in excess of 30% of EBITDA if it can show that the ratio of its equity over its total assets is equal to or higher than the equivalent ratio of the group in which it is a member and certain other requirements are met (article 4(5)(a)); or (ii) a "group EBITDA" test under which taxpayers that are part of a consolidated group for financial accounting purposes to deduct excess borrowing costs in accordance with the group ratio of excess borrowing costs over EBITDA (article 4(5)(b)).

- EU member states were required to transpose the interest expense limitation rules into their domestic law by 31 December 2018, with the new measures to be effective on 1 January 2019, unless the member state is granted a derogation. A derogation is provided for member states that have targeted domestic rules that are equally effective to the rules in article 4 of the ATAD. These member states can continue to apply the domestic rules until the earlier of (i) the end of the first fiscal year following the date of publication of an agreement between the OECD member countries on a minimum standard with respect to BEPS action 4; and (ii) 1 January 2024. The European Commission must have been notified in this regard before 1 July 2017.

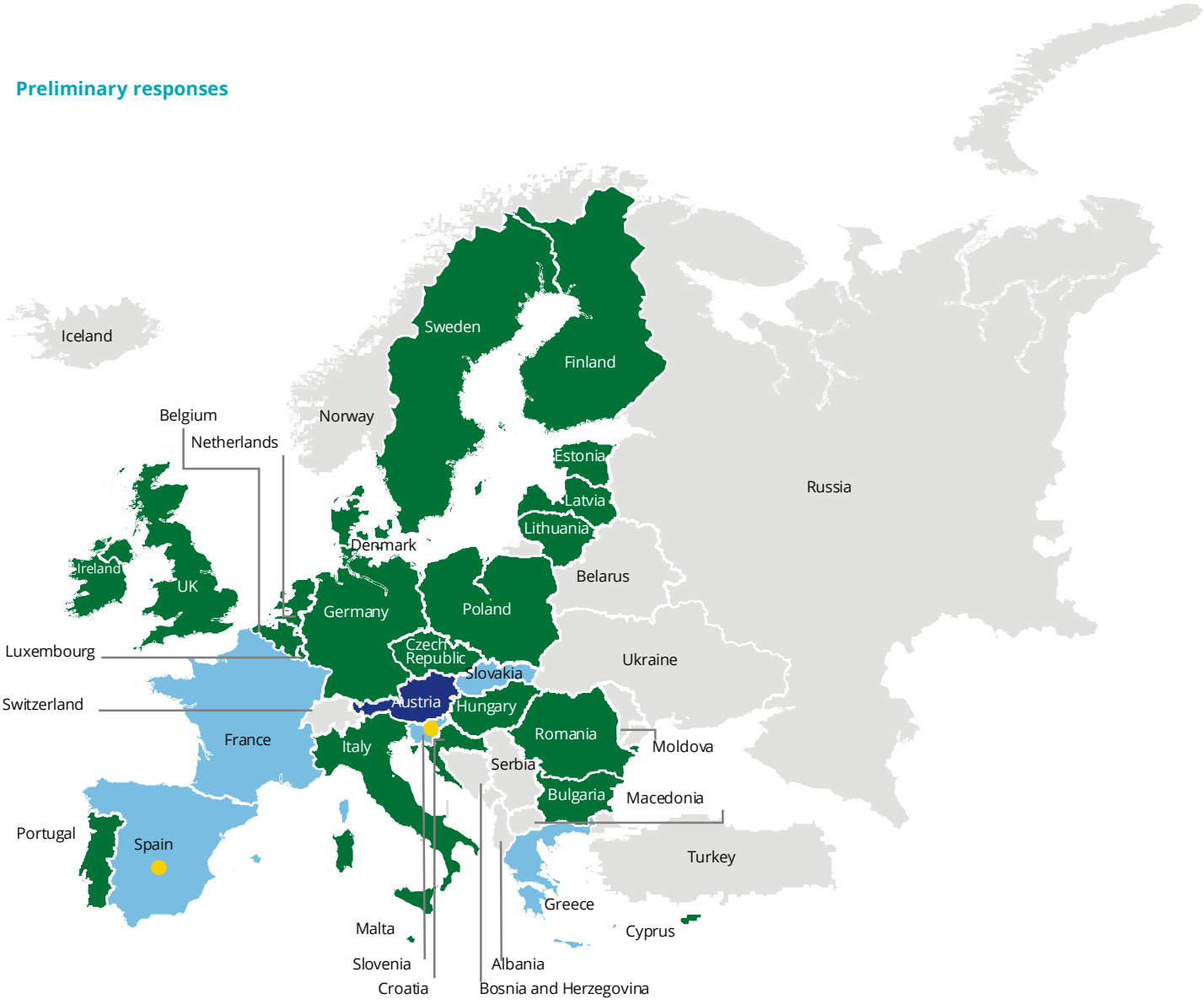
- Some EU member states already had rules to counter hybrid mismatch arrangements before the ATAD was adopted. It should be noted that EU directives set a minimum level of protection, so EU member states are required to implement only the minimum scope required under the directives, but they are free to introduce or retain rules that are more stringent than the rules prescribed in the directives, provided the rules do not otherwise offend EU law. As a result, where a member state already has rules in the areas covered by the ATAD, these rules have to be amended only to the extent they do not meet the minimum prescribed by the ATAD. Rules that are stricter than those in the ATAD do not have to be modified. If a member state does not have interest deduction limitation rules, it will be required to introduce measures that give effect to the ATAD rules.

