ERASMUS UNIVERSITY ROTTERDAM

Erasmus School of Economics

Bachelor Thesis Fiscal Economics

The Implementation of interest limitation in the Netherlands based on art. 4 ATAD

A study of how the Netherlands should implement art. 4 ATAD based on the recommendations of the BEPS-project

Name: F. S. D. (Femke) van de Water

Student ID number: 410122

Supervisor: L.C. van Hulten MSc

Second assessor: Mr. D.E. van Sprundel

Date final version: 24-07-2018

Table of Contents

Chapter 1 Introduction

1.1 Background

The unfolding globalisation process is a great driver of the integration of national economies. In the past tax systems evolved whenever a country formulated its tax policy focused on the needs of the domestic economy. Cross-border activities have put a strain on the relatively dated tax rules. Over the past years gaps and mismatches in tax rules have been exploited extensively. In the context of this exploitation the Organisation for Economic Cooperation and Development (OECD) started the Inclusive Framework on Base Erosion and Profit Shifting (BEPS).[1] This project is an initiative to implement rules to combat the artificial shift of profits to low or no-tax locations where there is little or no economic activity. Although some of the schemes are illegal, the majority is not. Those schemes undermine the integrity of the tax systems and voluntary compliance by all taxpayers. In light of these events, the BEPS-project has brought together over hundred countries to collaborate together on the framework to restore confidence in the system and ensure that profits are taxed where economic activities take place and value is created.[2]

The BEPS-package consists of fifteen different actions to equip the governments with both international and domestic instruments to address tax avoidance. The package is designed to be implemented through revision of the national law. In other words, it provides the participating OECD and G20-countries with minimum standards and complete rules to address BEPS-issues.[3] One of these actions is Action 4, which outlines a common approach to limit base erosion involving interest deductions and other financial payments.

Economically speaking, money is a mobile and fungible good. Therefore the use of related party and third party interest is a relatively simplistic method of exploiting tax

---

[1] Addressing Base Erosion and Profit Shifting, OECD, February 2013.
[2] About the Inclusive Framework on BEPS at OECD.org.
[3] OECD, *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, OECD Publishing, Paris: 2017.

rules. For multinationals it can function as an ingenious tool for adjusting the amount of debt in a group entity. Consequently, the group entity may achieve favourable tax results by increasing the level of debt of individual entities by intragroup financing. The limitation on the deductibility of interest can also be escaped by making payments that juridical do not qualify as interest payments but are economically equivalent. The OECD detects risks in this area in three basic scenarios:[4]

1. Groups placing higher levels of third party debt in high tax countries;
2. Groups using intragroup financing to generate interest deductions in excess of the third party interest expense; and
3. Groups using third party or intragroup financing to fund the generation of tax exempt income.

It is most likely that the first two risks occur simultaneously creating a situation where entities use intragroup financing to increase the debt and move the interest costs to high tax countries.[5] The third risk covers actions where the parent company uses external debt for a capital contribution for the subsidiary. Under specific circumstances it is possible that dividends paid from the subsidiary to the parent company are exempted from tax creating a vacuum.[6]

In order to combat these risks the OECD has explored recommendations regarding best practices of rules to prevent base erosion through the use of interest expense. The recommended approach is in essence based on a fixed ratio rule which limits an entity's net deduction for interest and economically equivalent forms of interest payments to a percentage of its earnings before interest, taxes, depreciation and amortisation (EBITDA). A minimum threshold, rules in the context of a consolidated group and more targeted rules can expand this approach.

1.2 Introduction to the ATAD

The international BEPS project induced the European Commission to establish legislative initiatives. The European Commission set up the Anti Tax Avoidance Package

[4] OECD, *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, OECD Publishing, Paris: 2017, p. 13.
[5] P. Hoogterp, 'Voorkomen buitensporige renteaftrek in Action 4 en art. 4 ATAD', *WFR* 2017/147.
[6] Parent - Subsidiary Directive (90/435/EEC), art. 6.

to promote fair, simple and effective corporate taxation.[7] As part of this package the Commission accepted the Anti Tax Avoidance Directive (ATAD). This directive should provide for a comprehensive framework of anti-abuse measures and create a minimum level of protection against base eroding tax planning activities. One of the five legally-binding anti-abuse measures against common forms of aggressive tax planning is art. 4 on interest limitation.[8] This implies that the Member States of the European Union (EU) are obliged to amend national tax laws to be in line with the directive.

1.3 Art 4. ATAD and the Netherlands

The Netherlands must implement art. 4 ATAD in its legislation by 1 January 2019. The coalition has announced that new legislation will be published in September 2018 to unify the Dutch tax laws with art. 4 ATAD. The current government plans have already given direction towards the final legislation in terms of how strict the Netherlands wishes to implement art. 4 ATAD.[9] In light of this announcement and the implementation deadline it is relevant to evaluate how art. 4 ATAD should be implemented in the Dutch legislation such that it covers the objective of the BEPS-project.

This leads to the following research question:

Is the draft legislation for the implementation of art. 4 ATAD in the Netherlands in line with the recommendations of Action 4 of the BEPS-project? If not, what amendments to the draft legislation should be considered?

1.4 Outline

In order to answer the research question several sub-questions will be explored. Every chapter will elaborate on one of the questions and is followed up by a partial conclusion. The sub-questions are as follows:

1. What is the goal and essence of Action 4 of the BEPS-project?
2. How is action 4 translated into art 4. ATAD?
3. What is the current status of the implementation of the directive in the Netherlands? How should art. 4 ATAD be implemented in the Dutch legislation to be in line with the BEPS recommendations?

---

[7] European Commission, *Anti Tax Avoidance Package,* January 2016.

[8] Directive (EU) 2016/1164.

[9] Regeerakkoord 2017: 'Vertrouwen in de toekomst', Rijksoverheid, 10-10-2017, N145.

Chapter two of this thesis will explain and define action point 4 of the BEPS-project more extensively. This will be followed up with a detailed explanation of how Action 4 is translated into art. 4 ATAD in chapter three. In light of the current implementation deadline (1 January 2019) the draft legislation and the progress of the implementation of the directive in the Netherlands will be discussed in chapter four. In pursuit of the current implementation progress chapter four will also further investigate whether the draft legislation for the implementation of art. 4 ATAD is the best fitting approach based on the benchmarks and factors prescribed in the OECD report.[10] Derived from the partial conclusions and available information on future legislation by the Dutch Government this thesis will expound how art. 4 ATAD should be implemented in the Dutch legislation.

