Interest Limitation Rules: At a Crossroads between National Sovereignty and Harmonization

This article analyses BEPS Action 4 and article 4 of the EU Anti-Tax Avoidance Directive (2016/1164), determines the country-specific adjustments necessary as a result of article 4 of that Directive and examines the future development of interest limitation rules in the context of national sovereignty and harmonization.

1. Introduction
The asymmetric treatment of alternative financing options incentivizes the use of debt to benefit from tax savings. Many countries have implemented regulations to limit the deduction of interest payments for tax purposes to diminish debt tax planning opportunities. To achieve a common standard and application of these rules, the European Union has passed the Anti-Tax-Avoidance Directive (2016/1164) (ATAD), which includes requirements for an interest limitation rule based on Action 4 of the OECD’s Base Erosion and Profit Shifting (BEPS) Project. First, this article analyses the design of BEPS Action 4 (section 3) and article 4 of the ATAD (section 4). Second, country-specific adjustments of EU Member States arising from implementation of article 4 of the ATAD will be determined (section 5). Third, the future development of interest limitation rules will be analysed in light of the interplay between national sovereignty and harmonization (section 6).

2. The Importance of Interest Limitation Rules
In general, corporate tax systems permit companies that use debt financing to deduct interest payments from the tax base, whereas returns on equity capital that are paid out to shareholders are non-deductible expenses for the company. This asymmetric treatment of equity and debt financing incentivizes the use of debt capital to achieve excessive interest deductions to reduce the tax burden.

Apart from the tax advantage every company can achieve by using debt financing, multinational groups have access to an additional benefit. In contrast to domestic groups, multinational groups have the possibility of reducing the overall tax burden of the group by allocating external and internal debt capital to group entities with reference to the tax rate differentials of the group members.

In this context, the OECD identifies three typical tax-planning activities of multinational companies using debt financing. First, groups locate, in general, more of their external debt to group entities in high-tax countries. Second, groups use internal debt via intra-group loans to place interest payments, in addition to third-party interest payments, with group companies in high-tax countries. Third, groups use an optimal combination of equity and external or internal debt to generate, in addition to the tax-efficient location of interest expenses, tax-exempt income in high-tax countries. Consider a situation in which a group member in a low-tax country needs capital. In response, a group company located in a high-tax country takes out a loan from a bank. This group member provides the affiliated group member in the low-tax country with equity capital equal to the amount of the loan. This structure results in interest payments that are deductible in the high-tax country and the receipt of dividends from the company in the low-tax country, which are, in general, tax-exempt in the high-tax country.

Many countries have observed, on the one hand, that the asymmetric treatment of equity and debt capital for tax purposes incentivizes companies to accumulate excessive amounts of debt capital. On the other hand, multinational groups have the possibility of reducing their overall tax burden by adjusting the amount of debt and equity attributable to different group members. To diminish these tax planning opportunities and prevent undercapitalization of companies, many countries have established specific thin capitalization rules that limit interest deductibility for tax purposes. The success of unilateral thin capitalization rules to tackle international base erosion and profit shifting: Empirical evidence from firm-level panel data, 66 Natl. Tax J. 1 (2013) and T. Buettner et al., Restricted interest deductibility and multinationals’ use of internal debt finance, 23 Intl. Tax Public Fin. 5 (2016).


7. See sec. 5.
shifting is, however, doubtful, as the fungibility of money and financial instruments allows the parties to benefit from interest deductions by using alternative tools and international financing structures that escape existing interest limitation rules. 8

3. Action 4 of the BEPS Project

Since 2013, the OECD and G20 countries have been working on countermeasures to address base erosion and profit shifting. The tax planning activities identified in section 3. that lead to base erosion through the use of interest expenses are of concern to the OECD. This concern is addressed in Action 4. “Limiting Base Erosion Involving Interest Deductions and Other Financial Payments”, which was released as an updated final version in 2016. The aim of Action 4 is to provide a best practice approach in the design of an interest limitation rule that implements internationally coordinated standards and ensures that profits are taxed where economic activities take place. 9 It is evident that an internationally uniform approach is the most effective way to tackle the use of interest as a means of BEPS if the common best practice approach includes all forms of interest payments, treats groups in equivalent positions consistently and prevents circumvention of the rule. 10 The best practice approach should, however, also be efficient, which means that the regime should be reasonable and feasible to apply by taxpayers and tax authorities. 11