- Not all member states fully transposed the ATAD into their domestic law by 31 December 2018. If a member state fails to comply with EU law, the European Commission may open an infringement procedure, and if necessary, it may bring the case before the Court of Justice of the European Union. The commission initially launched infringement procedures against 10 EU member states for failure to fully implement the directive. Four of those infringement procedures are still pending (i.e., Belgium, Denmark, Portugal, and Spain).

- The UK withdrew from the EU on 31 January 2020 and following the end of the EU-UK withdrawal agreement's transition period on 31 December 2020, EU law generally no longer applies to the UK. However, as the UK was a member state at the time of ATAD, and was subject to obligations for the timely transposition of the ATAD into domestic law, this slide deck continues to comment on the status of the interest expense limitation rule under UK domestic law. Changes to EU law (e.g., revisions to the Directive) with an implementation date on or after 1 January 2021 will not result in an obligation for the UK to make changes to its domestic law.

Transition period

Preliminary responses



Member states that have domestic, targeted rules for preventing BEPS that are equally effective as article 4 of the ATAD are granted a transitional period. These member states can continue to apply the existing, targeted rules until 1 January 2024.

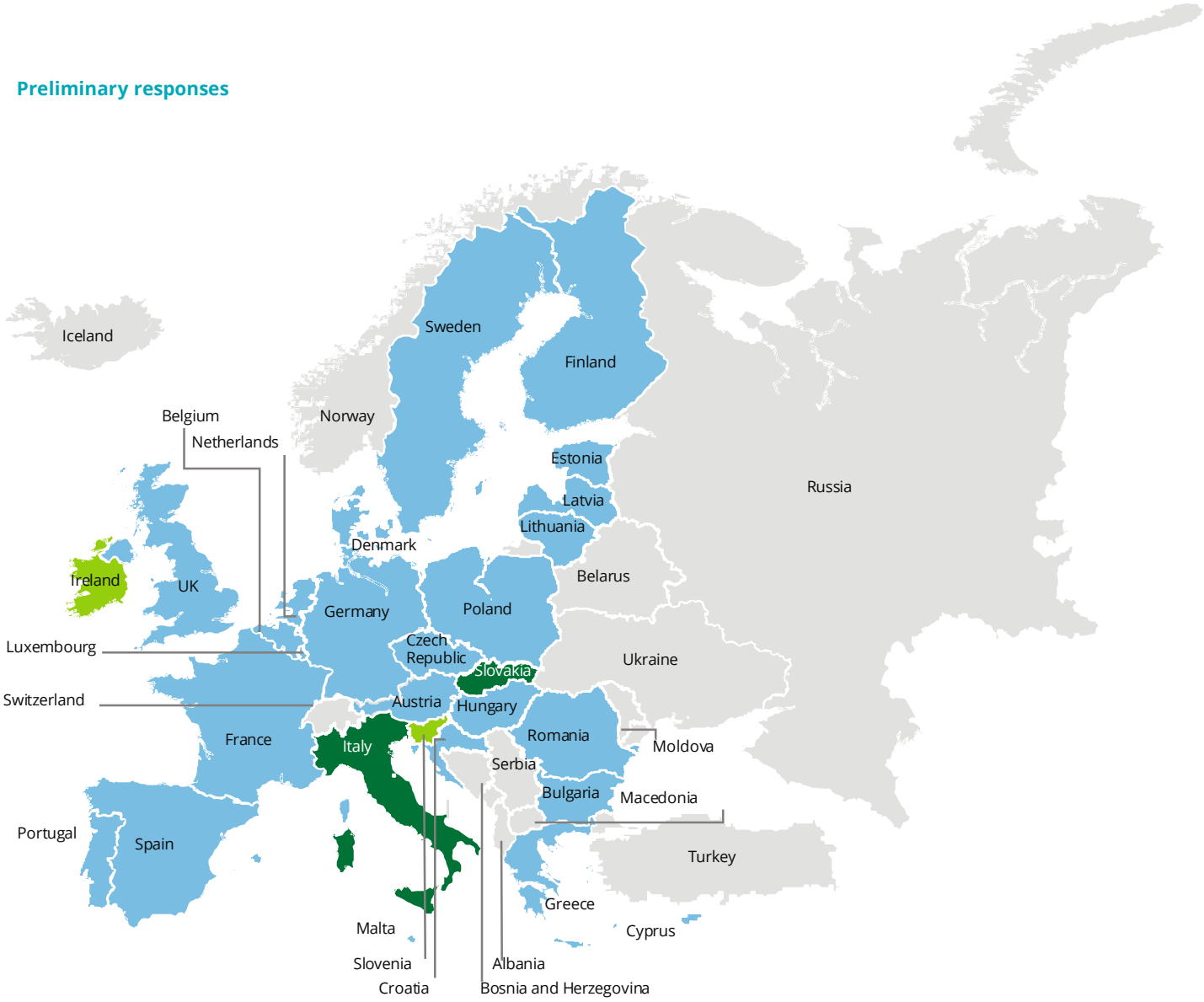
The map indicates the member states where the application of the transition period has been approved.