1.5 Scope

The reader of this thesis must bear in mind that this thesis focuses on the implementation and effects of the limitation on interest deductions imposed by art 4 ATAD in the Netherlands. The framework of BEPS will be discussed to the extent it is considered to be relevant for Action 4. Part of Action 4 is the transfer pricing guidance related to third party financial transactions, this topic will only be briefly introduced in the second chapter of this thesis but will not be discussed extensively. Although the ATAD is a European initiative, implications for the implementation by Member States, other than the Netherlands will not be reviewed. This thesis will also not investigate the future of the current interest limitation rules in the Dutch corporate income tax Act 1969 (DCITA).

[10] OECD, *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, OECD Publishing, Paris: 2017, p. 53-54.

Chapter 2 Action 4 of the BEPS-project

2.1 Introduction

The BEPS-project has been shortly introduced in the first chapter. It explained that the OECD detected risks in the field of profit shifting and base erosion to artificially lower the corporate tax liability. The second chapter of this thesis will expand this introduction to explore the goal and essence of the BEPS-framework. Firstly, the origin of the BEPS-project will be introduced, which will function as background information to the development of Action 4. This will be followed up by an introduction to the content of Action 4 and a more detailed explanation of the recommended best practice approach as a comprehensive framework against BEPS. Before getting to the partial conclusion, the application of the best practice approach and European Law issues will be discussed. To conclude this chapter, the following question will be answered: *What is the goal and essence of Action 4 of the BEPS-project?*

2.2 Origin of the BEPS framework

The BEPS-project aims to address the artificial shift of profits to low or no-tax locations where there is little or no economic activity. The origin of the framework dates back to 2012, when the G20[11] requested the OECD to analyse base erosion and profit shifting and develop an action plan to combat these issues comprehensively.[12] In February 2013, the OECD published the report *Addressing Base Erosion and Profit shifting*, which concluded that not the national corporate tax laws enable BEPS, but rather the interplay among tax rules in different countries. Domestic tax laws that are not cross-border co-ordinated, international tax standards that have not kept up pace with international tax standards and lack of information at the level of tax administrators and policy makers have provided opportunities to undertake harmful tax practices. Out of shared desire to overcome BEPS the OECD and the G20 countries endorsed the 15-point action plan.[13]

[11] The members of the G20 are Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Republic of Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, the United Kingdom, the United States and the European Union.
[12] OECD, *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, OECD Publishing, Paris: 2017, p. 24.
[13] OECD, *Explanatory Statement*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, 2015, p. 5.

Of the fifteen actions described in the BEPS Action Plan, several address variations of using interest for base erosion and profit shifting. Action 2 focuses on neutralizing the effect of hybrid mismatches. These mismatches occur when hybrid financial instruments and hybrid entities are explored to generate double tax deductions, or deductions in one country without corresponding taxation in another. Another variation includes the issue of interest income in controlled foreign companies (CFC) in low tax jurisdictions. Recommendations to close these opportunities have been developed under Action 3.[14] The emphasis in this paper is on Action 4, which has developed recommendations for the design of rules to address BEPS via interest payments and payments economically equivalent to interest.

2.3 What is Action 4?

Against base erosion and profit shifting by using interest payments and payments economically equivalent to interest, Action 4 calls for development of a common approach to facilitate convergence of individual national rules in the area of interest deductibility.[15] The rules are designed to close BEPS opportunities using third party, related party and intragroup debt to achieve excessive interest deductions or to finance the tax deferred or exempt income.

An entity is part of a group if a company directly or indirectly controls[16] that entity or if the entity itself controls one or more entities. This group may either be a domestic group, when it operates in one jurisdiction or a multinational group where it operates in more than one jurisdiction through entities and permanent establishments.[17]

A number of base erosion and profit shifting risks refer to arrangements between related parties. An entity, which is part of a group may also be related to individuals or other entities which are not part of the group, but where a significant relationship exists.

---

[14] OECD, *Explanatory Statement*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, 2015, p. 13-14.

[15] OECD, *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, OECD Publishing, Paris: 2017, p. 19.

[16] When a person or entity directly or indirectly holds more than 50% of the stakes in the entity.

[17] OECD, *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, OECD Publishing, Paris: 2017, p. 37.

For the purpose of the OECD report, two parties are related if they are not part of the same group but meet one of the following conditions:

- The first party has an investment that provides that party with effective control over the other party, or a third party holds an investment providing that party with effective control over both parties;
- The first party has an interest in the second party which is equal or greater than 25%, or there is a third party which holds this interest in both parties;
- According to Article 9 of the OECD model tax convention.

Supplementary to the above conditions a party is also related if there is an indirect relation that results in above ownership or if family members or have a significant relationship that has impact on the value or control of the entities. Generally, entities may be related to one another without being part of the same group.[18]

In addition to the limitation of interest deduction, Action 4 also focuses on developing transfer pricing guidance related to party financial transactions. Through amendments in the Transfer Pricing Guidelines the amount of interest payable to group entities lacking appropriate substance should be limited to no more than a risk-free return on the provided funding. Moreover, group synergies are required to be taken into account when evaluating intragroup financial payments.[19] The focus of the OECD report, however, is on the first mentioned form of BEPS. The report introduces a best practice approach to tackle these issues, which will be further explored in the next section. The proposal must apply to all interest payments and equivalent forms of interest. With this approach the OECD strives for a consistent treatment for groups in similar positions. Essentially, the critical objective of Action 4 is to link an entity's net interest deductions directly to the generated taxable income.

2.4 The best practice approach

In the process of providing an effective solution against the identified risks the OECD developed the best practice approach. On one hand the approach should be robust

---

[18] OECD, *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, OECD Publishing, Paris: 2017, p. 77-78.

[19] OECD, *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, OECD Publishing, Paris: 2017, p. 23.

against tax planning to avoid or reduce its effect. On the other hand, the best practice approach should be straightforward to apply for entities and tax authorities. The approach is based on a summation of optional and obligatory elements:[20]

1. *De minimis*[21] monetary threshold;
2. The fixed ratio rule;
3. The group ratio rule;
4. Carry back and carry forward of disallowed interest;
5. Targeted rules to support general interest limitation rules and address specific risks; and
6. Specific rules to address issues raised by banking and insurance sectors.

Combining above elements should provide a solid framework to address base erosion and profit shifting. The general elements of the best practice approach, the fixed ratio and group ratio rule and the *de minimis* threshold, form a robust solution to BEPS involving interest and economic equivalent forms of interest payments comprehensively. In order to protect the integrity of the general limitations and to deal with more specific BEPS risks, the general rules should be complemented by more specific rules as announced in the last three elements of the best practice approach.

