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ANTI-TAX AVOIDANCE DIRECTIVE: INTEREST LIMITATION RULE

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ABSTRACT

Since the beginning of 2019, EU's version of the interest limitation rule has been applied in its Member States. Regardless, throughout its implementation process the rule has genarated its fair share of varying opinions and notable controversy. The aim of this thesis is to shead light on the interest limitation rule in the EU, while discussing its possible effects from both a legal as well as a more economic perspective. To accomplish this task, this thesis utalises comparative method, doctrinal research, legal interpretation and analysis of legislation, analysing both law and literature. In its conclusion, this thesis suggests that the interest limitation rule has the capability of combating base erosion and profit shifting in the EU. However, it could also have significant negative effects on EU foundations and economy that should not be understated.

Keywords: BEPS, interest limitation rule, tax planning, EU law, Anti-Tax Avoidance Directive

List of abbreviations

ATAD	Anti-Tax Avoidance Directive
ATAP	Anti-Tax Avoidance Package
BEPS	Base erosion and profit shifting
CJEU	Court of Justice of the European Union
EBIT	Earnings before interest and taxes
EBITD	Earnings before interest, taxes and depreciation
EBITDA	Earnings before interest, taxes, depreciation and amortisation
ECJ	European Court of Justice
EU	European Union
IFRS	International Financial Reporting Standards
MNE	Multinational enterprise
OECD	Organisation for Economic Cooperation and Development
PE	Permanent establishment
SME	Small and medium-sized enterprise
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union

INTRODUCTION

Tax planning has not only been awarded internationally with the reputation of a legitimate way to minimise one's tax burden, it is also compatible with the European Union's (EU's) fundamental freedoms and in compliance with the purposes of the law. Its compatibility extends even to international tax law's complementary business purpose test[1], as well as EU's genuine economic activity test[2].[3] However, the beginning of the 21st century was heavily marred by countries facing serious financial difficulties due to the 2008 financial crisis along with the following Great Recession.[4] Hence, as attention turned on a worldwide scale to the base erosion and profit shifting (BEPS) activities of multinational enterprices (MNEs), similarly became the tool that enables it under question. As a result, to ensure tax state's survival and the notion of fairness, countries began seeking ways to counter the aggressive tax planning activities,[5] the Organisation for Economic Cooperation and Development (OECD) taking on a leading role and creating the BEPS Project of 15 actions addressing tax avoidance.[6]

As a response to this worldwide movement, in 2016 the European Commission introduced its Anti Tax Avoidance Package (ATAP) for "fairer, simpler and more effective corporate taxation in the EU"[7], including as one of its key elements the Anti-Tax Avoidance Directive[8] (ATAD, the Directive). Though interest deduction limitation has been a somewhat controversial topic, with its enclusion into the OECD's BEPS Project, the European Commission also included an interest

[1] OECD (2014), *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, p. 69 referenced in Dourado (Dourado A. P. (2015). Aggressive Tax Planning in EU Law and in the Light of BEPS: The EC Recommendation on Aggressive Tax Planning and BEPS Actions 2 and 6. *Intertax*, Vol. 43, Issue 1, 43).

[2] Court decision, 12.9.2006, Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue, C-196/04, ECLI:EU:C:2006:544 paragraphs 54-55 referenced in Dourado (Dourado (2015), *supra nota* 1, p 43).

[3] Dourado (2015), *supra nota* 1, p 43.

[4] Avi-Yonah, R. S.; Xu, H. (2017). Evaluating beps – *Erasmus Law Review* 10(1), 3

[5] Dourado (2015), *supra nota* 1, p 43.

[6] *BEPS Actions*. OECD. Accessible: http://www.oecd.org/ctp/beps-actions.htm , 20 April 2019.

[7] *Anti Tax Avoidance Package.* European Commission. Accessible: https://ec.europa.eu/taxation_customs/business/company-tax/anti-tax-avoidance-package_en , 8 March 2019.

[8] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ L 193, 19.7.2016, p. 1–14

limitation rule in the ATAD. However, whether this inclusion truly leads the way to the realisation of the ATAP's ambitions has been thoroughly questioned. While the ATAD's interest limitation rule's aim is to rightly discourage MNEs from engaging in artificial debt arrangements for the sole reason of overall taxburden minimisation,[9] due to its construction, its affects might spread far beyond that, and not in an altogether desired fashion either. From possibly eroding effects on EU's fundamental freedoms and principles to EU based entities being at a risk of facing unfair burden both globally and on the Internal Market, there are many ways the ATAD's interest limitation rule, despite its unquestionably good intentions, could result in more harm than good.

With the required application deadline of the ATAD having passed but a few months ago in the beginning of 2019 and multiple Member States having modified their tax laws but recently to comply with the ATAD, the impact of the interest limitation rule on the Internal Market can now be more thoroughy inspected. Thus, this thesis aims to shead more light on the manifestation of the interest limitation rule in the Member States, while also speculating as to its long-term effects on the Internal Market, by explaining the interest limitation rule and the reasoning behind it, comparing the implemenation of the rule in EU Member States Malta, Finland and France as well as attempting to observe the most noteworthy effects of this rule in the EU from both a legal and an economic perspective.

With all of the above in mind, this thesis shall attempt to answer two main questions: 1) How is the interest limitation rule interpreted and implemented on the various levels of EU law? 2) What effects could the interest limitation rule have on EU law and economy? The author of this thesis shall attempt to thoroughly answer these two questions using various research methods including comparative method, doctrinal research, legal interpretation and analysis of legislation: the author will explain the background and justifications for the interest limitation rule from both EU as well as OECD's perspective to gain a better understanding on the underlying principles and desired effects of the rule, considering also how likely the manifestation of these effects are in their desired form. Additionally, the author shall explain the laws Malta, Finland and France have implemented to comply with the ATAD and provide comparison on them. The author shall also attemt to determine interest limitation rule's other affects on the EU by analysing varying opinions on its

[9] *The Anti Tax Avoidance Directive.* European Commission. Accessible: https://ec.europa.eu/taxation_customs/business/company-tax/anti-tax-avoidance-package/anti-tax-avoidance-directive_en , 8 March 2019.

affects, both legal and economic. Thus, the research objects mainly consists of law and literature, as well as news, case law and various relevant web materials.

The first chapter shall be dedicated to explaining the interst limitation rule. Here both the perspective of the OECD as well as the EU will the examined. This examination shall provide the basis for further analysis of the rule in later chapters. The second chapter provides insight on the implementation of the ATAD's interest limitation rule in Malta, France and Finland. These three were chosen, as all of them have recently implemented the interest limitation rule into their respective tax regimes, their background regarding the rule differs and they represent Member States of various economic levels. Therefore, after discussing the rule's implementation in these Member States separately, this thesis also provides some comparison on them. Finally, before the author's concluding remarks on the topic, this thesis will discuss the possible impacts the ATAD's interest limitation rule could have on EU law and economy. As mentioned, these are but new rules, and consequently there is quite little information offered on their economic impact on the Internal Market yet. However, interest limitation rules as a concept lack novelty due to their various counterparts around the world, thus allowing for reasonable conclusions as to their impacts regardless.

1. Background of the interest limitation rule

BEPS activities of MNEs have seen notable increase as a result of significant integration of both world economies and markets.[10] As a global issue quite unsolvable by individual countries, perhaps the most reasonable way to effectively combat BEPS was to discover a common, global solution.[11] Therefore, in 2015 the G20 together with the OECD released to the public the BEPS Project.[12] This Project includes reports and actions intended to aid countries in designing resilient tax systems able to combat tax avoidance strategies that exploit legislative gaps in order to artificially shift profits to low or no-tax jurisdictions.[13]

A notable opportunity for tax planning has been presented by different loan arrangements, as OECD has also stated in its BEPS Action 4 package on Limiting Base Erosion Involving Interest Deductions And Other Financial Payments: "[t]he use of third party and related party interest is perhaps one of the most simple of the profit-shifting techniques available in international tax planning"[14]. This possibility emanates from the asymmetric ways financing via debt or equity is treated in corporate tax law. While interest payments can be deducted from the company's tax base, same cannot be said for equity returns, thus creating an incentive for companies to rely more heavily on debt than equity to reduce their overall tax burden. For MNEs there is also the additional opportunity to utilise group internal debt to shift profits from its entity located in a high tax rate country to one in a low tax rate country.[15] Concequently, there are truly grand possibilities for MNEs to reduce their worldwide tax burden by planning their loan arrangements to effectively utalise any and all opportunities the gaps of different tax systems provide. Yet, MNEs using this system to their best advantage, while perhaps somewhat unethical, can hardly be considered