The best practice approach of the OECD includes a fixed ratio rule, which limits net deductions of interest to a percentage of earnings before interest, taxes, depreciation and amortization (EBITDA) based on tax numbers. The suggested range for the possible ratio is between 10% and 30%. This approach has several advantages. While it is easy to apply by taxpayers and tax authorities, it also connects the interest limitation with the economic activity of an entity. If an entity wants to fall outside the scope of the interest limitation rule, it must adapt its EBITDA to its financial activities or vice versa. 12

The proposed range of 10% to 30% provides countries with the freedom to decide which ratio is appropriate in the context of their country-specific conditions. Against this background, countries are also allowed to use a fixed ratio based on EBIT instead of EBITDA. If a country decides to use an EBIT-ratio, however, this ratio must be equivalent to the proposed EBITDA rule. Nevertheless, the best practice approach is sufficiently well defined, such that the OECD has ensured that a coherent and consistent approach will be applied. 13

The interest limitation rule should be effective in respect of both external and intra-group net interest, including all forms of debt and payments that are economically equivalent to interest or incurred in connection with the raising of capital, for example, payments under profit participation loans or the financing cost elements of financial lease payments. The consideration of all deductible financing costs tackles various debt planning strategies, avoids circumventing the regulation and ensures equal treatment of taxpayers in the same situation by using different financing instruments to finance with debt. 14

At a minimum, the interest limitation rule should apply to entities in multinational groups because these entities are most at risk for BEPS. In this context, it is important to evaluate if the interest limitation rule needs to be extended to entities of domestic groups and standalone entities to ensure that the domestic rule is compliant with constitutional obligations and EU law. 15

A fixed ratio rule that limits the deduction of financing costs is a very superficial provision that disregards the economic perspective that groups in different sectors and industries may have different capital requirements and thus are leveraged differently for non-tax reasons. This is why the OECD suggests, under its best practice approach, combining the fixed ratio rule with a group ratio rule. A group ratio rules allows an entity of a group to deduct interest up to the ratio of net third-party interest to the EBITDA of its group. 16

The OECD also recognizes that the interest deduction is dependent on the EBITDA, which is a rather volatile measure that hinges on earnings and production costs. In addition, the financing of a project and the receipt of earnings from a project typically occur at different times. Therefore, the best practice approach allows for a carry-forward of disallowed interest and unused EBITDA or a carry-back of disallowed interest. The possibility to use non-deductible interest and unused EBITDA in future periods reduces uncertainty for groups concerning their future business planning. Furthermore, it reduces double taxation that arises if interest expenses are permanently non-deductible for tax purposes, but the associated interest income is taxed in the hands of the capital lender. 17

In addition to these rules, countries can introduce a de minimis threshold based on net interest expenses to exclude entities that have a low BEPS risk. This could reduce both the compliance costs of these entities and the administrative costs of the tax authorities. 18

On top of the fixed and group ratio rule and related optional reliefs, targeted rules to support the general interest limitation rule, which address specific risks and special rules, for example, for the banking and insurance indus-

10. Id., at 22-23.
12. OECD, supra n. 2, at 49 and 32.
13. Id., at 52.
14. Id., at 33-34.
15. See id., at 37-38; S. Lampert et al., Article 4 of the EU Anti Tax Avoidance Directive in Light of the Questionable Constitutionality of the German “Interest Barrier” Rule, 56 Eur. Taxn. 8 (2016), journals IBFD.
16. OECD, supra n. 2, at 61.
17. Id., at 71-72.
18. Id., at 39.
tries, could also be implemented and support the effectiveness of combating BEPS.


In response to the OECD activities, the European Commission produced an Anti-Tax Avoidance Package, which included a proposal for an Anti-Tax Avoidance Directive (ATAD) to ensure taxation where profits and value are generated. The Council sought general, but flexible, solutions in accordance with the recommendations of the OECD to improve the functioning of the internal market. The preferred approach for implementing BEPS avoidance measures is an EU directive to guarantee a minimum standard and consistency amongst Member States. Improving the internal market’s resilience against cross-border tax avoidance practices depends on uniform implementation rather than the implementation of individual solutions by each Member State. National corporate tax systems are disparate and independent actions would only replicate the existing fragmentation. Nevertheless, the provisions of the ATAD have to be implemented into 28 separate corporate tax systems. This is why the ATAD is limited to general provisions and leaves implementation to the Member States.

Against this background, the ATAD was adopted by the Council on 20 June 2016 and contains, in addition to the interest limitation rule, a rule for controlled foreign companies, a switchover rule, a rule for exit taxation and a general anti-abuse rule. All Member States must, in general, adopt this Directive in their national corporate tax systems by 31 December 2018. If, however, Member States can prove that they have national targeted rules to prevent BEPS risks associated with the deduction of interest expenses that are as effective as the obligatory interest limitation rule, implementation of article 4 of the ATAD must be realized by 1 January 2024 at the latest.