The *de minimis* threshold is an optional and general limitation rule and depends on a fixed monetary value of net interest expense.[22] The goal of the threshold is to exclude entities that pose a sufficiently low base erosion and profit shifting risk from a fixed ratio and group ratio rule. Ruling out these entities enhances the focus on entities, which impose a material risk. Simultaneously, it reduces the compliance costs for other entities and allows tax authorities to focus on the greatest risk.[23]

The *de minimis* threshold is a straightforward method of calculating the allowed interest deductions. Entities who have net interest expense below this threshold may deduct interest expense without further restriction imposed by Action 4. Unquestionably, the

---

[20] OECD, *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, OECD Publishing, Paris: 2017, p. 29.
[21] Refers to a threshold that carves-out entities with a low level of net interest expense.
[22] Offsetting gross interest expense against interest income.
[23] OECD, *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, OECD Publishing, Paris: 2017, p. 39.

entities must apply the national tax laws in order to obtain the value of net interest deductions. To prevent negative exploitation of the rule, the threshold should apply to the entire consolidated group[24] and not to separate entities. Therefore countries should consider anti-fragmentation rules. This should overcome the incentive to split a company into different entities each of which falls below the threshold, in order to apply *de minimis* multiple times.[25]

The best practice approach has been formed around a fixed ratio rule that limits interest deduction to a fixed percentage of its profit, measured using the EBITDA. It is considered to be a relatively straightforward method to apply and links an entity's interest deduction directly to taxable income. Due to the fact that an entity's tax deductions are directly linked to taxable income the method is considered to be sufficiently robust against tax planning. The fixed ratio rule is a tool that does not take into consideration that groups operating in different industries possibly require different levels of debt. Similarly, an entity can also be highly leveraged for non-tax reasons.

The benchmark for the fixed ratio is determined by net interest divided by EBITDA ratio.[26] To determine the best benchmark for the fixed ratio rule the OECD has looked into financial data on publicly traded multinational groups with a positive EBITDA that would in principle be able to deduct interest equivalent to their net interest expense over the period 2009 to 2013. The OECD analyzed the amount of interest that would in principle be deductible if a benchmark fixed ratio is set under different levels. The results showed that at a benchmark of 10% to 30% the multinational groups are able to deduct all of their net interest at an increasing rate. Once a benchmark exceeds 30%, the rate at which more groups are able to deduct all net interest increases more slowly. This might encourage entities to decrease the level of debt. Unfortunately, a fixed ratio rule might also incentivize entities to increase the level of debt to 30% EBITDA to maximize

[24] A consolidated group includes a parent company and all entities, which are fully consolidated in the parent's consolidated financial statements. OECD, *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, OECD Publishing, Paris: 2017, paragraph 125.

[25] OECD, *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, OECD Publishing, Paris: 2017, p. 30.

[26] OECD, *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, OECD Publishing, Paris: 2017, p. 29-30.

their allowed interest deductions. However, as the performance of a company will only be finalized at the end of the financial year, it is difficult to maximize net borrowing cost throughout the year.

On basis of the analysis and the detected risk, it is recommended that countries apply a benchmark fixed ratio within the corridor of 10% and 30%. The OECD argues that this corridor will allow groups most if the interest deduction.[27] Recognizing that countries differ in terms of their legal framework and economic circumstances, the OECD has announced a series of relevant factors to help a country find a benchmark fixed ratio that is suitable for addressing base erosion and profit shifting.[28]

The first factor touches upon the combination of the fixed ratio rule and the group ratio rule. Where a country operates a fixed ratio rule alongside a group ratio rule, an entity may be able to deduct more interest up to the relevant ratio of its group. Therefore, a country is able to apply a lower benchmark fixed ratio rule, depending on the group ratio rule to moderate the effect of this in groups that are highly leveraged. On the other hand, if a fixed ratio rule is applied in isolation, a country may introduce a higher benchmark fixed ratio as there is no complementary ratio to mitigate the limitation of interest deductions.[29]

Corresponding to element 4 and 5[30] of the best practice approach, a country may apply a higher fixed ratio if it does not permit carry forward of unused interest capacity or carry back of disallowed interest expense or if a country has other targeted rules that address BEPS. The report discussed that carry back and carry forward may give rise to a tax asset that entities can monetize by increasing their net interest expense. Also, countries may apply targeted rules that disallow interest expenses used to fund tax exempt

---

[27] OECD, *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, OECD Publishing, Paris: 2017, p. 53.
[28] OECD, *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, OECD Publishing, Paris: 2017, p. 30.
[29] OECD, *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, OECD Publishing, Paris: 2017, p. 54.
[30] Carry back and carry forward of disallowed interest and targeted rules to support general interest limitation rules and address specific risks.

income or other detected risks. Consequently, countries that facilitate these risks should reflect this by applying a lower benchmark fixed ratio.[31]

Net interest may also be influenced by the level of a country's interest rates and should therefore be taken into account. A country may apply a higher benchmark if it has high interest rates compared with those of other countries. High interest rates[32] automatically lead to relatively higher borrowing costs without threatening fair taxation. Additionally, a country may differentiate in benchmark depending on the size of an entity's group. Generally, large groups are more likely to raise debt centrally and are hence less likely to be affected by interest rates in the different countries. Moreover, they may have better access to global capital markets and a better bargaining position with lenders. To create a level playing field the OECD gives a country the choice to apply one benchmark fixed ratio to group entities and a higher benchmark to the other entities.[33] For European Union situations this is not allowed, as these countries are obliged to have legislation consistent with EU Law. This will be further described in section 2.6 European Law issues.

Although the OECD permits a restriction of the best practice approach to entities in multinational groups, differentiation of the benchmark fixed ratio can lead to constitutional or legal issues. In general, the highest risk of base erosion and profit shifting is posed by entities in multinational groups. Entities, part of a domestic group or standalone, are considered to be of less risk. Where for constitutional or legal reasons a country has to apply the same treatment to different types of entities, which do not pose an equivalent amount of base erosion and profit shifting risk, a country may apply a higher benchmark. In such situations, a country may also decide to apply a lower benchmark to ensure that BEPS is addressed sufficiently.[34]

---

[31] OECD, *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, OECD Publishing, Paris: 2017, p. 55.

[32] It is suggested that a long-term government bond rate of 5% may be considered to be high.

[33] OECD, *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, OECD Publishing, Paris: 2017, p. 56-57.

[34] OECD, *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, OECD Publishing, Paris: 2017, p. 56.

The applicable benchmark to address BEPS is dependent on several factors of a country's individual economy and legal circumstances and is highly influenced by further regulation of the best practice approach. Details on the elements of the best practice approach will be more extensively discussed in the remainder of this chapter. Most importantly, countries participating in the project are recommended to implement the fixed ratio rule with a sufficiently low benchmark to combat base erosion and profit shifting using interest.