[10] OECD (2016), *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 - 2016 Update: Inclusive Framework on BEPS*. OECD/G20 Base Erosion and Profit Shifting Project. Paris: OECD Publishing, p. 3. Accessible https://doi.org/10.1787/9789264268333-en (8 March 2019).
[11] EconPol Policy Report 8/2018 Vol. 2 Dissecting the EU's Recent Anti-Tax Avoidance Measures: Merits and Problems, p. 1-2.
[12] Avi-Yonah, Xu (2017), *supra nota* 4, p 6.
[13] *Base erosion and profit shifting*. OECD. Accessible: http://www.oecd.org/tax/beps/ , 8 March 2019.
[14] OECD (2016), *supra nota* 10, p 19.
[15] Haufler, A., Runkel, M. (2009). Firms' Financial Choices and Thin Capitalization Rules under Corporate Tax Competition. – *Conference Competition Among Nation States,* 16-17 October 2009, Munich and Venice. Max Planck Institute for Intellectual Property, Competition and Tax Law, Wissenschaftszentrum Berlin für Sozialforschung, p 1.

unexpected or unreasonable, as maximising their profits is their primary function. Therefore, governemnts are left with no other possibility but to change this system by introducing new legislation, if they they wish to more effectively combat BEPS.

Thus, as a response to the OECD's BEPS project, in January 2016 the European Commission introduced the ATAP followed closely by the ATAD, that was adopted by the Council of the European Union on 20 June 2016. The ATAD includes five key measures for combating BEPS in the EU: the controlled foreign company rule, the switchover rule, the exit taxation rule, the general anti-abuse rule as well as the EU's version of the interest limitation rule.[16]

This chapter shall explain the background and purposes of the EU's interest limitation rule beginning from the BEPS project and the purposes behind it. Short discussion as to the rule's worldwide effects is also included in order to illustrate possible effects of its inclusion in the ATAD. Furthermore, the EU's interest limitation rule is explained by examining its manifestation in the ATAD more closely. Finally, the author shall exmine the relationship between the underlying purposes of the interest limitation rule and its adopted form in the ATAD to determine whether it fulfills its desired purposes.

1.1. Base erosion and profit shifting project Action 4: limiting base erosion involving interest deductions

As the OECD attempted to create internationally uniform rules to effectively combat interest being used as a part of BEPS activities, the proposed approach includes not only internal and related party, but also external debt arrangements. Additionally, all forms of interest as well as any and all of its equivalents are included in order to establish that the rules treat all companies in same situations in the same manner, and ensuring there is no mode for bypassing the rules by structuring debt arrangements differently.[17] However, this extension of interest's meaning could also merely be the result of there being no universally agreed upon definition of either interest or dividend, and

[16] *The Anti Tax Avoidance Directive.* European Commission. Accessible: https://ec.europa.eu/taxation_customs/business/company-tax/anti-tax-avoidance-package/anti-tax-avoidance-directive_en , 8 March 2019.
[17] OECD (2016), *supra nota* 10, p 23.

OECD wishing to steer away from creating one.[18] Finally, the interest limitation rule should at the very least apply to all entities of MNE's due to the high risk of profit shifting activities among them. Nevertheless, for higher levels of protection the rule could be extended to include entities of domestic groups or standalone entities as well.[19]

The OECD's best practice approach is fundamentally based on its fixed ratio rule, which limits net interest cost deductibility to a percentage of the entity's earnings before interest, taxes, depreciation and amortisation (EBITDA). The recommended percentage in the fixed ratio rule is anywhere between 10 to 30 percent.[20] The advantage of a fixed ratio is its simplicity from the viewpoint of both governments and companies, and it also ensures that a part of the profits earned remain subject to tax. Regardless, the OECD also identified some issues with the simplicity of this rule, including its inability to take into account the sectoral differences effect on debt levels and the possibility of funding strategies including high debt ratio for non-tax purposes.[21] An earnings-based measure was chosen after comparing the different aspects of using earnings- and asset-based measures, and while OECD recommended using EBITDA, EBIT was included as another option, so long as other elements of the rule were applied according to the best practice approach.[22] As for the chosen percentage range, it was recognized as the most appropriate one to tackle BEPS activities, without risking the goal of allowing groups the ability to deduct their net third party interest costs, and also taking into account the differing economic environments and other BEPS targeting rules in different countries. The precise percentage a state chooses from the recommended range will depend on some additional factors. These factors include for instance taking into account any other BEPS combating rules the country has, as well as the level of interest rates compared to other countries.[23]

While the simplicity of the fixed ratio rule offers ease in its implementation, its unrelenting nature is not without downsides and its proportionality could be quite questionable. Thus, in its report, the OECD has also included recommendations for supplementing the best practise with various

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[18] Traversa, E. (2013). Interest Deductibility and the BEPS Action Plan: nihil novi sub sole? *British Tax Review*, 5, 609.
[19] OECD (2016), *supra nota* 10, p 37.
[20] *Tax Newsletter – International Developments BEPS Action 4: interest deductions and other financial payments* (2015). Ashurst. Accessible: https://www.ashurst.com/en/news-and-insights/legal-updates/beps-action-4-interest-deductions-and-other-financial-payments/ , 11 March 2019.
[21] OECD (2016), *supra nota* 10, p 51.
[22] *Ibid*., p. 47-49.
[23] *Ibid*., p. 52-54.

other rules. To counteract the fixed ratio rule being unable to consider the non-tax related purposes of groups in different sectors and industries having different capital requirements and thus being leveraged differently, the OECD introduces a group ratio rule.[24] The form of the group ratio rule is for the most part but a suggestion, but it is designed to allow an entity that has a net interest expense above the limit of the fixed ratio rule of its country to be able to deduct interest costs up to the level of net third party interest to EBITDA ratio of its entire group, should it be higher.[25]

The other rules the OECD recommended in order to reduce impact of interest limitation rules in cases where there is little to no risk of BEPS include a *de minimis* threshold to exclude entities with low level net interest expenses, such as small and medium-sized enterprises (SMEs), from the sphere of both fixed ratio and group ratio rules. Additionally, Action 4 includes rules to allow disallowed interest or unused interest capacity being carried forward or disallowed interest being carried back to be used in different tax periods to minimise the risk of groups incurring permanent interest disallowance resulting from, for example, incurred interest expense for funding projects with capabilities for future taxable income.[26] BEPS Action 4 also included possibility for specific exclusions for companies in either banking or insurance sectors as well as for those engaged in certain public benefit projects, targeted rules applicable to related party debt and arrangements for minimising the effects of the fixed ratio rule, as well as grandfathering rules to minimise the costs implementation of these rules will have on companies.[27]

This best practice approach of OECD's, although non-binding for all states and jurisdictions, is expected to become of significant influence in interest deduction limitation rule implementation around the globe. After all, so far close to a 100 states and jurisdictions have signed the BEPS project, while over 20 of them, including such large economies as the United Kingdom, Japan, France and Australia, have already deposited their instrument of ratification, acceptance or approval as well. Even countries characterised as tax havens, such as Barbados, the United Arab Emirates and South Korea, have signed the BEPS project.[28] This is especially significant, as there

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[24] Hillman, L., Hoehl, R. (2018). Interest limitation rules: At a Crossroads between National Sovereignty and Harmonization – *IBFD,* European Taxation April 2018, 141.
[25] Bhogal, S. (2015). Deducing beps action 4: Interest deductibility. *International Tax Review* 26(9), 36.
[26] Gilleard, M. (2016). The beps special. *International Tax Review* 26(10), 29-30.
[27] Ashurst (2015), *supra nota* 20.
[28] Tell, M. (2017). Interest Limitation Rules in the Post-BEPS Era. *Intertax*, 45(11), 756.; *Signatories And Parties To The Multilateral Convention To Implement Tax Treaty Related Measures To Prevent Base Erosion And Profit Shifting Status as of 25 February 2019* (2019). OECD. Accessible: http://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf , 17 March 2019; Boffey, D. (2017) *EU blacklist names 17 tax havens and puts Caymans and Jersey on*

were some doubts as to their commitment to such a project.[29] However, not all agree with this notion. Recent research has proposed that the tools of Action 4 might not be as effective as was their aim.[30] Similarly, some claim the BEPS project cannot be considered the destination, but rather a first step towards the complete remodelling of the international tax system.[31] With such inconsistent reviews, the author of this thesis must conclude that in the end only time will conclusively see to Action 4's real impact. Yet, regardless of its perhaps questionable global impact, the EU has been a notable supporter of the BEPS Project from the very beginning, and with the creation of the ATAD, has ensured that the EU Member States are among the first countries to implement it, be it then for the better or worse.