The Directive, in line with Action 4, stipulates that interest expenses that exceed interest revenue should be deductible in the tax period in which it arises, to the extent of 30% of the company’s EBITDA. This rule is applicable, in particular, to taxpayers that are subject to corporate tax because these taxpayers bear the main BEPS risk.

In addition to the EBITDA-fixed ratio rule, Member States can enact additional provisions to take the characteristics of their national tax systems into account. The Member States can implement the following additional provisions, which comply with the recommendations of BEPS Action 4:

- a de minimis threshold of EUR 3 million (also in respect of groups);
- an exclusion for standalone entities;
- permission for a group member to deduct its excess interest expenses if the ratio of its own equity to its total assets is equal to or greater than the equivalent ratio of the group (deviation of two percentage points permitted);
- an alternative rule for groups (allowing for the deduction of interest expenses in excess of 30% of EBITDA), which involves:
  (i) determining the group ratio (excess interest expenses of the group vis-à-vis third parties over the group’s EBITDA); and
  (ii) deducting interest expenses as a product of the group ratio determined and the entity’s EBITDA; and
- use of unused interest expenses and interest capacity in later or previous periods (unlimited carry-forward of excess interest expenses, unlimited carry-forward and three-year carry-back of excess interest expenses or unlimited carry-forward of excess interest expenses and five-year carry-forward of unused EBITDA).

5. Country-Specific Adjustment Requirements

Based on article 4 of the ATAD, country-specific adjustments are necessary to guarantee a minimum standard and consistency amongst the Member States. The EU Member States have an obligation to apply the general EBITDA provision. All other specific rules can be implemented voluntarily. As such, they can be designed in a way that suits the national corporate tax systems. Member States can freely decrease the 30% ratio or place time limits on or restrict the amount of non-deductible interest expenses that can be carried forward or back to ensure a higher level of protection. They can also use rules that target intra-group debt financing, in particular thin capitalization rules, in addition to the interest limitation rule provided by the ATAD. Article 3 of the ATAD clarifies that the Directive does not preclude the application of provisions aimed at protecting domestic tax bases. Nevertheless, to fulfil the minimum standard of the ATAD most Member States need to make adaptations.

In six Member States, a general rule to avoid tax planning and BEPS via interest deductions is missing. Only in special circumstances (for example, artificial arrangements or expenses not associated with the production of income) will Cypriot companies be affected by a limitation of expenses. In Estonia, only corporate distributions will be taxed; therefore, the arm’s length principle must be considered. Ireland has targeted provisions that capture specific structures (for example, tax-motivated interest payments). The same applies in Malta. Furthermore, the Netherlands has a set of different rules that do not address interest expense limitations in general. In addition to the general requirement of the arm’s length principle, allowances relating to, for example, intra-group debt exist. Sweden uses the arm’s length principle and some limitations on related company transactions to address BEPS.
problems. In summary, the aforementioned countries have a general anti-avoidance rule, which is employed in a different manner in each state. Some also have targeted restrictions, which apply in specific situations under particular circumstances. The different national tax systems do not, however, have a fundamental limitation on interest deductions. Nevertheless, a limitation is required based on the Directive, which means that these countries need to adapt their rules. They have to implement a general restriction on the deduction of interest expenses by limiting the deductibility of excess interest expenses over interest revenues to 30% of the taxpayer’s EBITDA. In addition to implementing the new provision, existing targeted rules remain unaffected if the Member States prefer not to change their whole system. Targeted rules that aim to restrict tax avoidance strategies through related-party debt remain appropriate.

In addition to a general anti-avoidance regulation, eight Member States have introduced specific interest limitation provisions in the form of performance-related limitations. Germany, Greece, Italy, Portugal, Spain and the United Kingdom have a provision that meets the requirements of the ATAD because they all limit the deductibility of net interest expenses depending upon the corporate taxpayer’s EBITDA. Even the percentage limit (30%) is the same. Deviations exist in respect of the exemptions and simplifications. Nevertheless, the six countries mentioned do not require adaptation because their national tax systems meet the interest expense limitation standard in terms of a performance-related provision. In addition, Finland and the Slovak Republic also have performance-related provisions that focus on a company’s EBITDA. These restrictions, however, only limit the deductibility of net interest expenses on loans between related parties. As such, the tax systems of these two countries need to be adjusted to expand the scope of the existing provisions to third-party financing. Moreover, the present rate totals 25% in each country, which is consistent with the ATAD because the provisions of the ATAD constitute a minimum level; thus, stricter regulations are not affected and, therefore, need not be adjusted. All these countries could implement further exemptions without any risk of non-compliance.