Although the fixed ratio closes BEPS opportunities, introducing a benchmark fixed ratio could also lead to double taxation for groups leveraged above this level. To provide a solution for unjust double taxation the OECD introduces the group ratio rule. Primarily, the group rule allows a group entity to deduct more interest expense under specific circumstances. An entity may deduct net interest expense up to its group net interest divided by EBITDA ratio, to the extend this is higher than the benchmark fixed ratio, discussed in the previous paragraph. Moreover, a country may also decide to apply an uplift to the net third party interest expense of up to 10 percent. Thus, the group ratio rule is complementary to the fixed ratio rule and should therefore contribute to the robustness of the response to BEPS. Countries are allowed to apply different group ratio rules[35] or no group ratio rule at all. If a country chooses not to implement the group ratio rule, the fixed ratio rule must be applied consistently to separate entities of the domestic and multinational groups.[36]

2.5 Applying the best practice approach

The best practice approach is directly linked to an entity's net interest expense. However, a general interest limitation rule may also operate indirectly, by restricting the amount of debt to which interest deductions may be claimed. In deciding which approach to apply, the OECD has taken into account that limitation of the level of debt does not necessarily address base erosion and profit shifting risks with regard to excessive interest rates. To combat these risks countries would need to introduce additional rules, such as an arm's length test, increasing complexity of the best practice

[35] Refers to asset-based ratio rules.

[36] OECD, *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, OECD Publishing, Paris: 2017, p. 30-31.

approach. Additionally, the level of debt may vary over a certain period, which means that the measured debt may not be representative for an entity's true position. The interest expense however, is a more reliable source, as it will reflect al changes of borrowings over time.

There is a favorable side to the debt approach. It is considered that the level of debt is relatively predictable under the control of management of an entity. Nevertheless, the amount of interest expense is more unpredictable reflecting changes in interest rates. A direct limitation of interest expense could make it difficult for companies to enter a long-term debt arrangement because of risk of future interest allowance.

The objective of the OECD in Action 4 is to tackle base erosion and profit shifting involving interest and payment economically equivalent to interest. Taken the several factors into account, the OECD has decided to base the best practice approach on a limitation of interest expense.

Another key question in the application of the best practice approach is whether the limitation rule should apply to gross interest expense or net interest expense. In other words, should an entity offset the interest expense to the interest income it receives before applying the best practice approach? The advantage of the gross interest method is its simplicity and is considered to be more robust against tax planning. Unfortunately, the method is highly sensitive to the risk of double taxation in situations where entities are subject to tax for interest income, but part of gross interest expense is disallowed. A solution to the risk of double taxation is to use the net interest expense method. This would also permit an entity to raise third party debt and on-lend borrowed funds within its group without incurring a disallowance of its gross interest expense. The net interest method cancels out the effect of the intragroup interest expense and income.

Although net interest expense is considered to be the most fitting method, base erosion and profit shifting can still take place. It is possible that an entity uses interest expense to shelter its interest income from tax, reducing the level of net interest expense. To overcome this, the OECD recommends the countries to complement the general interest limitation with targeted provisions.

2.6 European Law issues

In light of the implementation, the OECD emphasizes that obligations under European law, national constitution and the terms of the tax system must be kept in mind when implementing the best practice approach.[37] The report on Action 4 briefly elaborates on European Law issues that need to be considered in the context of interest limitation rules. The EU member states should take into account the freedom of establishment and the free movement of capital. Besides the EU treaty freedoms, there are two directives with relevance to thin capitalization rules: the Parent Subsidiary Directive[38] and the Interest and Royalty Directive[39]. In cases where interest is re-qualified as dividend the Parent Subsidiary Directive might be relevant as this changes the net interest. In case of requalification the entity must be granted the benefits of the directive ruling out the effect of the interest limitation. The Interest and Royalty Directive arranges that interest and royalty payments are exempt from taxation in the State where they arise and thus only taxable in the other state. One could argue that disallowing interest deduction could result in taxation of interest and therefore fall within the scope of the directive.[40] However, the Court of Justice has decided in the case Scheuten Solar Technology[41] that the directive only applies to the tax position of the creditor. This implies that interest deductibility may be limited at the level of the debtor and therefore not restricting the scope of Action 4 of the Inclusive framework on BEPS.[42]

2.7 Conclusion

In conclusion, the goal and essence of Action 4 is to converge national tax rules in the area of interest deductibility to provide a robust and effective solution to base erosion and profit shifting using interest and payment economically equivalent to interest.

[37] OECD, *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, OECD Publishing, Paris: 2017, p. 31.
[38] Directive 2011/96/EU.
[39] Directive 2003/49/EC.
[40] OECD, *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, OECD Publishing, Paris: 2017, p. 89-90.
[41] ECJ, 12 May 2011, Case C-397/09, ECLI:EU:C:2011:292 *(Scheuten Solar Technology GmbH/ Finanzambt Gelsenkirchen-Süd)*.
[42] M.J.A. van den Honert, 'De zaak-Scheuten Solar Technology', *WFR* 2010/998.

In order to achieve this, the best practice approach has been developed which consists of multiple elements. The fixed ratio rule, one of the main elements, should apply to all entities, which are part of a multinational group. However, to ensure that the benchmark fixed ratio tackles BEPS effectively, it is recommended that all entities subject to the fixed ratio rule are also subject to more targeted provisions. These should minimize avoidance of the effect of the best practice approach by means of tax planning. Where an interest limitation is applicable, this could lead to double taxation for groups leveraged above the benchmark fixed ratio. Therefore the OECD allows for a group ratio rule that takes into account the net interest over EBITDA ratio at a group level. The OECD recognizes that there are entities that may pose a sufficiently low risk that excluding them by means of a *de minimis* threshold is appropriate. Combining the above elements with more targeted provisions should provide a solid framework to address BEPS.

Although the OECD provides a minimum set of rules, participating countries are free to introduce stricter rules for the purpose of closing BEPS opportunities. The OECD acknowledges that the applicable benchmark to effectively combat BEPS depends on factors of the individual economy and its legal circumstances. Finally, the level of protection is highly influenced by the interplay of the elements of the best practice approach. Further explanation on the elements of the best practice approach and its implementation will follow in the next chapters.