Legend:

- 5 — limitation rule
- 22 — No transition period for interest expense limitation rule
- 1 — Interest limitation rules implemented with effective date 1 January 2021
- ● — Will apply transition period

Application of de minimis threshold

Preliminary responses



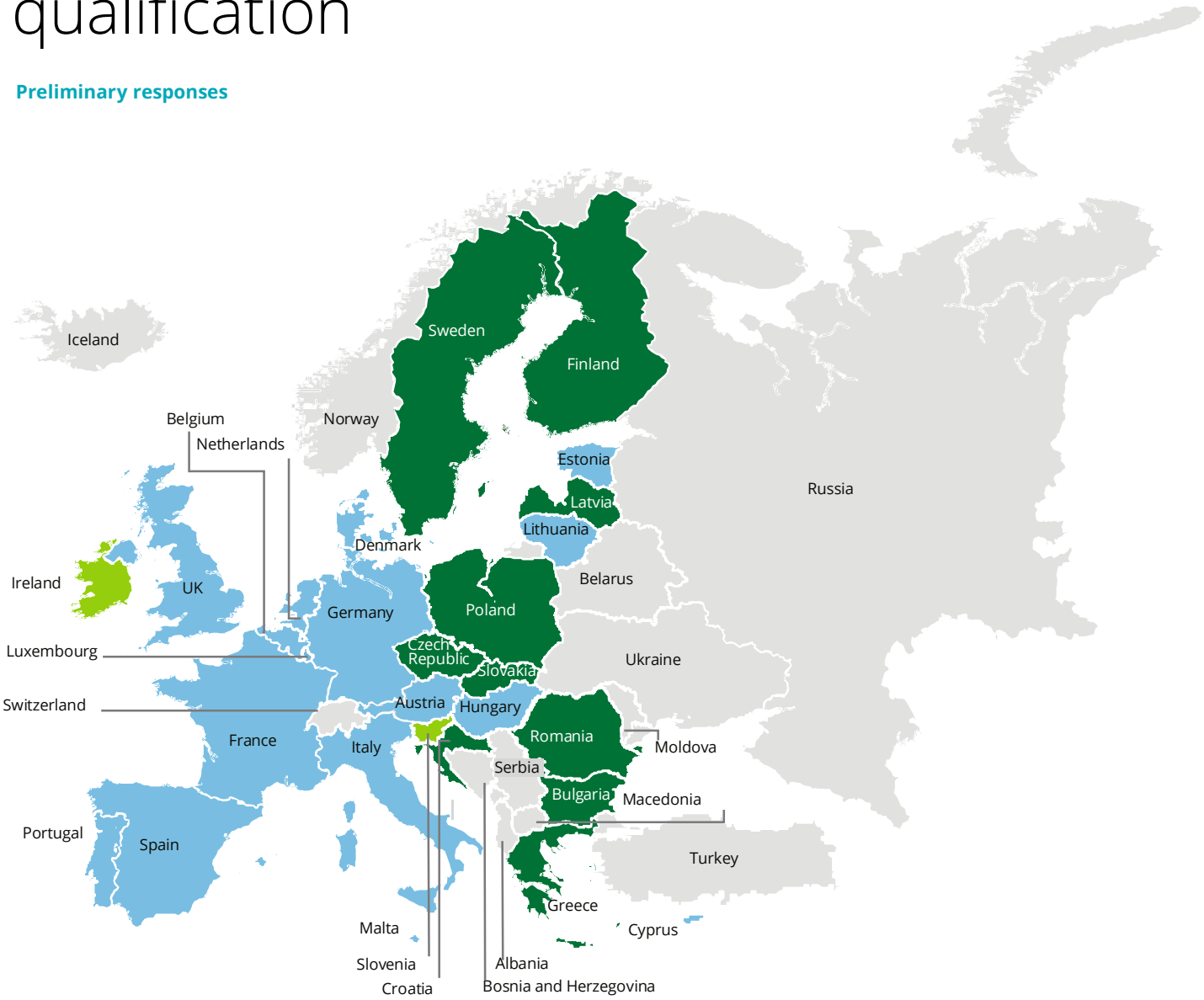
Member states may grant taxpayers the right to deduct excess borrowing costs below EUR 3 million, which will be determined for the whole group. A lower (or no) threshold also is possible.