1.1.1. Implementation into European Union law

Compiling Action 4, the OECD also included in it multiple mentions regarding its possible incompatibilities with EU legislation the Member States would need to take into consideration when implementing the rules. However, even though Action 4 was designed to present guidelines for individual states in dealing with BEPS, upon its release in 2015, the Council stressed in its conclusions that the EU countries would need to discover a common but flexible EU level solution to fulfil their obligations under BEPS.[32] Thus, instead of the Member States individually implementing rules, the task was directed to the Commission to find a solution to the various issues regarding the compatibility between the Action 4's obligations and EU law, including problems with EU treaty freedoms and directives.[33] This must have undoubtedly been a most challenging task, as there are many inconclusive exchanges of views on the possible restrictions EU law could pose on both the outcomes and implementation of the BEPS project.[34] Whether the Commission has succeeded in avoiding any issues arising related to EU freedoms, principles and law in contrast to the BEPS Action 4 will be for the most part assessed in chapter 3 of this thesis.

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notice. Accessible: https://www.theguardian.com/business/2017/dec/05/eu-blacklist-names-17-tax-havens-and-puts-caymans-and-jersey-on-notice , 19 March 2019; Bajpai, P. (2019) *The World's Top 20 Economies*. Accessible: https://www.investopedia.com/insights/worlds-top-economies/ , 2 April 2019.

[29] Kavelaars, P. (2013). Eu and oecd: Fighting against tax avoidance. *Intertax* 41(10), 515.

[30] Ting, A. (2017). Base Erosion by Intra-group Debt and BEPS Project Action 4's Best Practice Approach — A Case Study of Chevron. *British Tax Review*, Issue 1, p. 80 referenced in Ting (Ting, A. (2018). Creating Interest Expense Out of Nothing at All – Policy Options to Cap Deductions to "Real" Interest Expense. *British Tax Review*, Issue 5, 590).

[31] de Wilde, M. (2017). Taxing multinationals post-beps what's next. *Erasmus Law Review* 10(1), 2.

[32] Council Directive (EU) 2016/1164, *supra nota* 7, Recital 2.

[33] OECD (2016), *supra nota* 10, p 89-90.

[34] Schön, W., Baker, P. (2015). The BEPS Action Plan in the light of EU law. *British Tax Review*, 3, 277.

1.2. Anti-Tax Avoidance Directive

In regards to taxation, to a large extent the competence to legislate on tax law issues has remained with the Member States, even if the requirements of EU laws and freedoms must still be respected.[35] However, harmonising measures on EU level under Article 115 of the Treaty on the Functioning of the European Union (TFEU) are still possible in order to avoid domestic tax regimes directly affecting establishment or functioning of the EU Internal Market.[36] In its conclusions of 8 December 2015 regarding the BEPS Project, the Council concluded that a fast and effective implementation of the OECD's best practice approach was needed in the EU for the proper functioning of the Internal Market. Thus, utilising the power afforded on the EU under Article 115 TFEU, a directive was suggested as the appropriate form of implementation, to ensure both consistent practices for discouraging tax avoidance activities in the EU and Member States implementing their individual commitments under BEPS.[37] Due to the differences in national tax regimes of the Member States, and to ensure the fit of the tax avoidance discouraging rules into the tax systems of the 28 EU members, the form of the provisions in the resulting directive – the ATAD – is quite general.[38]

Article 1 of the ATAD sets the scope of the directive: it shall apply to all taxpayers subject to corporate tax in at least one Member State. Also permanent establishments (PE) are included in the scope, even if the PE is of an entity tax resident in a third country.[39] Article 3 concludes that the provisions in the ATAD constitute merely a minimum level of protection. Thus, Member States are allowed to implement stricter rules as well.[40]

1.2.1. Article 4 – interest limitation rule

The purpose of this Article is to discourage taxpayers' base erosion and profit shifting activities by introducing a limit to the amount exceeding interest costs can be deducted from the tax base.[41] In addition to the scope of the ATAD set in Article 1 and explained above, the definition of a taxpayer under Article 4 could also include "an entity which is permitted or required to apply the

[35] Streinz, R. (2015) Multilateral Instrument and EU Competence. British Tax Review, No. 3, 430.
[36] *Ibid*., p 440-441.
[37] Council Directive (EU) 2016/1164, *supra nota* 8, Recital 2.
[38] *Ibid.*, Recital 3.
[39] *Ibid*., Article 1.
[40] *Ibid*., Article 3.
[41] *Ibid*., Recital 6.

rules on behalf of a group, as defined according to national tax law"[42] and "an entity in a group, as defined according to national tax law, which does not consolidate the results of its members for tax purposes"[43]. Article 2 of the ATAD defines exceeding borrowing costs as the amount interest expenses or its equivalents incurred from any type of debt as well as finance raising expenses exceed taxable interest and other economically equivalent revenue the taxpayer is entitled to receive. In other words, exceeding borrowing costs refer to net interest expenses, or the interest expenses that exceed the amount the taxpayer receives as interest revenue.[44]

While the ATAD is meant to be the common response of the EU Member States to fulfil the obligations set under BEPS, when it comes to the interest limitation rule in Article 4, the only compulsory method for all Member States to include in their corporate tax system states that "[e]xceeding borrowing costs shall be deductible in the tax period in which they are incurred only up to 30 percent of the taxpayer's earnings before interest, tax, depreciation and amortisation (EBITDA)"[45]. Essentially, taxpayers are then required to pay corporate income tax on their net interest expenses that exceed the limit of 30 percent of the taxpayer's EBITDA. For the purposes of this interest limitation rule, EBITDA is calculated in accordance with paragraph 2 of Article 4 of the ATAD: tax-adjusted exceeding borrowing costs, depreciation and amortisation are added back to the taxable income. As stated above, the fixed ratio rule is the only mandatory method the Member States must implement. Thus, the following parts of the interest limitation rule are but optional for the Member States to include in their corporate tax systems.

To avoid overburdening SMEs and standalone entities, Article 4 includes optional limitations for their benefit.[46] With the implementation of paragraph 3 the Member States are allowed the possibility to derogate from the fixed ratio rule of paragraph 1 by allowing the taxpayer to deduct its net interest expenses up to EUR 3,000,000 and to be able to fully deduct its net interest expenses if it is a standalone entity. Here a standalone entity is regarded as a company not part of a group for financial accounting purposes and without associated parties or PEs, and the EUR 3,000,000 is the limit for the entire group. Paragraph 4 of Article 4 also includes a limitation to the fixed ratio

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[42] *Ibid*., Article 4 (1) (a).
[43] *Ibid*., Article 4 (1) (b).
[44] *Ibid*., Article 2 (1) and (2); Tell (2017), *supra nota* 28, p 757-759.
[45] Council Directive (EU) 2016/1164, *supra nota* 8, Article 4 (1).
[46] Trusevic, A. (2017). Interest Limitation and CFC rules in the Anti Tax Avoidance Directive. (Master's thesis). Tilburg University, Tilburg School of Law. Tilburg. p 11.

rule: Member States can exclude loans concluded before 17 June 2016 and those used for long-term public infrastructure project funding in the EU from the scope of the fixed ratio rule.

Additionally, Member States are offered the possibility to provide exceptions for entities of a consolidated group for financial purposes. Paragraph 5 point (a) of Article 4 entails that group entities can be allowed to fully deduct their exceeding borrowing costs if they can prove that the equity over total assets ratio is at minimum 98 percent of that of the group, and on the condition that assets and liabilities are valued in the consolidated financial statements as a rule in accordance with the International Financial Reporting Standards (IFRS) or the financial reporting system of a Member State.[47] The other option for exception for group entities is provided in point (b) of paragraph 5 in Article 4: a group entity can deduct a higher amount of its net interest expenses than what the fixed rule allows. The limit is calculated in two steps. First the group ratio is determined by dividing the exceeding borrowing costs of the entire group vis-à-vis third parties over the group's EBITDA. Then the calculated group ratio shall be multiplied by the group entity's EBITDA.[48] Thus, this EU's version of the group ratio rule would provide for an individual group entity the ability to deduct more of its net interest costs on the basis of the entire group's ratio.[49] Finally, paragraph 6 of Article 4 in the ATAD allows for Member States to include rules of carrying either forward or back exceeding borrowing costs that could not have been deducted in the current tax period.

