Taxation of Multinational Enterprises

Limitation of Deductions - Recent Developments

Overview

- What seems to be the tax issue(s)?
  - Lack of neutrality i corporate financing
  - The use of non-arm's length debt
  - Debt to finance tax exempt income

- Fundamentals in debt tax planning?

Overview

- ACE regimes
- Withholding taxes
- CFC
- From thin capitalization to earning-based

Enter OECD….

OECD BEPS Action 4

Limiting BE Involving Interest Deductions And Other Financial Payments

- The use of debt is perhaps one of the most simple profit shifting techniques in international tax planning
  - Groups placing third party debt in high tax countries
  - Groups using intragroup loans to generate interest deductions in excess of actual third party interest
  - Groups using third party/intragroup loans to fund tax exempt income

- Best practice to design rules which *directly* adress the risk, including excessive interest and finance tax exempt income

OECD BEPS Action 4

Recommendation

- Earning-based limitation rule (10-30% of EBITDA)
  - Asset-based approach more stable, but…
- Broad definition of net interest and similar expenses
- Carry forward
- Exemptions
  - De minimis
  - Group ratio rule (option for +10%) or equity escape rule
- Recommends targeted rules if needed

Impact?

Enter EU with a coordinated respons..

ATAD Art. 4

Minimum requirements

- Earning-based limitation rule
- 30% of EBITDA
- Broad definition of net interest and similar expenses
- Carry forward
- Exemptions
  - De minimis of 3 mEUR
  - Stand-alone entity
  - Group ratio rule or equity escape rule

EU countries

Impact?

- Germany
- Italy
- UK
- Spain/Portugal
- France
- Sweden
- Netherlands
- Luxembourg

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Non EU countries

Impact?

- USA
- Canada
- Japan
- China
- Brazil
- India
- South Africa
- Australia

Denmark

Before

- Thin capitalization
- Asset-based
- Earning-based

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Denmark

After

- Thin capitalization

- Asset-based

- Earning-based
  - From 80% of EBIT to 30% of EBITDA
  - From net financing cost to exceeding borrowing costs
  - New carry-forward
  - Group ratio rule

Final remarks

- Something was in motion in Europe…
- International standard set by the developing countries (OECD)…which may inspire…
- But the lack of tax neutrality is still an issue

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