Besides interest expense limitation provisions using performance-related criteria, another limitation approach is to punish a company’s undercapitalization. The remaining 14 Member States have thin capitalization rules in the form of a debt-to-equity ratio. Although a strict ratio of 1:1 applies to loans granted by shareholders (and those comparable to shareholders) in Belgium, most of the countries have a 4:1 debt-to-equity ratio. The predominant provisions only refer to loans provided by related parties; thus, debt financing from banks and other financial institutions is specifically not restricted. In addition to thin capitalization rules, other provisions (for example, limitations on interest rates) apply in some countries. In particular, Denmark and France have complex limitation systems with different reliefs and requirements, which must be verified through consecutive steps. Overall, a required performance-related limitation of interest expenses is missing in Austria, Belgium, Bulgaria, Croatia, the Czech Republic, Denmark, France, Hungary, Latvia, Lithuania, Luxembourg, Poland, Romania and Slovenia. For this reason, in these countries, adjustments are required. The national tax legislators must implement a provision that limits the deductibility of net interest expenses depending on the taxpayer’s EBITDA. Existing regulations could remain if they are not inconsistent with the requirements of the Directive.

Overall, it can be stated that 22 countries must introduce or change their interest limitation rules to fulfill the minimum requirements of the ATAD. Some of these countries have performance-related limitations that only need to be amended in part. Others limit the deduction of interest expenses with a thin capitalization rule. In most instances, only interest expenses relating to affiliated companies are limited. To achieve consistency with the ATAD, implementation of a performance-related interest limitation provision, which limits the deductibility of net interest expenses to 30% of the taxpayer’s EBITDA, is inevitable. Further provisions with regard to the limited deductibility of interest expenses are less restricted by the Directive and allow for much more flexibility in the individual countries and their tax systems. Some countries have already started to develop a legislative proposal to implement the provisions of the ATAD into national law (for example, Sweden).26

6. National Sovereignty versus Harmonization

The need for adaptation as described in section 5. follows from Action 4 of the OECD’s BEPS Plan, which calls for implementation of internationally coordinated standards to ensure that profits are taxed where economic activities take place.27 The European Commission has followed the OECD’s lead, subject to the additional goal of improving the functioning of the European Single Market.28 The question is how these aims can be achieved and which future developments will occur in light of the interplay between national sovereignty and harmonization.

The proposal of the OECD in BEPS Action 4 and the ATAD demonstrate a change in direction regarding the design of interest limitation rules. While previous interest limitation rules in most countries specifically targeted intra-group interest to ensure that debt is at arm’s length, the new provision proposed by the OECD and the regulation introduced in the European Union include all interest to ensure, in a general way, that interest is connected to an economic activity in the country (EBITDA).29 The question that arises is whether or not the new interest limitation rule is consistent with national tax systems and constitutions.

27. OECD, supra n. 2, at 3-13.
The basis of most tax systems is the principle of net taxation, which stems from the ability-to-pay principle and the principle of equality. The principle of net taxation prescribes that expenses that are causally related to income be unrestrictedly deductible in determining taxable income. Restricted interest deductibility violates the net tax principle, which generally requires a specific justification by the legislator.

The German interest limitation rule was introduced to reduce the incentive for excessive debt financing and abusive debt financing structures in order to protect the domestic tax base. The German Federal Fiscal Court has questioned the constitutionality of the German interest limitation rule because the regulatory purpose of the rule is not substantive enough to justify a violation of the net taxation principle. The German Federal Constitutional Court must now decide on the constitutionality of the provision. This potential unconstitutionality also arises in other countries. It should be noted, however, that this potentially unconstitutional German interest limitation rule is also the basis for the ATAD, which will have implications regarding EU law.