From the above description of the Article 4 the author of this thesis concludes that the Article has been modelled quite closely after BEPS Action 4. Also, even though the form of the interest limitation rule Commission chose to implement in the ATAD is similarly structured as the German interest limitation rule, [50] contrastingly to the German rules, in the ATAD the exceptions to the fixed ratio rule are but optional for the Member States, thus resembling closely the supplementing rules of the OECD's fixed ratio rule. Evidently, the Commission has indeed delegated to a notable extent the power of ultimate decisions on how to fit the interest limitation rules into the national systems of the Member States in their own hands. After all, the BEPS project recommendations were designed for individual countries to implement as they saw fit. However, the author

[47] Council Directive (EU) 2016/1164, *supra nota* 8, Articles 4 (5) (a) and 4 (8); Trusevic (2017), *supra nota* 46, p 12.
[48] *Ibid*., Article 4 (5) (b).
[49] Trusevic (2017), *supra nota* 46, p 12; Tell (2017), *supra nota* 28, p 758-760.
[50] *German Federal Court of Finance questions constitutionality of German interest limitation rule* (2016). Norton Rose Fulbright. Accessible: https://www.nortonrosefulbright.com/en/knowledge/publications/1f6317c5/german-federal-court-of-finance-questions-constitutionality-of-german-interest-limitation-rule , 14 April 2019.

concludes that with such leeway granted on the Member States, the ATAD's impact as a consistency bringing instrument for all EU Member States that, as the Council concluded, have quite differing national corporate tax systems,[51] is questionable. While it does force all Member States to enforce interest limitation rules with a similar common ground being the fixed ratio rule, the freedom of legislating on the issue as regards to the various derogations from it still has strong influence on the extent of consistency the ATAD's rule could have in the EU. Meanwhile national tax sovereignty of the Member States negates the entire purpose of overly notable harmonisation; as long as there are interest limitation rules in all Member States erected on similar grounds, the level of harmonisation of the Internal Market protecting interest limitation rules should be acceptable. Therefore, the author concludes that regardless of the perhaps lack of significant harmonising effects of the ATAD's interest limitation rule, it does seem to quite effectively reflect its purposes of discouraging tax avoidance in the EU on similar grounds while providing for a way to ensure the implementation of the rule in all Member States.

[51] Council Directive (EU) 2016/1164, *supra nota* 8, Recital 3.

2. Implementation of the Anti-Tax Avoidance Directive's interest limitation rule

According to the ATAD, the Member States must adopt its rules by 31 December 2018 and apply them as of 1 January 2019.[52] However, this rule is not absolute. ATAD's Article 11 paragraph 6 states that Member States already having included targeted and equally effective rules as those of the ATAD combating BEPS to their national tax regime are allowed to apply them until 1 January 2024 at the latest.[53] In its Notice of 7 December 2018 the Commission clarified the equal effectiveness of the national rule being determined on the basis of both the legal similarity as well as economic equivalence of the national rules. Thus, the rules must be profitability based and will be assessed on the basis of the similarity of application to Article 4 of ATAD on the amount of revenue it produces and tax liability it creates.[54] As a result, since the beginning of the year 2019 all Member States have included some form of interest limitation rules in their national corporate tax systems.

This chapter shall provide an overview of Member States' different starting points in adopting and applying the interest limitation rule of the ATAD. Additionally, to illustrate the materialisation of the ATAD's interest limitation rule in the EU, implementation of the rule in three different Member States is explained. These three states were chosen as they have all but recently amended their corporate tax systems to comply with the ATAD, their background regarding interest limitation rules differ notably and they represent Member States from different levels on the EU's gross domestic product spectrum, thus providing for a suitable overview of Member States' attitude towards the interest limitation rule.[55] After this closer look, the author shall discuss the similarities and differences in the national interest limitation rules of the three states, also considering the implications of the comparison.

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[52] Council Directive (EU) 2016/1164, *supra nota* 8, Article 11 (1).
[53] *Ibid*., Article 11 (6).
[54] Commission Notice — Measures considered equally effective to Article 4 of the Anti-Tax Avoidance Directive OJ C 441, 7.12.2018, p. 1–2.
[55] *Which Member States have the largest share of EU's GDP?* (2018). Eurostat. Accessible: https://ec.europa.eu/eurostat/en/web/products-eurostat-news/-/DDN-20180511-1 , 17 April 2019.

2.1. Member States with no general rule for base erosion and profit shifting prevention through interest limitation rules

In six Member States, namely Cyprus, Estonia, Ireland, Malta, Netherlands and Sweden, there was no specific interest limitation rule to combat profit shifting activities in place prior to the adoption of the ATAD. Regardless, these states did all have general anti-avoidance rules with some even including more targeted restrictions. However, with the adoption of the ATAD, new interest limitation rules must have been adopted and applied in accordance with Article 4 of said directive, and their existing targeted rules newly assessed.[56]

2.1.1. Malta

Malta's Minister for Finance transposed the ATAD, including its interest limitation rule, into Maltese law in December 2018. These rules became applicable on 1 January 2019 and are applied in addition to companies, also to any other arrangements subject to tax in Malta in the same way as companies are. PE's of non-Maltese residents in Malta and subject to its tax are also included.[57] In case of the interest limitation rule, the term taxpayer also includes entities permitted or required to apply the rules on behalf of a group, as well as a group entity that does not consolidate its members' results for tax purposes. In these cases, both the net interest expenses and EBITDA can be calculated on group level including every group entity's results. Financial undertakings are excluded from the interest limitation rules, even if part of a consolidated group for financial accounting purposes.[58]

As the ATAD, the Maltese fixed ratio rule for interest limitation allows for exceeding borrowing costs to be deductible up to 30 percent of EBITDA in the tax period during which they were incurred. However, as the ATAD allows and Action 4 recommends, Malta has also included some derogations to the rule. Both the limit of up to EUR 3,000,000 deductibility as well as standalone entities having the right to fully deduct the exceeding borrowing costs of paragraph 3 of Article 4 of the ATAD were added. Additionally, paragraph 5's option (a) was also included, thus allowing for group entities to fully deduct their exceeding borrowing costs under certain conditions. The scope of the Maltese interest limitation rule was also modified to exclude loans concluded before 17 June 2016 and those for long-term public infrastructure projects in the EU. The latter exclusion

[56] Hillmann, L., Hoehl, R. (2018), *supra nota* 24, p 142-143.
[57] Maltese Government adopts law to implement EU Anti-Tax Avoidance Directive; NID rules approved by EU Code of Conduct Group. EY. Global Tax Alert, 14 December 2018, p. 1-2.
[58] *Ibid*., p. 3.

however depends on the Maltese Commissioner for Revenue finding special features in the project to justify it. Finally, taxpayers are awarded the possibility to carry exceeding borrowing costs forward without any time limitations, while unused interest capacity due to the taxpayer's inability to deduct the costs because some of the above listed rules faces a carry-forward limit of maximum five years.[59]

2.2. Member States with performance based interest limitation rules

In Finland, Germany, Greece, Italy, Portugal, Slovakia, Spain and the United Kingdom, additionally to their general anti-tax avoidance rules, there have also been specific interest limitation rules in place. These rules were applied in the form of performance-related limitations, as the ATAD's rule. Thus, six of these Member States' national corporate tax systems have interest limitation rules that do not need adaptation, as they fulfil the requirements of the ATAD already in their current form. On the other hand, even though Finland and Slovakia also have EBITDA focusing interest limitation rules, these rules only apply to debt arrangements between related parties. Consequently, the rules in these two countries must at least be adjusted to include third party debt arrangements as well. All eight countries of this group could also implement additional exceptions with no risk of non-compliance with the ATAD.[60]

2.2.1. Finland

To fulfil Finland's obligations under the ATAD, the Finnish Ministry of Finance issued an amendment to the country's interest limitation rules.[61] These rules are applied to the tax year of 2019 and onwards. As a notable change to Finland's previous interest limitation rules, the new rules include non-related party loan arrangements in addition to those between related parties. The new rules also apply to all corporate taxpayers resident in Finland, including companies subject to income tax law and partnerships. However, financial institutions are exempted from the scope of the interest limitation rules, as are stand-alone entities.[62]

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[59] *Ibid*., p. 3.; A.L. 411 tal-2018, ATT DWAR IT-TAXXA FUQ L-INCOME (KAP. 123) Regolamenti tal-2018 li jimplimentaw id-Direttivital-Unjoni Ewropea kontra l-Evitar tat-Taxxa, Article 4.