Legend:

24	Threshold
2	No threshold
2	Not yet clear

Group approach for taxpayer qualification

Preliminary responses



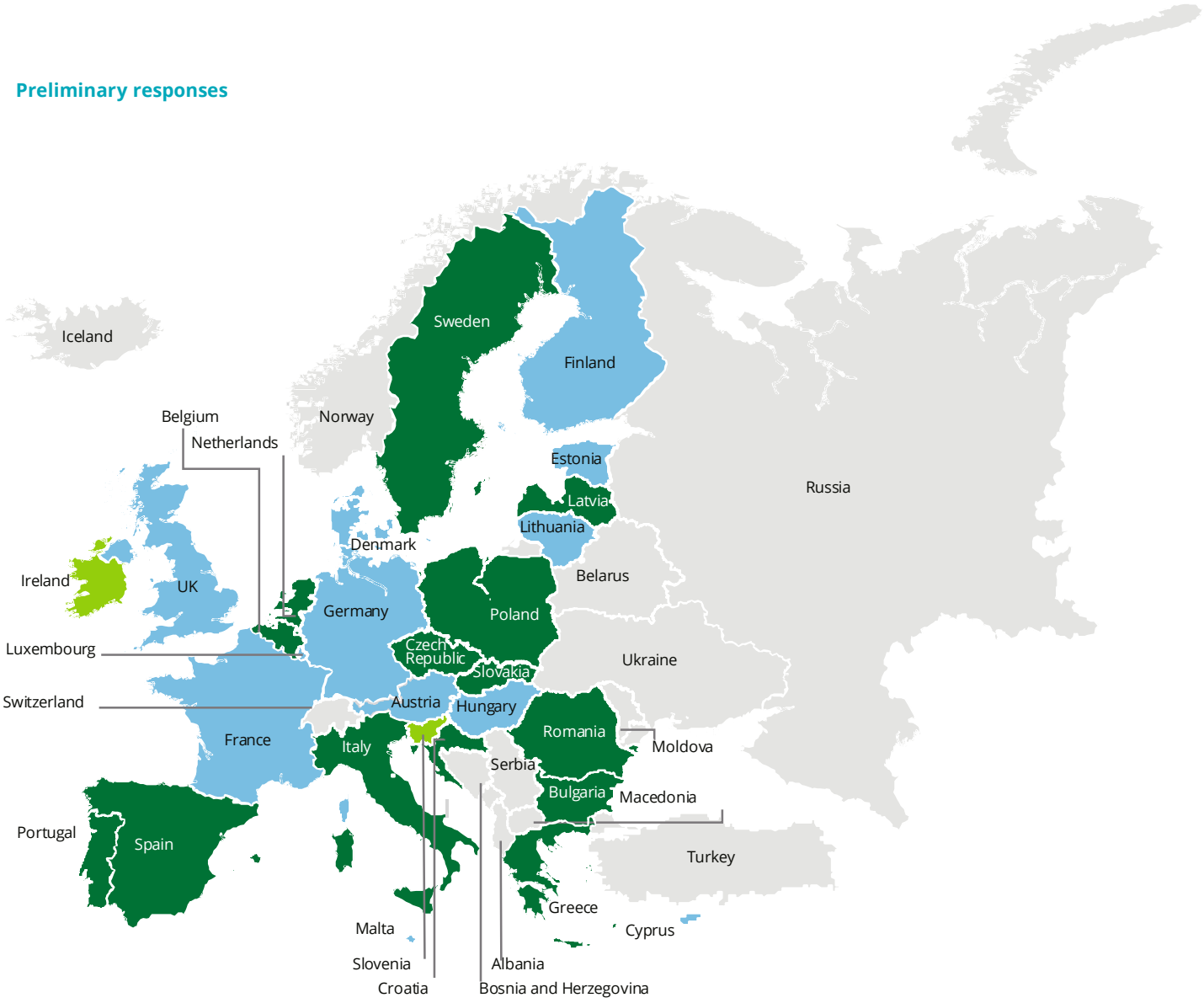
Article 4(1) of the ATAD allows a member state to treat as a taxpayer: (a) an entity that is permitted or required to apply the rules on behalf of a group, as defined under domestic tax law; or (b) an entity in a group, as defined under domestic tax law that does not consolidate the results of its members for tax purposes. In such cases, excess borrowing costs and the EBITDA may be calculated at the level of the group and comprise the results of all its members.

Legend:

16	Group approach applied
10	No group approach applied
2	Not yet clear

Application of group escape clause

Preliminary responses



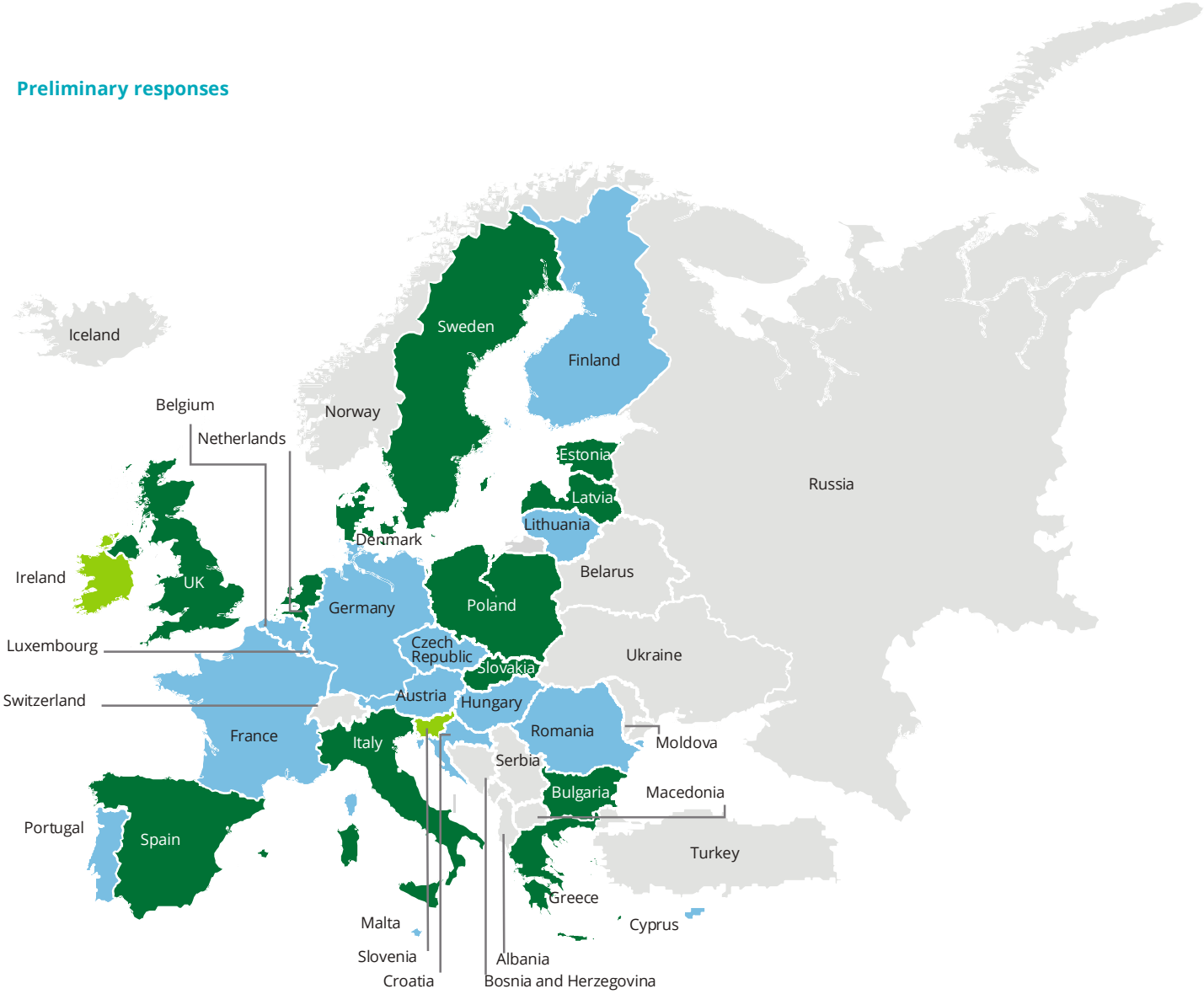
Member states have the option to allow taxpayers that are part of a consolidated group for financial accounting purposes to apply a group escape clause that will allow taxpayers to deduct borrowing costs exceeding 30% of EBITDA, based on an equity/total assets ratio or a group EBITDA test.

Legend:

12	Group escape
14	No group escape
2	Not yet clear

Exception for standalone companies

Preliminary responses



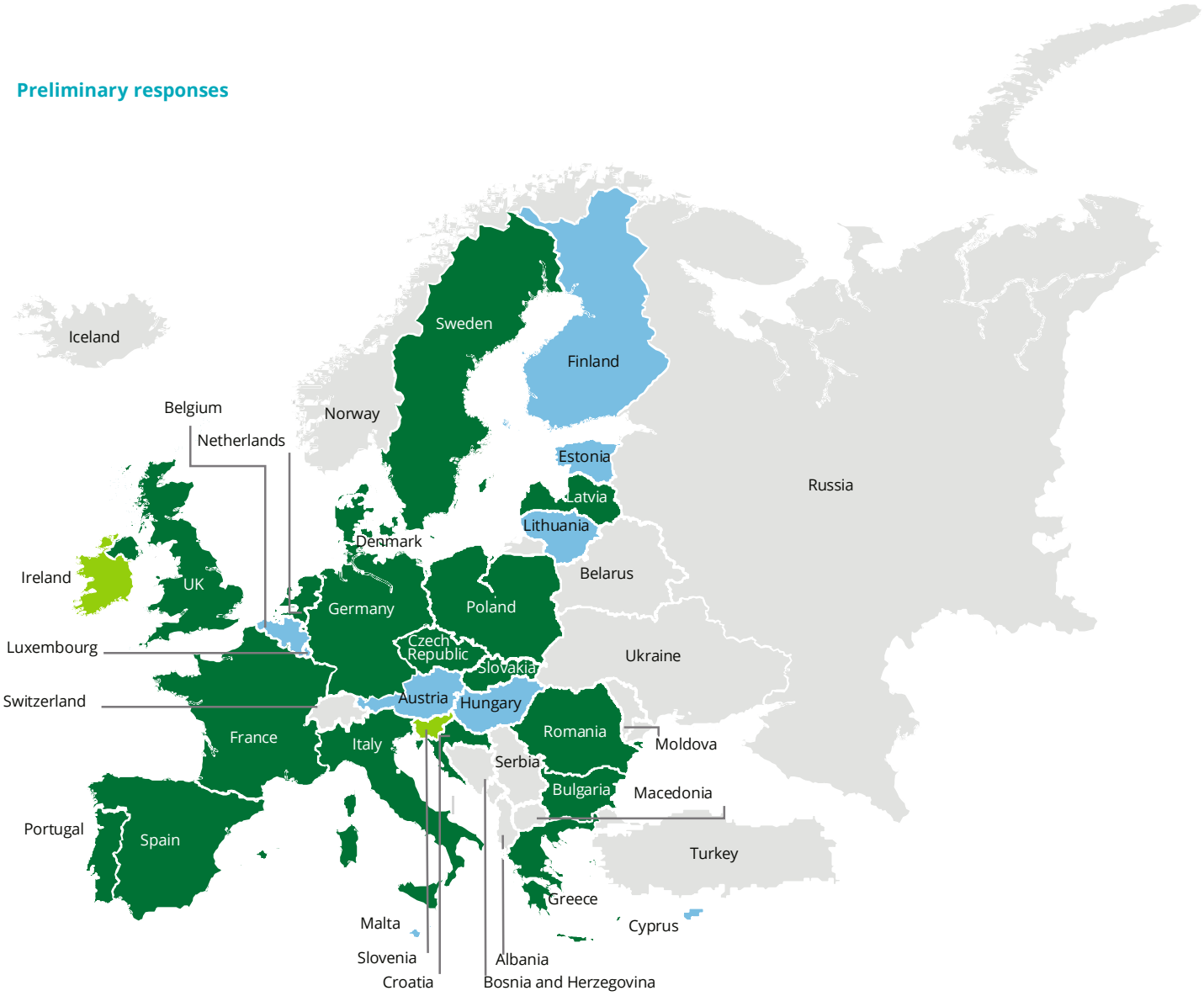
A member state may grant a taxpayer the right to fully deduct excess borrowing costs if the taxpayer is a standalone entity as described in article 4(3)(b) of the ATAD.

Legend:

14	Exception for standalone entity
12	No exception for standalone entity
2	Not yet clear

Exclusion for existing loans

Preliminary responses



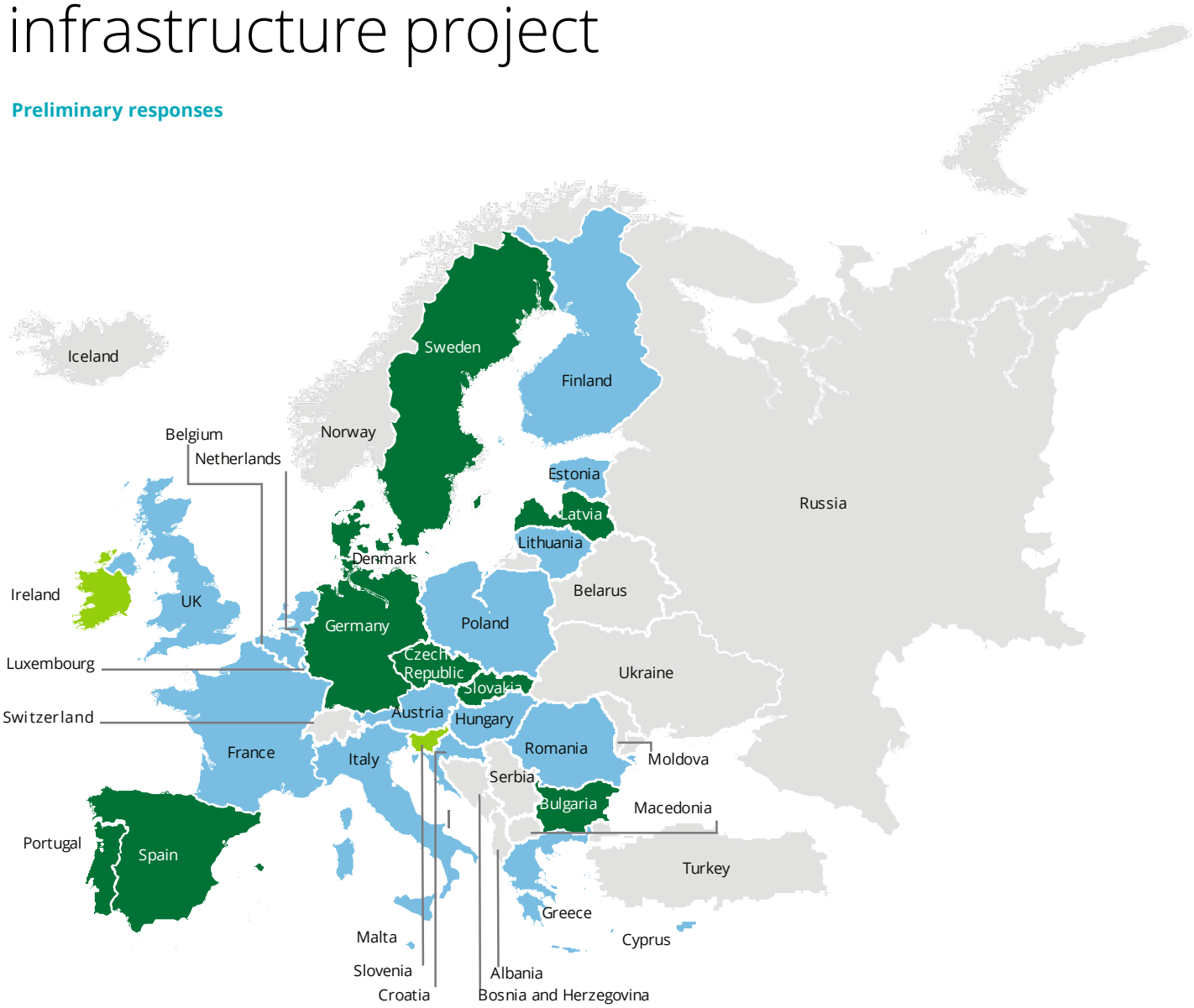
A member state may allow the exclusion of loans concluded before 17 June 2016 as described in article 4(4)(a) of the ATAD.