The ECJ, in previous cases, decided that a different treatment of an interest deduction for tax purposes between a domestic entity that pays interest either to a domestic or foreign entity restricted the freedom of establishment. In Lankhorst-Hohorst (Case C-324/00), the ECJ did not accept the justification that the regulatory purpose of the rule was to reduce tax avoidance because the design of the regulation was not specifically aimed at tax avoidance structures. In recent cases, however, the ECJ has accepted specific abuse clauses if they do not exceed the scope of EU anti-abuse provisions and the taxpayer can provide evidence to rebut a presumption of abuse. It is arguable that ECJ case law concerning the accordance of national tax law with the fundamental freedoms does not foster cooperation, but national sovereignty. The scope and focus of interest limitation rules determine which fundamental freedoms are being restricted. In this context, EU Member States need to determine the appropriate justification for a restriction of the fundamental freedoms. The OECD has stated that "the need to preserve the balanced allocation between EU Member States of the power to impose taxes and the need to prevent tax avoidance and to combat artificial arrangements" are examples of justifications for a restriction on the fundamental freedoms. This reference of the OECD indicates that a conflict with the fundamental freedoms may arise.

From an economic perspective, the ATAD implements an interest limitation rule that is binding for Member States, based on the suggestion of the OECD, leading to a coordinated approach to tackling debt tax planning. This uniform approach reduces the risk that the introduction or redesign of an interest limitation rule by a single country could negatively affect the country’s attractiveness in terms of international business activities or restrict competition between domestic and multinational groups. Instead, a uniform regulation of interest limitation provisions should make the application and impact of the regime more predictable and enable entities and groups to plan their capital structures with more confidence and planning security. In addition, this consistent EU approach will contribute to decision-neutral taxation by reducing distortions in terms of capital allocation, the risk of double taxation and opportunities for BEPS.

The uniform fixed ratio approach of the ATAD, however, simply provides for a minimum level of protection against BEPS in the European Union. The EU Commission does not want to restrict national sovereignty excessively. For this reason, Member States are free to design and implement de minimis thresholds, group ratios or other specific target rules in a way that is consistent with their national tax systems. This freedom of national sovereignty may incentivize Member States to implement special reliefs in order to exclude certain entities or groups from the application of the interest limitation rule. The different relief provisions that may arise in the European Union will influence the capital structure decisions of companies and their tax planning behaviour.

Although EU Member States have a certain degree of freedom to implement relief regulations, the general fixed ratio provision must generally be implemented under national law by 31 December 2018, but no later than 1 January 2024. The authors’ analysis of country-specific adjustment requirements in section 5 indicates that only six countries, namely, Germany, Greece, Italy, Portugal, Spain and the United Kingdom, have provisions that meet the requirements of the ATAD. The 22 remaining countries must introduce or change their interest limitation rules such that at least the requirement for an EBITDA-fixed ratio rule is met.

This substantial need for adaptation means that Member States will be taking an initial step towards greater harmonization of their national tax systems in the European Union. In addition to the current fight against BEPS, the European Commission is pursuing the long-term objective of a Common Consolidated Corporate Tax Base.
(CCCTB). In October 2016, the European Commission published a proposal for a Council Directive on a Common Corporate Tax Base, which represents an initial step toward harmonization of the corporate tax base in all EU Member States. This proposal includes an article on the proposed interest limitation rule, which largely corresponds with the interest limitation rule of the ATAD. In adopting the ATAD, EU Member States are consciously or unconsciously moving toward increased harmonization. This harmonization process will reduce BEPS in the European Union, but it will also restrict tax competition between EU Member States. Once Member States do not have the possibility to compete for tax revenues via tax base regulations, they might strengthen competition by adjusting tax rates or introducing tax reliefs, such as tax holidays. In addition, a Common Corporate Tax Base will reduce BEPS in the European Union but will have little effect on BEPS activities outside the European Union. If not all countries participate in the OECD Action Plan, BEPS cannot be tackled effectively. Furthermore, EU Member States will suffer from competitive disadvantages compared to countries that do not implement BEPS actions.

At first glance, the willingness to participate in the BEPS Project appears impressive. The OECD and G20 members have developed an Inclusive Framework on BEPS to set standards on BEPS issues and review and monitor the implications of the BEPS package. Currently, 108 countries have committed to implementing the BEPS package and participating in the Inclusive Framework to monitor the application of the four minimum standards. These minimum standards include Action 5 on Harmful Tax Practices, Action 6 on Treaty Abuse, Action 13 on Transfer Pricing Documentation and Action 14 on Dispute Resolution. The interest limitation rule in Action 4 is not considered to be a minimum standard. Instead, the OECD expects convergence over time once countries implement and redesign the provisions of their domestic law.