Chapter 3 The Anti Tax Avoidance Directive

3.1 Introduction

The first chapter contained a brief introduction to the Anti Tax Avoidance directive. It explained that the directive is an initiative by the European Commission to create a minimum level of protection against base erosion and profit shifting. While previous interest limitation rules in the majority of the countries mostly targeted intra-group interest to ensure debt is at arm's length, the new provisions include all interest to ensure that interest is connected to economic activities[43] This chapter will zoom in on the content of the directive to clarify how action 4 of the BEPS project is translated into art. 4 ATAD. Firstly, the Anti Tax Avoidance Directive will be introduced more elaborately. Secondly, the content of art. 4 of the directive will be extensively set out and linked to the best practice approach of the BEPS-project. Finally, the partial conclusion will answer the question: *How is action 4 translated into art 4. ATAD?*

3.2 The Anti Tax Avoidance Directive

Many countries have implemented regulations to limit the deduction of interest payments for tax purposes to diminish tax planning opportunities. In response to the OECD activities on the BEPS-project, the European Commission developed the Anti Tax Avoidance Directive. This directive contains measures to address aggressive tax planning, boost tax transparency and create a level playing field for all businesses in the European Union.[44] With this directive the European Commission has sought to provide a general set of rules in accordance with the BEPS conclusions to protect the internal market against cross-border tax avoidance practices. The Council of the European Union aims for a coordinated and effective implementation of the anti-BEPS measures and considered that a European directive is the preferred vehicle for implementation of the BEPS framework at EU level.[45]

---

[43] L. Hillmann & R. Hoehl, 'Interest Limitation Rules: At a Crossroads between National Sovereignty and Harmonization', *European Taxation* 2018/04, vol. 58 p. 143.

[44] European Commission. (2016, 28 January). *Fair Taxation: Commission presents new measures against corporate tax avoidance* [Press release] retrieved from http://europa.eu/rapid/press-release_IP-16-159_en.htm.

[45] Council Directive 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, (OJ L193/1, 19.7.2016, p. 1), [hereinafter ATAD (2016/1164)].

The Council of the European Union considers that independent actions to increase the resilience against BEPS, would copy the existing fragmentation of the national corporate tax systems. Rather than the implementation of individual solutions by Member States, the European Commission strives to guarantee a minimum standard and consistency within the European Union. This minimum standard involves taking action to discourage tax avoidance practices and ensuring fair and effective taxation in a sufficiently coherent and coordinated fashion. The Commission argues that the rules have to fit into 28 separate corporate tax systems and that the Member States themselves are better placed to shape the specific elements of the directive in a way that best fits their national corporate tax system. Therefore, the ATAD is limited to general provisions to be implemented by the Member States.[46] Implementation of the directive should strengthen the average level of protection against tax avoidance practices in the internal market. The Commission recognizes however, that only a common framework can prevent fragmentation of the market and end current BEPS opportunities through mismatches and distortions. Besides a common framework like the BEPS-project recommends, the Directive also provides taxpayers in the EU with legal certainty in that the measures are compatible with the Union Law.[47]

The ATAD consists of five anti-abuse measures, which all Member States should implement against common forms of base erosion and profit shifting in the internal market. These measures find itself in the following areas: limitations to the deductibility of interest, exit taxation, a general anti-abuse measure, controlled foreign company rules and rules against hybrid mismatches.[48] The first area, limitations to interest deductibility, in relation to the ATAD will be further explored in the next section. In case of double taxation due to application of one of the above mentioned rules, taxpayers should receive a tax relief through a deduction for the tax paid in another Member State or third country. Consequently, the rules should not only aim to address tax avoidance practices but also avoid creating other obstacles in the market.[49]

[46] Preamble, paragraph 3, ATAD (2016/1164).
[47] Preamble, paragraph 2, ATAD (2016/1164).
[48] Preamble, paragraph 5, ATAD (2016/1164).
[49] Preamble, paragraph 5, ATAD (2016/1164).

The preamble of the Anti Tax Avoidance Directive introduces the five above-mentioned risks in the field of aggressive tax planning. With respect to the issue of excessive interest deductions the Commission acknowledges that groups of companies have actively engaged in BEPS to reduce the overall tax liability. In general, it is necessary to discourage such practices by limiting the de deductibility of interest.

3.3 Article 4 of the ATAD

In an effort to combat BEPS, the European Commission has developed art. 4 ATAD. The goal of the article is to build up an interest limitation rule that discourages excessive interest payments by limiting the deductibility of taxpayer's borrowing costs.
Similar to the best practice approach that was developed under the BEPS-project, the interest limitation rule is built up of several elements:

1. A fixed ratio rule;
2. Definition of the EBITDA;
3. A safe harbor rule[50];
4. Excluded borrowing costs;
5. A group ratio rule;
6. Carry back and carry forward;
7. Exclusion of financial undertakings; and
8. Definition of a consolidated group.[51]

The combination of above elements is the framework for interest limitation as developed under art. 4 ATAD. In accordance with the best practice approach, the article is built around the fixed ratio rule. The Commission announces in the introduction to the directive that this is the fundamental aspect of the limitation on interest. The group ratio rule and a monetary threshold complement this element to form a comprehensive framework. Understanding of the concept EBITDA, which has also been discussed under the BEPS-project, and the concept of a consolidated group are two essential building blocks of the interest limitation rule. For this reason these are defined in two separate paragraphs of art. 4 ATAD. Besides the general interest limitation rule Member Sates are required to introduce one of the three proposed rules of carry back and carry forward. Finally, Member States are given the option to exclude specific borrowing costs and

[50] Fixed amount to which net interest is always deductible.
[51] Article 4 ATAD (2016/1164).

financial undertakings, which are part of a consolidated group, from the limitation rule.[52]

The closing paragraph of art. 4 ATAD gives a general direction to the implementation of the article and how it relates to the consolidated group. For the purpose of this article, a consolidated group consists of all entities fully included in the consolidated financial statements drawn up in accordance with either the national financial reporting system in the Member State or with IFRS[53].[54] In addition to that, Member States are permitted to give taxpayers the right to use consolidated financial statements.