[60] Hillmann, Hoehl (2018), *supra nota* 24, p 142

[61] *Elinkeinolain korkovähennysrajoitusta koskevan sääntelyn muuttaminen, hallituksen esityksen valmistelu*. Valtiovarainministeriö. Accessible: https://vm.fi/hanke?tunnus=VM169:00/2017 , 17 March 2019.

[62] *Finland: Proposed amendments, interest deduction limitation rules* (2018). KPMG. Accessible: https://home.kpmg/xx/en/home/insights/2018/10/tnf-finland-proposed-amendments-interest-deduction-limitation-rules.html , 17 March 2019; Laki elinkeinotulon verottamisesta annetun lain muuttamisesta 19.12.2018/1237, 18 b § (1).

The Finnish fixed ratio rule remains the same: a threshold of 25 percent of earnings before interest, taxes and depreciation (EBITD) calculated by adding to taxable business profit interest expenses, tax deprecations as well as net group contributions. Thus, the Finnish fixed ratio rule is five percentage points stricter compared its counterpart in the ATAD in addition to amortisation being excluded from the profitability determination calculations. Regardless, Finland did include multiple exceptions to the main rule. The Finnish consolidated group exception rule, which is the equivalent of the ATAD's Article 4 paragraph 5(a), remains in the new interest limitation rules. However, although Finland decided to implement some additional derogations to the fixed ratio rules, these are also partly stricter compared to the ATAD's approach. While exceeding borrowing costs from non-related party loan arrangements are deductible up to EUR 3,000,000, in related party arrangements the limit of EUR 500,000 will remain. The carry-forward of non-deductible net interest expense remains without time limitations. The exception for public infrastructure projects in paragraph 4(b) of Article 4 of the ATAD is also added to the Finnish interest limitation rules, as is the grandfathering rule, thus allowing non-application of these rules to third-party loan arrangements concluded before 17 June 2016.[63]

2.3. Member States with thin capitalisation rules

Along with the performance based limitation rules, the other widely used option for preventing BEPS via interest deduction limitation are the thin capitalisation rules. These rules intend to prevent companies as a result of excessive borrowing becoming under-capitalised with the purpose of avoiding taxes through interest deductions.[64] This capitalisation is thus the result of an entity's capital having a disproportionate amount of debt compared to its equity, resulting in an overly leveraged entity.[65] Rest of the EU Member States, namely Austria, Belgium, Bulgaria, Croatia, Czech Republic, Denmark, France, Hungary, Latvia, Lithuania, Luxemburg, Poland, Romania and Slovenia, have included thin capitalisation rules in their corporate tax systems.[66]

[63] *Ibid*., 18a§; Laki elinkeinotulon verottamisesta 24.6.1968/360, 3§; *Finland publishes new interest deduction limitation rules to be effective as of 1 January 2019* (2018). EY, Global Tax Alert. Accessible: https://www.ey.com/gl/en/services/tax/international-tax/alert--finland-publishes-new-interest-deduction-limitation-rules-to-be-effective-as-of-1-january-2019 , 17 March 2019.
[64] Ronfeldt, T. (2009). Action against capital funds the Danish rules on cfc taxation and thin capitalization are inadequate. *Intertax* 37(1), 42.
[65] Morris, M. (2014). United in diversity, divided by sovereignty: Hybrid financing, thin capitalization, and tax coordination in the European Union. *Arizona Journal of International and Comparative Law* 31(3), 781.
[66] Hillmann, Hoehl (2018), *supra nota* 24, p 142.

The Member States' thin capitalisation rules are all in the debt-to-equity ratio form, although there are some exceptions to the popular 4:1 ratio. And although some of the states have included other provisions as well, all of them are missing the performance-related interest limitation rules required. Adjustments are therefore clearly needed for the corporate tax systems of all these Member States. However, to the extent they are not inconsistent with the ATAD, their existing rules could remain.[67]

2.3.1. France

Regardless of the Commission assessing the Article 212 of the French General Tax Code to be in accordance with Article 11 paragraph 6 of the ATAD, the French legislators already included the provisions on France's implementation of the ATAD's interest limitation rule in the Finance Bill for 2019[68] that was approved by the French Parliament in December 2018. The adjustments in this Bill on the interest limitation rules are applicable to financial years from 1 January 2019 onwards and under certain conditions, the rules also apply at the level of the French tax consolidation regime.[69] This optional regime provides the opportunity for a parent company of a French group to file only one tax return for all of its French operations, thus allowing for offsetting of losses and profits.[70] However, as a whole, the amendments of the Bill on France's existing rules are not overly substantial, as there was already a strong foundation for interest deduction limitation in place.[71]

As a general limitation, deductibility of net interest expenses from the tax base is possible up to an amount not exceeding the higher of these two thresholds: EUR 3,000,000 or 30 percent of the company's EBITDA. However, a modified debt-to-equity ratio is also included in the Bill. In such situations where thinly capitalised companies exceed the limit of 1,5:1 debt-to-equity ratio, while a portion of their net interest will be subject to the above explained general limitation, the remaining part is deductible in accordance with a strengthened threshold. This means deductibility

[67] *Ibid.*, p. 142.
[68] LOI n° 2018-1317 du 28 décembre 2018 de finances pour 2019.
[69] Commission Notice (2018), *supra nota* 54, p 1; *French Parliament approves Finance Bill for 2019* (2018). EY, Tax Insights. Accessible: https://taxinsights.ey.com/archive/archive-news/french-parliament-approves-finance-bill-for-2019.aspx , 17 March 2019.
[70] Jacquot, N., Raingeard, E. (2009). Ruling changes french tax consolidation regime. *International Tax Review* 20(1), 18.
[71] Dueñas, S., Bunn, D. (2019) *Tax Avoidance Rules Increase the Compliance Burden in EU Member Countries*. Accessible: https://taxfoundation.org/eu-tax-avoidance-rules-increase-tax-compliance-burden/ , 4 April 2019.

up to the higher of the following limits: EUR 1,000,000 or 10 percent of the company's adjusted taxable income.[72]

The Bill introduced also some exceptions to the thresholds explained above. There is a safe harbour designed for consolidated group entities that allows for 75 percent of the net interest expense that exceeds the threshold of the general limitation to remain deductible, should an entity's equity-to-asset ratio be at minimum 98 percent of that of its group. However, this safe harbour includes no thinly capitalised entities. For them deductible net interest expenses are determined based on differing rules for non-related and related party debt. In case debt derived from non-related parties, the general limitation rules will apply and those expenses deemed non-deductible can be carried forward to subsequent financial years with no time limitations, while related party debt is subject to the strengthened threshold and only one third of the non-deductible expenses can be carried forward to subsequent financial years even if there are still no time limitations. There is also a specific safeguard for thinly capitalised group entities: should the debt-to-equity ratio of an entity be at maximum 102 percent of that of its group, the entity's net interest deductions can be calculated based on the general threshold instead of the strengthened one. This specific safeguard also applies to tax consolidated groups.[73]

Other exceptions include general carry-forward of interest expenses excluded from deduction without time limitations and carry-forward of unused portions of deduction capacity for five following financial years, both rules additionally containing their respective exceptions and clarifications. However, there are no grandfathering rules in the Bill, nor are financial undertakings specifically excluded from the application. On the other hand, net interest expenses related to long-term public infrastructure projects are exempted.[74]

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[72] *French Parliament approves Finance Bill for 2019* (2018). EY, Tax Insights. Accessible: https://taxinsights.ey.com/archive/archive-news/french-parliament-approves-finance-bill-for-2019.aspx , 17 March 2019; *Finance law for 2019 implements ATAD 1 measures, changes tax consolidation rules* (2018). Deloitte, Tax@hand. Accessible: https://www.taxathand.com/article/10852/France/2018/Finance-law-for-2019-implements-ATAD-1-measures-changes-tax-consolidation-rules , 21 April 2019.
[73] *Ibid.*
[74] *Ibid.*

2.4. Comparison and implications of the implementations

The ATAD called for consistent practices in combating BEPS via interest deductions. However, due to the Directive's construction, the Member States were provided with a possibility to customise the interest limitation rule entirely to their respective systems, and customise they indeed did.

