MAPLES GROUP

UPDATE

EU Proposal for Further Interest Limitation Rules - the Impact on International Business

On 11 May 2022, the European Commission published draft EU legislation[1] to introduce further interest limitation rules across the EU to limit the tax deductibility of interest expense. This draft EU Directive has been colloquially named DEBRA ("debt-equity bias reduction allowance").

These new rules are separate and additional to the EU interest limitation rules introduced by the EU Anti-tax Avoidance Directive 2016 (EU ATAD) on foot of the OECD BEPS initiative, and which are now in force in Ireland and Luxembourg and elsewhere in the EU. More information on this can be found in Part one[2] and Part two[3] of our EU Interest Limitation: Impact on Investment and Fund Structures webcast series.

The implementation and final form of the draft Directive is subject to unanimous agreement by all EU Member States.

The draft Directive provides that EU Member States shall implement the provisions into national law to be effective with effect from 1 January 2024.

Who will the new interest limitation rules apply to?

Any taxpayer subject to corporate income tax anywhere in the EU, including non-EU businesses with an EU permanent establishment, will be within the scope of these new rules.

How do the new interest limitation rules work?

Unlike the EU ATAD interest limitation rules, which are detailed and contain several exceptions, these new rules propose a simple interest restriction with limited exceptions.

In summary, the tax deductibility of "exceeding borrowing costs" of a taxpayer will be capped at 85% each year.

"Exceeding borrowing costs" ("EBC") are as defined by EU ATAD and broadly means "interest paid minus interest received". For example, if a company had 80 of interest income, 20 of dividend income and 100 of interest expense, its EBC would be 20, meaning its interest expense would be restricted to 97 (80 + (20 x 85%)) instead of 100.

The new rules are designed to co-exist alongside the EU ATAD interest limitation rules. So if the application of the EU ATAD rules results in lower interest deductibility, that lower amount is available for deduction only, and the difference may be carried forward or back for use in other years in accordance with and subject to EU ATAD.

[1] https://ec.europa.eu/taxation_customs/system/files/2022-05/COM_2022_216_1_EN_ACT_part1_v6.pdf

[2] https://maples.com/en/knowledge-centre/2021/4/eu-interest-limitation-impact-on-investment-and-fund-structures-part-one

[3] https://maples.com/en/knowledge-centre/2021/4/eu-interest-limitation-impact-on-investment-and-fund-structures-part-two

There is no "de minimis" exception unlike the EU ATAD rules.

Are there any exceptions?

Certain regulated "financial undertakings" are exempted from these new rules.

These include a credit institution, an insurance undertaking, a reinsurance undertaking, an AIF, a UCITS and certain regulated securitisation and special purpose vehicle entities, all as defined by the relevant EU legislation.

Notional Interest Deduction

The proposed Directive also contains measures to provide for a "notional interest deduction" for equity funding in certain cases, based on a deemed fixed interest rate.

Public Consultation

The European Commission currently has a public consultation on the new measures open until 11 July 2022.

Maples Group will be working with relevant industry groups in relation to that consultation process. We would be pleased also to work with and assist any businesses who wish to make a submission to the public consultation.

What should business do next?

Businesses will need to review their structures in light of these new proposals, particularly given the intended implementation date of 1 January 2024, only 18 months off.

In particular, industries with traditionally high leverage may be affected by the new rules.

This would include sectors such as real estate, aviation leasing, and technology and IP intensive businesses.

Certain investment fund structures may also be affected where leveraged asset holding companies are held by tax exempt or tax transparent investment funds.

Finally, the securitisation sector relies on debt funding, and the availability of the exceptions referenced above to non-mainstream structures will need to be considered.

Further Information

If you have any questions on the draft proposals, please reach out to your usual contact in the Maples Group's Tax practices in Ireland or Luxembourg or one of the individuals listed below

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