As previously discussed, the European Commission permits deduction of interest that is related to taxable income and aims to exclude interest deductions related to tax exempt income. Paragraph 2 of art. 4 ATAD specifies that the EBITDA is calculated by adding back income subject to corporate tax, the tax-adjusted amounts for exceeding borrowing costs, depreciation and amortization. Tax exempt income, such as dividends received from a subsidiary, must be excluded from the EBITDA for the purpose of this article.[55] The dependency on EBITDA is considered to be an effective and simple method to determine maximum interest deductibility. There is a certain correlation between allowed interest deduction and the tax base: the lower the tax base the lower the interest deduction. Considering this correlation, tax planning would lead to a decrease in allowed interest deductions.[56]

The first paragraph of art. 4 refers to the fixed ratio rule which implies that net interest is deductible up to a maximum of 30 percent of an entity's earnings before interest, tax, depreciation and amortization. Contrary to corridor of 10 to 30 percent of the fixed ratio rule under the BEPS-project, the ATAD does not specify a lower limit. For the purpose of this article, a Member State may also treat as taxpayer:

1. An entity that is permitted or required to apply rules on behalf of a group; or

[52] Article 4 ATAD (2016/1164).
[53] International Financial Reporting Standards.
[54] Article 4 paragraph 8 ATAD (2016/1164).
[55]Article 4 paragraph 2 ATAD (2016/1164).
[56]A. van der Kruk & D. Bodelier, 'Verslag van hét grote NOB Anti-BEPS Congres van 3 oktober 2016', *WFR* 2017/17.

2. An entity in a group that does not consolidate the result of its members for tax purposes.

These circumstances are determined based on the national law of the respective Member State. In such cases, the net interest and the EBITDA may be calculated at the level of the group. This means that it consists of the results of all group members. Consequently, the fixed ratio rule may be applied to an entire group at once.[57] The commentary prior to the article states that it is possible for Member States to adopt an alternative measure equivalent to the EBITDA-based ratio, which refers to the taxpayer's Earnings Before Interest and Tax (EBIT). This method, however, is not further defined in the directive.[58] In my opinion, it is important that the ATAD follows the recommendations of the BEPS-project here. Ultimately, the OECD strives for a more uniform approach for interest deductibility and deviating from this would not give the right signal to the countries that participate in the BEPS-project.

Complementary to the fixed ratio rule, a Member State may choose to introduce a group ratio rule of which the Commission introduces two variations. Where an entity is a member of a consolidated group for financial accounting purposes a Member State can decide to allow interest deduction if the entity can demonstrate that its equity to asset ratio is equal or higher than the equivalent ratio of the group. The group ratio rule may be applied under two conditions. The first condition is that the taxpayer must value all its assets and liabilities identically to the method that is used in the consolidated financial statements of the group. The second condition is that the equity to asset ratio of the taxpayer is equal to that ratio of the group with a maximum deviation of two percentage points.[59] The second group escape is specified by paragraph 5 (b). An entity is allowed to deduct net interest up to the net interest to EBITDA ratio of the group if this ratio is higher than the fixed ratio benchmark. It also specifies the method as to how to calculate the higher limit to the deductibility of the interest under the consolidated group method. The first step is to calculate the group ratio by dividing the net interest by the group EBITDA and secondly the group ratio should be multiplied by the EBITDA of the separate entity to calculate the limitation on the interest deduction per entity.[60]

---

[57] Article 4 paragraph 1 ATAD (2016/1164).
[58] Preamble, paragraph 6, ATAD (2016/1164).
[59] Article 4 paragraph 5 (a) ATAD (2016/1164).
[60] Article 4 paragraph 5 (b) ATAD (2016/1164).

In addition to the fixed ratio and the group ratio rule, the Member States are allowed to introduce a save harbor rule. This gives the taxpayer the right of deduction of net interest up to a maximum of 3 million euros. In case an entity is part of a group, which should be determined based on national law, this threshold is a maximum for the entire group. A standalone entity[61] however, may be given the right to deduct all net interest. [62] This threshold is a direct translation of the *de minimis* threshold that is introduced in the best practice approach of the BEPS-project to rule out entities that do not impose material risk involving base erosion and profit shifting.

In the field of carry back and carry forward, the European Commission introduces three variations of rules. These can either be a carry forward without time limitation for the exceeding interest that cannot be deducted in the current tax period under the first five paragraphs. The second version complements the unlimited carry forward with a maximum carry back of three years. The third version allows an unlimited carry forward, but only a carry forward for unused interest capacity of maximum five years.[63] Although the OECD recommends a coherent interaction between the carry back and carry forward rule in combination with the fixed ratio rule, the ATAD does not give any further direction to the implementation of this element. In essence, the options are similar to the proposed rules in the BEPS-report.

To ensure a smooth and coherent transition of the corporate tax system to a system that has implemented the Anti Tax Avoidance Directive, the Commission has included the so called grandfathering clause. Any loans that were concluded before 17 June 2016 may be excluded from the scope of paragraph 1[64]. This exemption does not apply to modifications to any of these loans. In other words, if the terms of the loans are modified, this exclusion would be limited to the original terms of the loan. Next to that, loans that apply to long-term public infrastructure projects may also be excluded from the fixed ratio rule if the project operator, the interest costs, assets and income are all

---

[61] Refers to a taxpayer that is not part of a consolidated group for financial accounting purposes and has no associated enterprise or permanent establishment.
[62] Article 4 paragraph 3 ATAD (2016/1164).
[63] Article 4 paragraph 6 ATAD (2016/1164).
[64] Paragraph 1 involves the fixed ratio rule based on the net interest over EBITDA ratio.

within the Union.[65] This exclusion should be justified by demonstrating that the public infrastructure project has special features and show no BEPS risk.[66]

Although it is generally accepted that financial institutions and insurance undertakings should also be subject to interest limitation, the Commission acknowledges that these sectors require a more custom approach. Discussions in this have not been sufficiently conclusive at this point to provide specific rules. This is the reason exclusion of the financial undertakings have been made possible.[67] To facilitate this, the Commission has included paragraph 7 of art. 4. The Commission describes here that it allows Member States to exclude financial undertakings of the elements 1 to 6 from the scope of the interest limitation rule where it applies to the consolidated group for accounting purposes[68].[69] Having the option of excluding financial undertakings from the basic interest limitation rules might give Member States the possibility to develop a more desirable environment for these specific entities. However, I think that this is only temporary until a specific approach has been developed. Also, for simplicity Member States might not want to exclude these entities from the scope of the article.

3.4 Conclusion

Taking the elements of the Anti Tax Avoidance directive together, it seems that the Commission has succeeded to develop a minimum directive to implement the best practice approach of the BEPS-project coherently. The Commission has practically translated the best practice approach from the BEPS-project into art. 4 ATAD. However, due to the fact that the ATAD is a minimum directive, Member States are given some space to design and implement the interest limitation rule as would fit them best. The directive does not give any further recommendations to how the different elements of the interest limitation rule should interact with one another. This gives the Member States the opportunity to deviate from the recommendations of the OECD. Consequently, the objective of securing a coherent and coordinated transposition of the BEPS-measures may therefore be hard to reach. Translation of the BEPS-framework into the

[65] Article 4 paragraph 4 ATAD (2016/1164).
[66] Preamble, paragraph 9, ATAD (2016/1164).
[67] Council Directive 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (OJ L193/1, 19.7.2016, p. 3, paragraph 9).
[68] A consolidated group consists of all entities fully included in the consolidated financial statements drawn up in accordance with either the national financial reporting system in the Member State or with IFRS
[69]Article 4 paragraph 7 ATAD (2016/1164).