Legend:

9	Exclusion for existing loans
17	No exclusion for existing loans
2	Not yet clear

Exclusion of loans for a long-term public infrastructure project

Preliminary responses



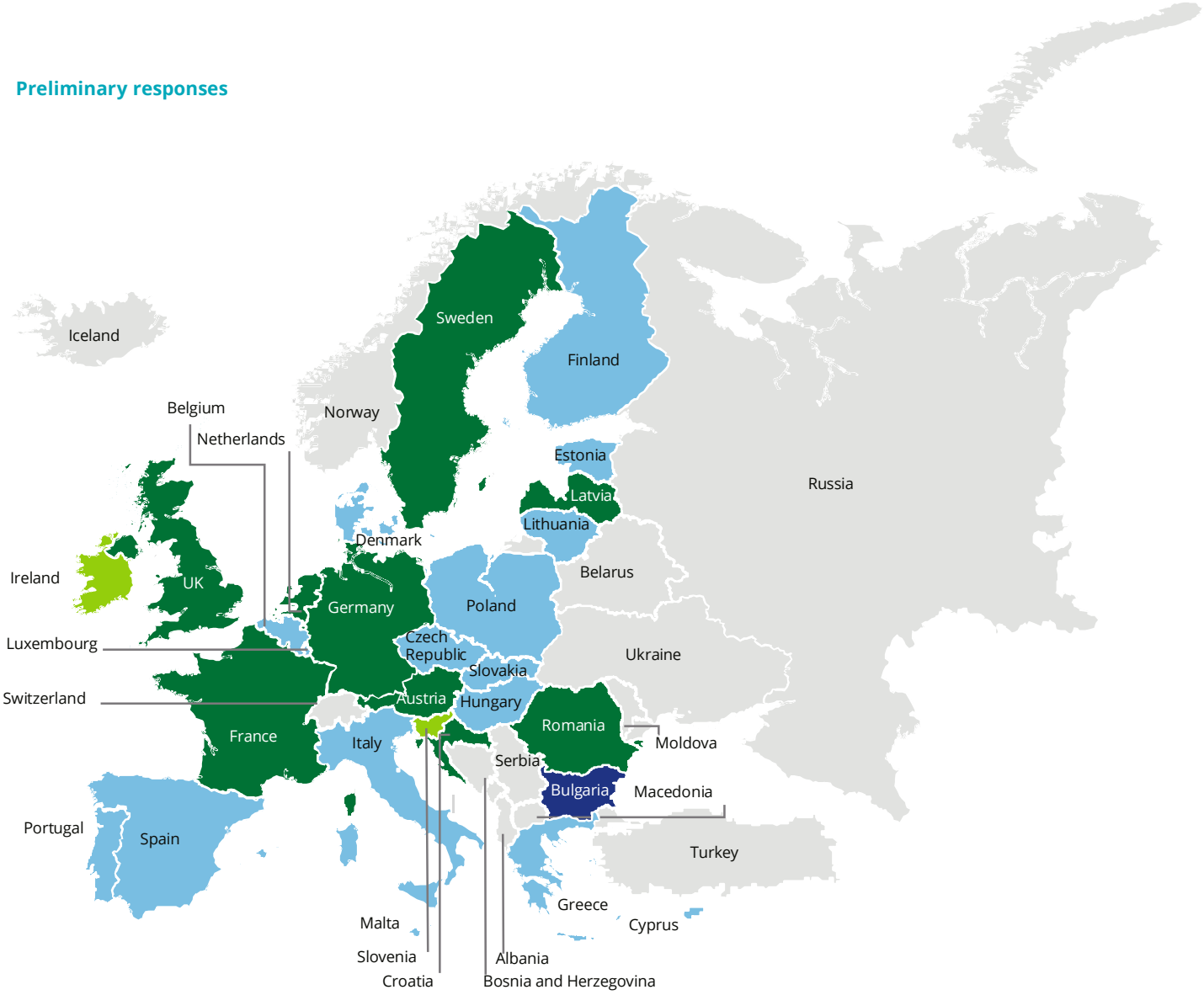
A member state may allow the exclusion of loans used to fund a long-term public infrastructure project as described in article 4(4)(b) of the ATAD.