While the Maltase law is very similar to ATAD's interest limitation rule, thus allowing for many derogations from the basic rule, the Finnish government has amended their bill to be significantly stricter in comparison. France on the other hand has implemented new laws and amended old ones to create a system mixing performance-related limitations with those resembling the nature of thin capitalisation rules. Accordingly, some variation on economic results will most probably be the outcome of these differences. However, while differences between the implementation of the new rules as such is clear, it is debatable, whether the practical implications of them in these three states will be all that significant. After all, none of the three states made relatively uncharacteristic interpretations of the interest limitation rule. Quite the contrary, their actions are better described as characteristic and in line with the principles of their respected corporate tax systems. Malta having no specific rules for interest limitation in place prior to the implementation of the ATAD included all exceptions from the fixed ratio rule, thus resulting in the most favourable outcome for the taxpayers. Finland with its more strict national corporate tax system only allowed for some exceptions to the fixed ratio rule and retained its harsher rules for related party loan arrangements. Finally, France connected the new performance based interest limitation rules with its existing thin capitalisation rules.

Therefore, despite the concern over the differing possibilities for implementing the rules, the interest limitation rule as such might not create notable differentiations between Member States after all. In fact, with the common fixed ratio rule being implemented into every EU national corporate tax regime and Member States for the most part retaining their respective national preferences on a corporate tax system, perhaps the purposes of the rule might be quite on target after all: the Commission wished to create consistency in the EU without disrespecting the corporate tax systems of the sovereign Member States and with the construction of the ATAD's interest limitation rule, the Member States now have common ground on interest limitation deduction, but were not required to overly dislodge from their national taxation policies.

3. Interest limitation rule's impact on the European Union

The Commission received quite a difficult task, being tasked with implementing Action 4 of the BEPS Project into EU law. It needed to establish a balance between harmonising Member States' corporate tax systems, while also ensuring the measures implemented into EU law would not breach EU's fundamental freedoms.[75] While the ultimate impact of the resulting harmonisation remains to be seen, the interest limitation rule's effect on the foundations of EU as a whole can be effectively evaluated.

Harmonisation is one of the key methods in creating neutrality and a level playing-field. Thus it has received an instrumental role in creating the EU Internal Market.[76] To an extent, taxation is no different. Regardless, before the ATAP there has been little harmonisation of the national corporate tax systems, due to the willingness of the Member States to conserve their tax sovereignty. However, prioritising anti-tax avoidance around EU in the form of the ATAP has changed this dynamic to a notable extent.[77] As a result, some possible effects of the ATAD's interest limitation rule on the Internal Market should be discussed as well.

This chapter will compare views on the impact the ATAD's interest limitation rule could have on the EU from both legislative as well as a more economic perspective. The author shall also profess her own conclusions on the issues based on these views.

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[75] Vestager, M., Moscovici, P. (2015) *This is the year for Europe to put its tax house in order*. Accessible: https://www.theguardian.com/commentisfree/2015/jan/17/europe-tax-commissioners-evasion-fraud-companies , referenced in Douma (Douma, S. (2015). Limitations on Interest Deduction: an EU Law Perspective. *British Tax Review*, No. 3, 364).

[76] De La Feria, R., Fuest, C. (2016). The Economic Effects of EU Tax Jurisprudence. *European Law Review*, 41 (1), 50.

[77] Cédelle, A. (2016). The EU Anti-Tax Avoidance Directive: a UK perspective. *British Tax Review*, 4, 490.

3.1. Impact on the fundamental principles and freedoms of European Union law

As combating BEPS in the Member States is a notable priority of the EU, the interest limitation rule of the ATAD attempts to unify the EU states in tackling it on relatively similar grounds. However, doubts have been raised by some as to this solution and its effects, both intended and unintended. Perhaps the most fundamental of these doubts circle around the compatibility of the interest limitation rule with the settled principles of the European Court of Justice (ECJ), the fundamental freedoms, as well as the principles of proportionality and equal treatment.[78]

When it comes to taxations issues, EU shares the competence on regulating on them with the Member States, thus allowing for EU level legislation to be adopted whenever necessary for the functioning of the Internal Market.[79] However, Article 5 of the Treaty on European Union (TEU) also sets limits on how this conferred power is to be limited with the principles of proportionality and subsidiarity. As established before, BEPS is not an issue easily dealt with by countries individually. Thus, here the focus shall be on Article 5's principle of proportionality and its demand that form and content of EU action cannot venture beyond what is deemed necessary to achieve the Treaties' objectives. Therefore, any EU action must be appropriate and necessary to achieve its aim without becoming excessive.[80] Whether the interest limitation rules fulfil these criteria shall now be discussed.

Dourado argues that Article 4 of the ATAD including in its scope domestic intra-group loans as well as standalone companies, regardless of them presenting little to no risk of BEPS, undermines the rule's appropriate and necessary nature. After all, a rule to combat tax avoidance should limit its scope to artificial arrangements for that purpose. Dourado is joined by Douma in also questioning proportionality of the EU interest limitation rules, as there is no consideration on the effects of the sector of activity or financial situation of the borrower on its borrowing activities or possibility for allowing the taxpayer to prove its non-avoidance motivators or the arm's length nature of the loan arrangement. After all, as OECD also considered, different sectors of business

[78] Dourado, A.P. (2017). The Interest Limitation Rule in the Anti-Tax Avoidance Directive (ATAD) and the Net Taxation Principle. *EC Tax Review*, Vol. 26, Issue 3, 113.
[79] *A gradual transition to more efficient and democratic decision-making in EU tax policy - Questions and Answers* (2019). European Commission Press Release Database, MEMO/19/224. Accessible: http://europa.eu/rapid/press-release_MEMO-19-224_en.htm , 12 April 2019.
[80] Court decision, 13.11.1990, The Queen v Minister of Agriculture, Fisheries and Food and Secretary of State for Health, ex parte: Fedesa and others, C-331/88, ECLI:EU:C:1990:391, point 13.

demand varying levels of debt on the basis of their business model and accumulating debt does not automatically imply an artificial arrangement to reduce taxes. Even the carry forward possibility of excess borrowing expenses provides no relief, as it is of no significant aid for companies in serious solvency problems. As a result, the interest limitation rule quite needlessly creates prejudice against loans and ventures beyond its purpose of combating BEPS.[81]

Furthermore, Douma considers that the interest limitation rule's proportionality could also be questioned when assessing the rule's effects on the principle of legal certainty. The Court of Justice of the European Union (CJEU) when analysing justifications and proportionality held that a rule is not proportionate to its purposes, if requirements of legal certainty are not properly met.[82] The CJEU also held that rules with insufficiently determined scope fall below the requirements of principle of legal certainty.[83] Therefore, possible violation of principle of legal certainty should not be discounted here, especially when considering Member States' implementation of ATAD's Article 4 into their respective national tax systems.[84]

Dourado adds that the ATAD's interest limitation rule also faces problems in regards to the general principle of equal treatment: without objective justifications there must be no different treatment for comparable situations, nor same treatment for different situations. Regardless, Article 4 bundles together all "avoidance and non-avoidance situations, domestic and cross-border situations, group companies and standalone companies, companies that need funding and those that could opt for other alternatives in the same manner"[85] with little regard for their differing circumstances. Additionally, there is no similar limitations on deductibility of other similar expenses to interest, such as entertainment expenses or profit distributions.[86] And while exclusion of those similar expenses could be justified under the comparable ease of their control compared to that of thin capitalization, Dourado claims that finding objective justifications for the inclusion of non-avoidance and domestic situations as well as standalone companies under the scope of Article 4 is quite a different story.[87]

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[81] Dourado (2017), *supra nota* 78, p 118-119; Douma (2015), *supra nota* 75, p 374.
[82] Court decision, 5.7.2012, Société d'investissement pour l'agriculture tropicale SA (SIAT) v Belgian State, C-318/10, OJ C 287, STC 1988, point 59 referenced in Douma (Douma (2015), *supra nota* 75, p 372).
[83] Court decision, 3.10.2013, Itelcar—Automóveis de Aluguer Lda v Fazenda Pública, C-282/12, ECLI:EU:C:2013:629, point 44 referenced in Douma (Douma (2015), *supra nota* 75, p 372).
[84] Douma (2015), *supra nota* 75, p 372.
[85] Dourado (2017), *supra nota* 78, p 120.
[86] Proposal for a Council Directive on a Common Corporate Tax Base, COM (2016) 685 final 2016/0337 (CNS), Article 12 referenced in Dourado (Dourado (2017), *supra nota* 78, p 120).
[87] Dourado (2017), *supra nota* 78, p 120.