ATAD is for a great deal based on how to develop a best practice approach that is compatible with European Law, but fails to take account of the interplay of the different elements for which the BEPS-project gave recommendations. Ultimately, the impact of the ATAD depends for a great deal on the choices and the implementation by the Member States.

Chapter 4 The implementation of the ATAD in the Netherlands

4.1 Introduction

Several Member States of the European Union have already implemented interest limitation rules related to performance. These limitations are related to a fixed ratio rule, a threshold and carry back and carry forward legislation. For example, Germany, has legislation that allows deduction of net interest expense deductible up to 30% EBITDA, unlimited carry forward of non-deductible interest, a carry forward of unused EBITDA of five years and a threshold of 3 million euros. Moreover, Finland and Slovakia have implemented a fixed ratio benchmark, which allows deductibility up to 25% and introduced limitation of interest expenses on loans between related parties. Contrary to these Member States, the Netherlands is one of the countries without a general rule to avoid tax planning and BEPS via interest deductions. Generally, the Netherlands allows deduction of interest if the interest expense is at arm's length and directly related to a company's operations. However, the Netherlands does have disallowance of interest deductions related to intragroup debt.[70]

Based on this information, it is inevitable that the Netherlands should drastically amend its interest limitation rules in order to have legislation that is in line with the Anti Tax Avoidance Directive. As the deadline for this implementation is approaching, this chapter will evaluate the current status of the implementation of the directive in the Netherlands. Then, the announced elements of the legislation will be reviewed and compared to how the interest limitation should be implemented to be in accordance with the ATAD and the implied recommendations of the BEPS-project.

4.2 Implementation in the Netherlands

In line with the BEPS project, the Netherlands recognizes that tax avoidance can only be addressed effectively in an international setting. Unilateral agreements do not combat this risk, but simply relocate the problem. The Netherlands has actively participated in the international BEPS project and has taken the lead in the realisation of the EU-directive against tax avoidance by chairing the European Union in the first six months of 2016. Of the inclusive framework, the Netherlands has already implemented several

[70] L. Hillmann & R. Hoehl, 'Interest Limitation Rules: At a Crossroads between National Sovereignty and Harmonization', *European Taxation* 2018/04, vol. 58 p. 146.

actions into national law.[71] Member States, including the Netherlands, will have to have implemented legislation regarding the best practice approach by 1st of January 2019.[72]

In light of this implementation deadline, the Dutch State Secretary for Finance has written an official letter to the President of the Second Chamber to discuss the International and European initiatives in the field of tax avoidance. The government has two main policies to address tax avoidance: protection against base erosion and profit shifting and the preservation of integrity and transparency. The interest limitation rule is part of the policy to enhance protection against base erosion. The Dutch parliament refers to this basic form of interest limitation as the earnings stripping rule and is based on art. 4 ATAD.[73]

The Dutch State Secretary for Finance explains in its letter to the Chamber that interest costs are primarily deductible from an entity's profit. Since money is a fungible good, multinational groups can easily manipulate the income and cost of interest by intragroup financing. The earnings stripping rule limits the deductibility of interest to a maximum of 30% of EBITDA. With regard to the robustness of the regulation, the parliament has chosen to not only address base erosion and profit shifting but also equalize the role of equity and debt for all entities subject to corporate income tax. In theory, a less beneficial treatment of borrowing costs would constrain the possibility of offsetting profit against interest. Through equal treatment of equity and debt the government wants to encourage equity driven financing and discourage financing by loans. Simultaneously, this should deliver more stable and economically healthy companies.[74]

4.3 Draft legislation of the earnings stripping rule

In July 2017 the Dutch government shared the draft legislation of the earnings stripping rule online to give all stakeholders the possibility to consult the government in the development of fitting legislation. A side note to the draft legislation is that the Cabinet resigned and that the coalition was in the middle of its negotiations when it was developed. Therefore, the legislators chose to develop legislation according to the

[71] *Kamerstukken II* 2017/18, 25087, 188, blg-833907.
[72] *Kamerstukken II* 2017/18, 25087, 188, p, 3.
[73] *Kamerstukken II* 2017/18, 25087, 188, p. 4-5.
[74] *Kamerstukken II* 2017/18, 25087, 188, p. 5.

minimum standard of the ATAD and to leave completion to the next Cabinet. In general, the legislators chose to follow the minimum level of protection, however, in case this led to excessive administrative costs for the Tax authorities, they chose to deviate from this minimum.[75]

As was explained earlier in this thesis, the ATAD is a directive that prescribes a minimum level of protection. In other words, the Member States are free to implement the directive as strict as they wish. The Dutch draft legislation follows the minimum standard. This involves a fixed ratio benchmark of 30% of the EBITDA. A separate paragraph was included in the legislation to define that the concept EBITDA is determined based on fiscal principles such that tax exempt revenues are not included. To stay in a competitive position to attract business to the Netherlands, I agree with the legislator to implement a fixed ratio benchmark of 30% of the EBITDA. As it is one of the core elements of the interest deductibility it is important that it tackles base erosion and profit shifting sufficiently, but at the same time it must provide a sufficient level of allowed interest deductibility.

Moreover, the draft legislation contains a safe harbour rule of 3 million euros and unlimited carry forward of disallowed interest. Although the European Commission allows for additional rules of carry back of disallowed interest or carry forward of unused capacity, this was not implemented for simplicity reasons. A more precise and technical elaboration on how the carry forward applies in situations that involve a fiscal entity, mergers and demergers should still be developed. This will most likely be aligned with current legislation on the offset of losses.[76] With regard to the carry back and carry forward rules, I do not feel like that the legislator put much thought to the effect of interest deductibility for companies that are not performing well. A drop in EBITDA directly puts a strain on the deductibility of interest. Especially for entities, carry back might give some tax relief. The fact that an entity can always apply the safe harbour rule does make sure that there is always a minimum allowed deduction and therefore takes account of part of this complication.

[75] Consultatiedocument implementatie ATAD1 dated 10 July 2017, retrieved from https://www.internetconsultatie.nl/consultatiedocumentatad1.
[76] Consultatiedocument implementatie ATAD1 dated 10 July 2017, p. 14, retrieved from https://www.internetconsultatie.nl/consultatiedocumentatad1.