This expectation of the OECD is, however, questionable. Most countries do not have performance-related provisions, such as the proposed EBITDA-fixed ratio, but undercapitalization provisions with a specific safe harbour rule (debt-to-equity ratio). Vietnam is the first non-EU Member State to introduce an interest limitation rule based on Action 4, which applies to third and related-party debt. From an economic perspective, the net benefit under an undercapitalization rule is, in general, higher than under a performance-related provision. This is because a company with financial constraints can deduct a higher amount of interest under an undercapitalization rule, in general, because the amount of the deductible interest expense is independent of the company’s performance. The higher interest deductibility thus has a positive effect on the company’s investment level. In contrast, companies not facing financial constraints can basically deduct less interest under an undercapitalization rule compared to a performance-related rule. Nevertheless, the investment level remains unaffected because companies without financial constraints have access to alternative financing options, for example, retained earnings. Switching from an undercapitalization rule to a performance-related rule is only preferable if, on the one hand, the host country’s financial development is high enough to overcome the negative effects on investment due to stricter interest limitation rules and, on the other hand, the host country has serious concerns about profit shifting via debt financing, for example, where the host country’s tax rate is higher compared to other countries.

7. Conclusion

Based on the authors’ analysis, only six Member States have interest limitation rules that correspond with the ATAD. The remaining 22 Member States must introduce or change their interest limitation rules such that, at a minimum, the requirement to include an obligatory EBITDA fixed ratio rule is met.

The introduction or redesign of interest limitation rules may lead to constitutional concerns under the various national tax systems and restrict the EU fundamental freedoms. From an economic perspective, harmonization results in decision-neutral taxation by reducing distortions of capital allocation, the risk of double taxation and opportunities for BEPS. The ATAD, however, simply provides a minimum level of protection against BEPS in the European Union. National sovereignty may incentivize Member States to implement special reliefs in order to exclude certain entities or groups from the interest limitation rule, which may have an effect on the decisions of companies and tax competition.

In adopting the ATAD, Member States will, consciously or unconsciously, be taking initial steps toward greater harmonization, which might culminate in the adoption of a Common Corporate Tax Base (CCCTB). A Common Corporate Tax Base will reduce BEPS in the European Union but will have a minimal impact on BEPS activities outside the European Union. At an international level, most countries provide for undercapitalization provisions.

47. OECD, supra n. 45, at 14-15.
48. See Offermanns et al., supra n. 11, at 57-60; Tell, supra n. 29, at 756-760; OECD, supra n. 2, at 197-206; D. Gutmann et al., The Impact of the ATAD on Domestic Systems: A Comparative Survey, 57 Eur. Taxn. 1, 3-6 (2017), Journals IBFD.
49. OECD, supra n. 45, at 13.
with a specific safe harbour rule, in contrast to the proposed performance-related provision. Since the net benefit under an undercapitalization rule is, in general, higher than under a performance-related provision, it remains to be seen whether or not countries will engage in the harmonization process.

### Annex: Interest Limitation Rules in EU Member States

#### Countries without a general rule to avoid tax planning and BEPS via interest deductions

<table>
<thead>
<tr>
<th>Country</th>
<th>Rules</th>
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<tbody>
<tr>
<td>Cyprus</td>
<td>Generally, all expenses incurred in the production of income are deductible. Limitation through a general anti-avoidance provision (for example, artificial and fictitious transactions).</td>
</tr>
<tr>
<td>Estonia</td>
<td>Corporate taxpayers are not subject to corporate income tax but to a distribution tax on distributed profits. General anti-avoidance rule applying the arm’s length principle.</td>
</tr>
<tr>
<td>Ireland</td>
<td>General anti-avoidance provision and targeted provisions that address special transactions (for example, transactions with related companies or tax-motivated interest payments).</td>
</tr>
<tr>
<td>Malta</td>
<td>General and some specific anti-avoidance rules to prevent tax avoidance.</td>
</tr>
<tr>
<td>Netherlands¹</td>
<td>Deduction of interest expenses if directly or closely connected with the company’s operations (considering the arm’s length principle). Disallowance of certain transactions relating to intra-group debt (for example, artificial transactions but proof to the contrary possible).</td>
</tr>
<tr>
<td>Sweden</td>
<td>General anti-avoidance provision.</td>
</tr>
</tbody>
</table>