As for the ATAD's interest limitation rule's relationship with the fundamental freedoms, on the surface the rule appears quite indiscriminatory: it makes no difference as to the origins of the debt, nor between cross-border and national debt expenses, while allowing for arrangements with little possibility for BEPS to be excluded. However, Dourado argues that when this apparent compatibility with the fundamental freedoms is set aside, there are some underlying problems that ought to be discussed. With the interest limitation rule's biased attitude towards loans while providing no suitable substitutes for them creating hindrance to funding and limits on expense deduction, the rule could be considered an obstacle for the freedom of establishment due to its possible impact on the attractiveness of practising fundamental freedoms.[88] This is especially the case, as Douma points out, because the taxpayer is not given a possibility to prove its non-tax avoidance related reasoning for the loan arrangement.[89]

Finally, the ATAD's interest limitation rules could cause tensions with the constitutions and tax regimes of the Member States. Hillmann and Hoehl emphasise that as most tax systems are based on the net taxation principle, thus requiring costs with causal connection to income be deductible in an unrestricted manner, the interest limitation rules violate it by lacking "a specific justification by the legislator"[90], which is generally required.[91] In fact, the ATAD's interest limitation rule's example has already been challenged for this reason: after declaring the German interest limitation rule unconstitutional, the German Federal Court of Finance referred the case to the German Federal Constitutional Court for final evaluation, claiming that the interest limitation rule violates the general principle of equality, the basis of the net taxation principle.[92] The principle of equality is a fundamental principle in taxation demanding taxpayers contributing to the state in proportion to their income earned under the state's protection.[93] Therefore, the decision of the German Federal

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[88] *Ibid*., p. 118-119.
[89] Douma (2015), *supra nota* 75, p 374.
[90] Lampert S., Meickmann T., Reinert M. (2016). Article 4 of the EU Anti Tax Avoidance Directive in Light of the Questionable Constitutionality of the German "Interest Barrier" Rule – *European Taxation*, Vol. 56, No 8, Journals IBFD, 325 referenced in Hillmann, Hoehl (Hillmann, Hoehl (2018), *supra nota* 24, p 144).
[91] Dourado, A.P. (2017). The Interest Limitation Rule in the Anti-Tax Avoidance Directive (ATAD) and the Net Taxation Principle – *EC Tax Review*, Vol. 26, Issue 3, 114 and Lampert S., Meickmann T., Reinert M. (2016). Article 4 of the EU Anti Tax Avoidance Directive in Light of the Questionable Constitutionality of the German "Interest Barrier" Rule – *European Taxation*, Vol. 56, No 8, Journals IBFD, 325 referenced in Hillmann, Hoehl (Hillmann, Hoehl, (2018), *supra nota* 24, p 144).
[92] Norton Rose Fulbright (2016), *supra nota* 50; *BFH refers constitutionality of interest deduction limitation rule to constitutional court* (2016). Deloitte. Accessible: https://www.deloitte-tax-news.de/german-tax-legal-news/bfh-refers-constitutionality-of-interest-deduction-limitation-rule-to-constitutional-court.html , 17 April 2019.
[93] Jarczok-Guzy, M. (2017).The principles of tax law equality in the context of direct taxation – *Journal of Economics and Management*, Vol. 30 (4), 73; Zieliński, R. (2011). The Principle of Equality of Taxation and the Structure of the

Constitutional Court certainly has great implications regarding the entire EU, especially if the German interest limitation rule is determined as unconstitutional.[94]

The author agrees that the fundamental basis of EU is therefore not explicitly safe from possible unintended consequences of the interest limitation rule. Justifications for the possible violations or restrictions of the above principles and freedoms are also effective only to a varying degree. As a result, Article 4 of the ATAD does possess the capability of negative effects on the EU alongside its BEPS combating possibilities, especially if the German Constitutional Court rules it incompatible with the German constitution. However, ultimately the CJEU is responsible for considering the effects and providing the final say on Article 4's relationship with the basis of EU law and Member States' constitutions.

3.2. Impact on the Internal Market

Article 4 of the ATAD imposes on all the Member States an interest limitation rule on the same basis, thus coordinating EU's approach on tackling BEPS and unifying the Member States' front against aggressive tax planning activities. According to Hillmann and Hoehl, from the perspective of the Member States, this harmonisation of the interest limitation to a performance based method decreases the risks of alterations of any one Member State's interest limitation rules posing as a significant threat on that state's attractiveness for multinational business activities or hindering competition between entities of domestic and cross-border nature. Moreover this cohesiveness in legislation paves the way for predictability and ease of planning in terms of application and impact of the interest limitation rules. The EU's harmonised approach also provides for more "decision-neutral taxation by reducing distortions in terms of capital allocation, the risk of double taxation and opportunities for BEPS"[95].[96]

Simplified Personal Income Taxation. Selected Issues – *The Critique of Law. Independent Legal Studies*, Issue 3 (1), 404.

[94] Norton Rose Fulbright (2016), *supra nota* 50.

[95] OECD (2017), *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments – Action 4: 2016 Update: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, International Organizations' Documentation IBFD, 22 referenced in Hillmann, Hoehl (Hillmann, Hoehl (2018), *supra nota* 24, p 144).

[96] *Ibid*., p. 144.

On the other hand, there are also opinions to the contrary, stating the economic results of the interest limitation rule are, if not negative, relatively neutral at best. As established earlier, the ATAD's interest limitation rule has generally the same structure as that of the German interest limitation rule.[97] Therefore, using analogous reasoning based on empirical evidence on the economic effects of the German interest limitation rule on German economy, Trusevic concludes that the ATAD's interest limitation rule is likely to have quite limited economic results at best and is in fact not the answer EU is looking for to effectively combat BEPS.[98] Additionally, Trusevic argues that despite the Member States allowing for an unprecedented amount of harmonisation in lieu of the ATAD and its interest limitation rule, this harmonisation is limited to one agreed upon fixed ratio rule and a series of possible exceptions to it that the Member States have wide range of opportunities for customising into their respective tax regimes. Thus, each different implementation result leads to varying economic results, possibly resulting in unfair situations for taxpayers of equal standing, but situated in different Member States (especially SMEs), hence creating such asymmetry on the Internal Market as to be considered against EU's ultimate economic objectives.[99]

Also EconPol's Policy Report regarding the merits and issues on the ATAD's measures expresses concern over the flexible implementation of the main rule's exceptions. Although this flexibility does effectively allow for the Member States to have the final say on how to fit the common ATAD interest limitation rule into their national tax system, also the limits set on this flexibility could pose an issue by possibly leaving the states with no opportunity for implementing their optimal choice. And even if these limits could be justified under tax competition limitation, merely the existence of optional exceptions could ultimately be enough to lead to such competition.[100] The Policy Report also expresses concern over the compliance costs these new interest limitation rules could generate for companies, especially in case of complex implementation into national law, as the UK has done.[101] Increasingly complex implementation of the interest limitation rules has a great likelihood of increasing compliance costs as well as creating uncertainty regarding taxation for non-targeted companies in its wake, thus possibly resulting in depressed economic activity as

[97] Norton Rose Fulbright (2016), *supra nota* 50.
[98] Trusevic, A. (2017), *supra nota* 46, p 14-18.
[99] *Ibid*., p. 18-24.
[100] EconPol Policy Report (2018), *supra nota* 11, p 8; de Wilde, M. (2014). Tax competition within the European Union is the CCCTB directive solution – *Erasmus Law Review* 7(1), 25-26.
[101] Collier, R. (2017) British Tax Review Finance Act Note (Section 20): Corporate interest Restriction – *British Tax Review* 5/2017, 555-557 referenced in EconPol Policy Report (EconPol Policy Report (2018), *supra nota* 11, p 21).

well.[102] In fact, the complexity is also present to an extent in France, as the new rules raise practical difficulties regarding determination of EBITDA and lack proper definitions for some accounting concepts, for which there is as of yet no guidance from the French tax administration.[103] Therefore, the author of this thesis infers that while the ATAD's interest limitation rules provide common ground on BEPS combating on the Internal Market as Hillmann and Hoehl suggest, there are also possibilities for great economic downsides that ought not to be discounted, especially as they could very well prove to become greater than the upsides.