Legend:

17	Exclusion of loans for long-term public infrastructure projects (in general or for specific projects)
9	No exclusion of loans for long-term public infrastructure project
2	Not yet clear

Exclusion financial undertakings

Preliminary responses



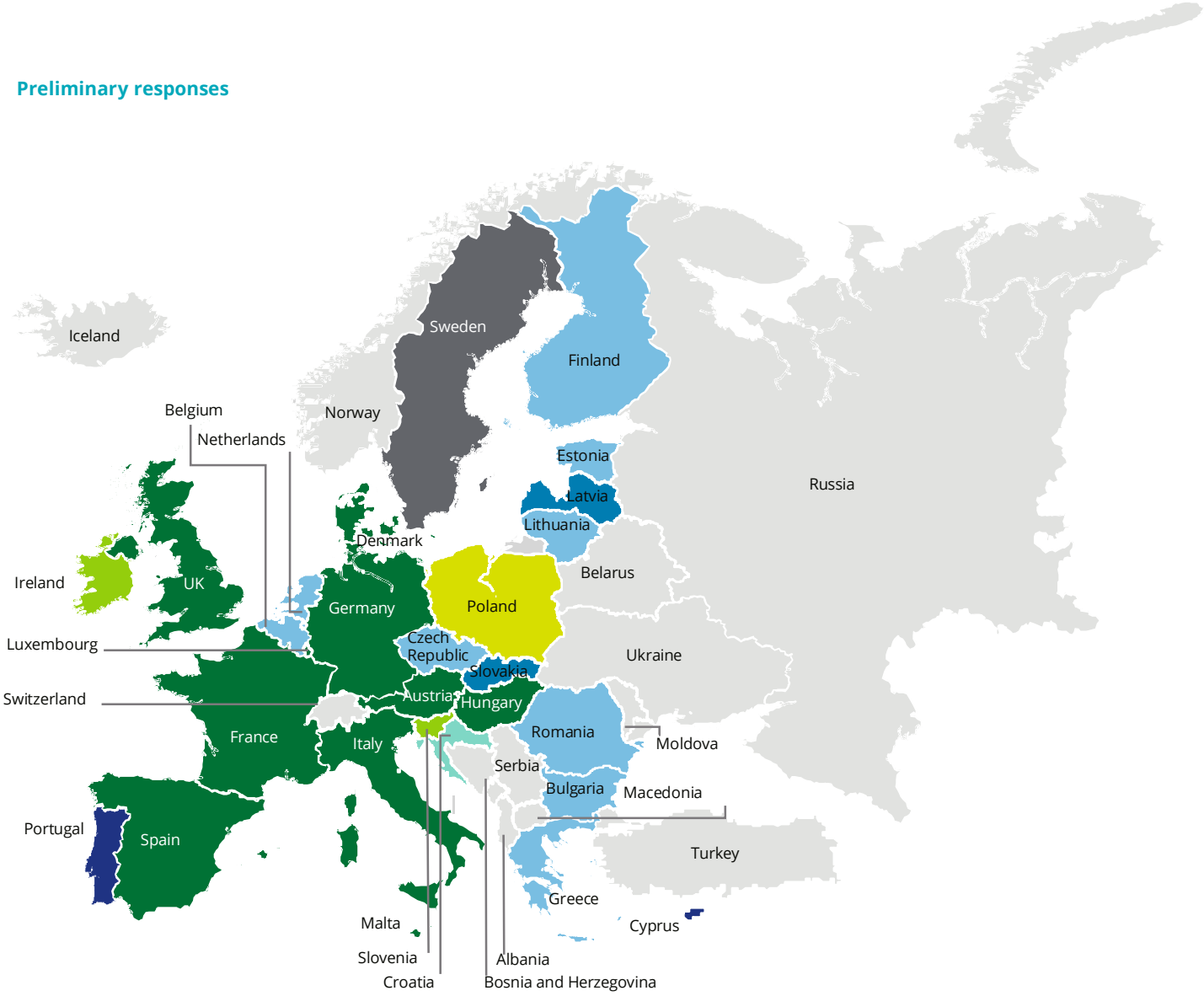
A member state may exclude financial undertakings from the scope of the interest expense limitation rule as described in article 4(7) of the ATAD.

Legend:

16	Exclusion financial undertakings
9	No exclusion financial undertakings
1	Exclusion for credit institutions only
2	Not yet clear

Carryforward and carryback

Preliminary responses



A member state may provide carryforward and carryback rules for excess borrowing costs that cannot be deducted in the current tax period, as well as for unused interest capacity as described in article 4(6) of the ATAD.

Legend:

2	No carryforward rules
9	Unlimited carryforward, no carryback
1	Three-year carryforward, no carryback
10	Unlimited carryforward, five year unused interest capacity
2	Five year carryforward, five-year unused interest capacity
1	Six-year carryforward, no carryback
1	Five-year carryforward with some exceptions, no carryback
2	Not yet clear

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