#### Countries with performance-related rules

<table>
<thead>
<tr>
<th>Country</th>
<th>Rules</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finland</td>
<td>Limitation of interest expenses on loans between related parties. Net interest expenses (paid to both related and non-related parties) deductible up to EUR 500,000. In the event of excess, net expenses deductible up to a maximum of 25% of the adjusted taxable income (non-deductible amount limited to the amount of net interest expenses on related-party debt). Remaining interest expenses deductible in further periods; exemption if shown that the equity-to-assets ratio is equal to or greater than the group consolidated ratio.</td>
</tr>
<tr>
<td>Germany</td>
<td>Net interest expenses deductible up to 30% of EBITDA. Unlimited carry-forward of non-deductible interest expenses, carry-forward of unused EBITDA up to five years (if no exemption applies). Exemptions: threshold of EUR 3 million, standalone companies, equity-to-assets comparison between the company and the group (equal to or greater than the same ratio of the group, shortfall up to 2% permitted; inapplicable if more than 10% of net interest expenses on related party debt).</td>
</tr>
<tr>
<td>Greece</td>
<td>Net interest expenses deductible up to 30% of EBITDA. Unlimited carry-forward of non-deductible interest expenses. Threshold of EUR 3 million.</td>
</tr>
<tr>
<td>Italy²</td>
<td>Net interest expenses deductible up to 30% of EBITDA. Unlimited carry-forward of non-deductible interest expenses and unused EBITDA. Excess of 30% of EBITDA over net interest expenses usable to increase relevant threshold in following tax periods. In cases of tax consolidation, excess interest expenses of a group member can be offset against EBITDA-leftover of another group company.</td>
</tr>
<tr>
<td>Portugal</td>
<td>Net interest expenses deductible up to the greater of EUR 1 million or 30% of EBITDA. Carry-forward of non-deductible interest expenses and unused EBITDA for a maximum of 5 years. Consideration of EBITDA on a group basis possible.</td>
</tr>
<tr>
<td>Slovakia</td>
<td>Limitation of interest expenses on loans between related parties. Net interest expenses deductible up to 25% of EBITDA.</td>
</tr>
<tr>
<td>Spain</td>
<td>Net interest expenses deductible up to 30% of EBITDA. Unlimited carry-forward of non-deductible interest expenses. Threshold of EUR 1 million. Excess of 30% of the EBITDA over net interest expenses usable to increase relevant threshold in subsequent 5 tax periods. For tax groups, deduction limit refers to the whole group.</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>Net interest expenses deductible up to 30% of EBITDA. Carry-forward of non-deductible interest expenses for a maximum of 5 years.</td>
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². See also Deloitte, International Tax Italy Highlights 2017 (Deloitte 2017).
<table>
<thead>
<tr>
<th>Countries with thin capitalization rules</th>
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<tbody>
<tr>
<td>Austria</td>
</tr>
<tr>
<td>- No specific thin capitalization rules but guidelines in accordance with case law</td>
</tr>
<tr>
<td>- Debt-to-equity ratio of 3:1 or 4:1 generally accepted in practice</td>
</tr>
<tr>
<td>- In respect of group financing, proof of ability to obtain funds from third-party creditors under the same conditions possible</td>
</tr>
<tr>
<td>- Reclassification as hidden profit distribution</td>
</tr>
<tr>
<td>Belgium</td>
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<tr>
<td>- Debt-to-equity ratio of 1:1 applies to loans granted by shareholders, qualification as non-deductible dividend</td>
</tr>
<tr>
<td>- 5:1 debt-to-equity ratio applies if creditor is a group member, tax exempt or taxed at a reduced rate with regard to the interest income, consideration as non-deductible business expenses</td>
</tr>
<tr>
<td>Bulgaria</td>
</tr>
<tr>
<td>- Net interest expenses on loans from shareholders, in specific instances from third parties, deductible up to 75% of a company’s EBIT</td>
</tr>
<tr>
<td>- Regulation applies only if liabilities exceed three times the equity of the company</td>
</tr>
<tr>
<td>- Carry-forward of non-deductible interest expenses for a maximum of 5 years</td>
</tr>
<tr>
<td>Croatia</td>
</tr>
<tr>
<td>- Non-deductible interest expenses if borrowed capital is provided by a shareholder (&gt; 25%) and loan amounts to four times the shareholder’s share in the capital</td>
</tr>
<tr>
<td>- Excess amount is not recognized for tax purposes</td>
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<tr>
<td>- Loans granted by banks or other financial institutions not affected</td>
</tr>
<tr>
<td>Czech Republic</td>
</tr>
<tr>