Effects of the interest limitation rule should also be considered on the Internal Market from a more global perspective. Virpi Pasanen, the former Tax Specialist of the Confederation of Finnish Industries, professed her wariness regarding the interest limitation rule's economic effects on the EU as a block, especially regarding future investment prospects. Despite agreeing with the general idea behind the ATAD, Pasanen is concerned of the effects of its details. She argues that while theoretically it is possible to treat funding via debt and equity on equivalent terms, in corporate tax systems based on the net taxation principle, where costs are deductible and income widely taxable, borrowing expenses used for funding an investment are clearly business costs that ought to be deductible. Thus, limitations on interest deductions are a clear added expense on investments, of which appropriateness Pasanen goes on to question heavily: is the EU truly in such a situation where it can afford this.[104] Pasanen's opinion was perhaps also a concern for the Finnish government, as it notably softened the adopted Finnish interest limitation rule by adding more exceptions to it, after receiving criticism that the original proposal would negatively affect the competitiveness of the Finnish tax regime and Finland's attractiveness for foreign investment.[105]

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[102] EconPol Policy Report (2018), *supra nota* 11, p 21-25.

[103] Clot, L., Hubert, T., Polak, A. (2019) *New interest deduction limitation rules*. Accessible: https://www.twobirds.com/en/news/articles/2019/france/loi-de-finances-2019-nouvelles-regles-de-sous-capitalisation , 3 April 2019.

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[105] Kuismanen, M., Kurki, L. (2018). *Lausunto luonnoksesta hallituksen esitykseksi elinkeinotulon verottamisesta annetun lain, tuloverolain ja maatilatalouden tuloverolain muuttamiseksi*. P. 2. Accessible: https://api.hankeikkuna.fi/asiakirjat/0c919a35-fa02-4f25-aebc-61624ff84c8c/cbc3bfde-edcc-41c3-ae03-cdb27ec1938e/LAUSUNTO_20180228074000.PDF , 21 April 2019; Kemell, A., Kujanpää, E. (2018). *Lausunto luonnoksesta hallituksen esitykseksi elinkeinotulon verottamisesta annetun lain, tuloverolain ja maatilatalouden tuloverolain muuttamiseksi korkomenojen vähennysoikeuden osalta*. P. 2. Accessible: https://api.hankeikkuna.fi/asiakirjat/0c919a35-fa02-4f25-aebc-61624ff84c8c/fbc9af37-dec0-4e9b-80a9-eb6306e90fc3/LAUSUNTO_20180227075000.PDF , 21 April 2019; Honkavaara, T. (2018). *Hallituksen esitysluonnos koskien elinkeinoverolain korkovähennysrajoitusta koskevan sääntelyn muuttamisesta*. P. 2. Accessible: https://api.hankeikkuna.fi/asiakirjat/0c919a35-fa02-4f25-aebc-61624ff84c8c/20db974a-f6a2-4b4d-838e-67861948d8f9/LAUSUNTO_20180227064000.PDF , 21 April 2019.

In Action 4 the OECD however disputes some investment issues, stating that there is not "enough empirical evidence to reach conclusions on the actual impact of interest limitation rules on foreign investment"[106]. Yet Dieter Bräuninger of the Deutsche Bank is concerned that as other countries are behind schedule or hesitant to implement the BEPS Action Plan into their national legislation, frontrunners such as the EU could place companies within its territory at a significant economic disadvantage. Therefore, the international efforts in establishing a level playing field in tax calculation could ultimately backfire leaving EU companies paying the price.[107] The author concurs with Pasanen and Bräuninger. The OECD Action 4 precludes the combined efforts of countries around the world implementing the interest limitation rule into their national legislation, and thus combating BEPS on similar grounds. If countries outside the EU lack these costs increasing rules, EU could very well be facing difficult economic consequences in the future.

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[106] OECD (2016), *supra nota* 10, p 21.
[107] Bräuninger, D. (2018) *German corporate taxes: Growing need for action*. Deutsche Bank Research, p. 1, 7. Accessible:https://www.dbresearch.com/PROD/RPS_EN-PROD/PROD0000000000476988/German_corporate_taxes%253A_Growing_need_for_action.pdf , 16 April 2019.

CONCLUSION

This thesis aimed at understanding the interest limitation rule, its implementation and effects. Financial difficulties of governments and individuals alike drove attention to BEPS activities of MNE's resulting in uncountable amount of unpaid taxes around the globe. Therefore, following the OECD's example, the EU settled on its own solution to this issue, namely the ATAP and its key element the ATAD that includes, among others, a common approach interest limitation rules. Interest deductibility from tax base has provided a grand opportunity for companies to practice BEPS by planning worldwide income utilising gaps in corporate tax systems to their best advantage. To adequately combat this aggressive tax planning, the OECD settled on its best practice approach that ultimately relies on a fixed ratio rule limiting net interest cost deductibility to merely a percentage of an entity's EBITDA that is supplemented with various exceptions to it. Consequently, the ATAD's interest limitation rule follows closely the OECD's lead, establishing a common performance based fixed ratio rule for all Member States that allows for multiple exceptions to it that the Member States can implement to derogate from it according to their national preferences in the name of tax sovereignty. The author of this thesis agrees that a directive is the preferred option in the EU for establishing common ground on BEPS combating and the construction of the ATAD's interest limitation rule supports the establishment of a consistent and functioning approach while respecting tax sovereignty of the Member States and effectively tackling BEPS trough interest deductions on the Internal Market.

The implementation of Member States with different background to interest deduction limitation provides quite a clear display on how differently the Member States decided to interpret the ATAD's interest limitation rule. Malta with no prior specific rules on interest limitation deciding on an implementation that includes all exceptions to the main rule has created the most favourable interest limitation rules for companies of the three. Finland on the other hand has characteristically amended its original interest limitation rules to include stricter derogations, especially regarding related-party debt. Finally, France also amended its rules to reflect both the ATAD's version as well as its original thin capitalisation rules. Thus, the author of this thesis includes that even on the

implementation level of the ATAD's interest limitation rule its purposes of consistency in combating BEPS though interest deductions has been adequately realised.

Despite these surface successes, there is a great deal of concern on the effects the ATAD's interest limitation could prove to have on both the fundamental basis of EU law and freedoms, as well as the more economic aspects of the Internal Market. While the BEPS combating opportunities of the rule are widely recognised, regardless the proportionality of this rule is heavily questioned, as the scope of the rule includes not only artificial arrangements, but also all other loan arrangements while allowing for little to no opportunity for companies to defend or prove the legitimacy of the arrangement. Also principles of legal certainty and equal treatment as well as the fundamental freedoms pose possible issues to this interest limitation rule, as careless implementation of these rules in the Member States could result in breaches of them. Finally, as the interest limitation rules pose a violation to the principles of equality and net taxation most national tax systems are based upon, declared unconstitutionality of the ATAD's interest limitation rules cannot be discounted either. Therefore, the author considers it quite probable that the interest limitation rule will yet inspire debates and controversy as to the proper relationship between the importance of tax avoidance and the protection of the fundamental basis of the EU.

The more economic aspects of the interest limitation rule also require due consideration. Within the Internal Market, while the cohesiveness of the interest deduction possibilities could be a notable asset in simplifying legislation for companies and lessening tax competition possibilities for the states, there is not a great amount of proof to indicate that the ATAD's interest limitation rule would better the EU economy. On the contrary, there are warning signs indicating these rules could result in added burden for EU based companies and that the added compliance costs will ultimately result in a more depressed EU economy. In addition, unfortunately the interest limitation rule's economic implications on the Internal Market are not much better from a more global perspective either. EU being a frontrunner in implementing the OECD's BEPS Project actions, there is a great deal of concern due to the lack of proper response from other states around the world. While a worldwide implementation of Action 4's best practise approach would provide for a level playing field for companies around the world, the current situation does not bode well for EU companies and negative impacts on foreign investment on the Internal Market cannot comfortably be discounted either. Therefore, the author of this thesis must conclude that while the ATAD's interest limitation rules' BEPS combating opportunities are quite indisputable, the rest of

the world has been dealt with an uncomfortably great deal of power in impacting the ultimate effectiveness and economic results of the ATAD’s interest limitation rule.

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