<td>- Debt-to-equity ratio of 4:1 applies to credit and loans granted by related parties</td>
</tr>
<tr>
<td>- Consideration as non-deductible business expenses</td>
</tr>
<tr>
<td>Denmark</td>
</tr>
<tr>
<td>- Different, successive regulations:</td>
</tr>
<tr>
<td>- debt-to-equity ratio of 4:1 and controlled debt exceeds DKK 10 million, excess interest expenses are not deductible; proof to the contrary that the same loan could exist between unrelated parties is possible</td>
</tr>
<tr>
<td>- deductibility of net interest expenses is limited to a maximum amount of 3.2% on the tax value of the company’s business assets (controlled and non-controlled debt) if expenses exceed DKK 21.3 million</td>
</tr>
<tr>
<td>France</td>
</tr>
<tr>
<td>- Different regulations for interest expenses paid to related companies:</td>
</tr>
<tr>
<td>- arm’s length test: interest limitation to the greater of average annual interest rate (standard market rate) and interest that the borrowing company would have received from third parties</td>
</tr>
<tr>
<td>- three-step-test:</td>
</tr>
<tr>
<td>(1) debt-to-net equity ratio of 1.5:1 for related-party debt</td>
</tr>
<tr>
<td>(2) interest paid to associated companies &gt; 25% of the company’s adjusted income</td>
</tr>
<tr>
<td>(3) amount of interest paid exceeds amount of interest received from associated companies Interest exceeding the highest of the three limits is not deductible; unlimited carry-forward of non-deductible interest expenses but reduction of that amount by 5% annually from the second year of the carry-forward; exemption: total debt-to-equity ratio does not exceed the same ratio of the group</td>
</tr>
<tr>
<td>- general limit of 25% of the net finance expenses of a company after application of the other, more specific rules; permanent disallowance (no carry-forward); threshold of EUR 3 million</td>
</tr>
<tr>
<td>Hungary</td>
</tr>
<tr>
<td>- Debt-to-equity ratio of 3:1 applies to any liabilities (with exception of bank loans), although certain receivables deductible from liabilities</td>
</tr>
<tr>
<td>- Reclassification as hidden profit distribution</td>
</tr>
<tr>
<td>Latvia</td>
</tr>
<tr>
<td>- Higher amount of:</td>
</tr>
<tr>
<td>- debt-to-equity ratio of 4:1 (exemption of borrowings from credit institutions, loans obtained from Latvian Treasury and credit institutions registered in EU Member States)</td>
</tr>
<tr>
<td>- interest paid exceeding 1.57 times the Latvian Bank’s weighted average annual interest rate applied to domestic non-financial companies</td>
</tr>
<tr>
<td>- Consideration as non-deductible business expenses</td>
</tr>
<tr>
<td>Lithuania</td>
</tr>
<tr>
<td>- Debt-to-equity ratio of 4:1 applies to loans granted by shareholders (directly, indirectly or together with related parties &gt; 50%)</td>
</tr>
<tr>
<td>- Consideration as non-deductible business expenses</td>
</tr>
<tr>
<td>- Proof to the contrary that the same loan could exist between unrelated parties is possible</td>
</tr>
<tr>
<td>Luxembourg</td>
</tr>
<tr>
<td>- No general thin capitalization rules, but in practice: debt-to-equity ratio of 85:15 for intra-group financing of participations</td>
</tr>
<tr>
<td>- Reclassification as hidden profit distribution</td>
</tr>
<tr>
<td>Poland</td>
</tr>
<tr>
<td>- Debt-to-equity ratio of 1:1 applies to loans granted by shareholders</td>
</tr>
<tr>
<td>- Option for an alternative method: interest on qualifying loans (related and third parties) deductible up to a predetermined amount (tax value of assets multiplied by reference rate of National Bank of Poland increased by 1.25 percentage points)</td>
</tr>
<tr>
<td>- But: total tax deductible amount cannot exceed 50% of company’s operational profit</td>
</tr>
<tr>
<td>- Carry-forward of non-deductible interest expenses for a maximum of 5 years</td>
</tr>
<tr>
<td>Romania</td>
</tr>
<tr>
<td>- Deductibility of interest related to loans obtained from legal entities other than credit and comparable institutions limited in two ways:</td>
</tr>
<tr>
<td>(1) deductible interest limited to the reference interest rate of National Bank of Romania, consideration as non-deductible business expenses</td>
</tr>
<tr>
<td>(2) debt-to-equity ratio of 3:1, unlimited carry-forward of non-deductible interest expenses</td>
</tr>
</tbody>
</table>
Countries with thin capitalization rules

<table>
<thead>
<tr>
<th>Country</th>
<th>Rule Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Slovenia</td>
<td>Debt-to-equity ratio of 4:1 applies to interest on loans granted or guaranteed by shareholders. Proof to the contrary that the same loan could exist between unrelated parties is possible.</td>
</tr>
</tbody>
</table>

2. See also Deloitte, Taxation and Investment in Czech Republic 2017 (Deloitte 2017).