The legislator has chosen to share two optional group escapes of which is suggested that only one will eventually be implemented. This is on one hand the group escape based on the equity-to-asset-ratio that should be equivalent to the group total. This escape allows the entity to deduct all its borrowing costs if its equity-to-asset ratio is higher than the ratio at the level of the group. On the other hand the group escape is based on the net interest to EBITDA ratio of the group. In case this ratio measured at the level of the group is higher than the fixed ratio benchmark, an entity is permitted to apply the higher ratio to determine allowed interest deductions. The first escape facilitates full deductibility of borrowing costs and the second escape facilitates a higher percentage of allowed interest deductions.[77] The Dutch State Secretary of Finance announced that the government wishes to stimulate equity driven financing, from my point of view the group escape that best fits this is the escape based on the equity-to-asset ratio. Contrary to the second variation of the group escape that actually might incentivizes to have a high level of debt in the entire group, the first variation stimulates to be more equity driven. Pursuing a group escape based on net interest to EBITDA ratio would be in contrast with striving for more stable and economically healthy companies.

The resigned Cabinet clearly chose to leave out several escapes for the interest limitation rule. These involve the exception for financial entities, for infrastructure projects and for loans from before 17 June 2016. It is argued that especially banks do not have excessive borrowing costs as banks have many interest revenues. In relation to other financial entities and infrastructure projects, the Cabinet does not wish to implement exceptions to the main rule as it complicates the legislation. Additionally, it is difficult to demarcate the concept of public infrastructure projects. The most determining motive of not implementing a grandfathering rule might be the budgetary motive. Especially in the first years after the implementation this will lead to significantly lower tax revenues.[78] The remaining paragraphs give insight to the

[77] Consultatiedocument implementatie ATAD1 dated 10 July 2017, p. 13-14, retrieved from https://www.internetconsultatie.nl/consultatiedocumentatad1.
[78] Consultatiedocument implementatie ATAD1 dated 10 July 2017, p. 15-16, retrieved from https://www.internetconsultatie.nl/consultatiedocumentatad1.

definitions of the relevant elements of the interest limitation rules, such as the definition of the EBITDA and consolidated group.[79]

4.4 Implications of the draft legislation

There were several stakeholders to comment to the draft legislation. The Dutch Order of Tax advisors (NOB)[80] calls in the first place for attention to the effect of the ATAD on the Netherlands and its business climate. The NOB asks the questions whether or not the Netherlands should introduce a group escape. In their opinion the answer to this question depends for a great deal on the type of businesses. If no group escape is introduced it is likely that capital intensive businesses will be affected by the earnings stripping rule more severely than the service sector. Moreover, the NOB asks whether a grandfathering rule for old loans is desirable. On one hand, the NOB believes that it would respect the motive of attracting certain (long term) loans. A disadvantage is the complexity of applying this rule, although it is believed that faculty can overcome this.[81]

In an article by one of the Dutch tax platforms similar questions and arguments are raised regarding the introduction of the group escape. They argue that the preference for a certain escape is strongly related to the type of business. Although the consultation asks for a preference of one of the two group escapes, the commentary also argues that an introduction of this element could also have implications for current interest limitation rules in the Dutch Corporate Income Tax. In their opinion introducing interest limitation with a group escape and simultaneously abolishing the current interest limitation rules, would still be in line with the ATAD. They also question the fact that the draft legislation does not contain a paragraph to exclude loans from before 17 July 2016. It is argued that the budgetary motivation should not push aside the fact that tax payers cannot simply get rid of their debt. Finally, questions are raised as to how the Cabinet will implement the carry forward clause and hopes for another consultation to discuss the impact on mergers and demergers.[82] In summary, the platform recognizes that the draft legislation follows the ATAD but raises questions to the budgetary effects, the execution and the effect on the Dutch business climate.

---

[79] Consultatiedocument implementatie ATAD1 dated 10 July 2017, p. 4-5, retrieved from https://www.internetconsultatie.nl/consultatiedocumentatad1.

[80] Nederlandse Orde van Belastingadviseurs, hereafter: NOB.

[81] R. A. van der Jagt, NOB reactie internetconsultatie implementatie ATAD1, 21 August 2017, p. 2-7.

[82] Redactie Vakstudie Nieuws, Internetconsultatie conceptwetsvoorstel implementatie ATAD1, 10 July 2017, *V-N* 2017/39.14.

In my opinion, it is important for the Netherlands to stay attractive for businesses to settle. For the purpose of addressing base erosion and profit shifting a more uniform approach toward interest deductibility seems like a suitable solution. However, due to the fact that the ATAD requires a minimum standard of protection, there is space for the Member States to vary their implementation. Although, I believe that it is important to tackle base erosion and profit shifting sufficiently, as a country you also want to stimulate the economy. In other words, you do not want to be less attractive than other Member States. To stimulate attractiveness and a smooth transition, I would advise to reconsider the introduction of a grandfathering rule and other variations of exemptions. This might complicate the implementation, but it is also a more specific way to give tax relief. In the first years this would probably constrain the tax revenue, but this will eventually fade away as the loans expire over the years.

Moreover, I share an equivalent opinion related to the simplicity of Dutch interest limitation rules. At the moment there are multiple articles in the Dutch Corporate Income Tax that try to eliminate interest deductions if not sufficiently linked to business operations. However, if the final legislation is in line with current articles, these should be abolished to prevent accumulation of interest limitation rules.

4.5 Recent development of the draft legislation

In February 2018 the current Dutch State Secretary for Finance wrote a letter to the Second Chamber that gave more direction towards how the Netherlands will implement the ATAD into its national legislation based on the agreements of the current coalition.[83] In an attempt to provide better protection of integrity and transparency the Dutch government has announced that it will not implement the group escape, whilst the ATAD allows for the weakening of the interest limitation. This means that the Netherlands has chosen the earnings stripping rule to be stricter than the European minimum standard. The Dutch government aims to address all entities with a debt to equity ratio that is higher than the allowed 30% of EBITDA, and not solely affect entities with a ratio that is higher than the group average. The *de minimis* threshold will further complement the fixed ration rule. Similar to the group ratio approach, the Dutch government has decided to implement this element of the best practice approach tighter

[83] Regeerakkoord 2017: 'Vertrouwen in de toekomst', Rijksoverheid, 10-10-2017, N145.

than the minimum standard of the directive. Contrary to the standard of 3 million that the ATAD allows, the Dutch government announces that she has decided to introduce a threshold of only 1 million. Finally, the earnings stripping rule will go into effect as soon as it is introduced. That means that there is no transitional arrangement for current debt financing.[84]

It is argued that a group escape weakens the effect of the interest limitation rule. In light of consistency and simplicity, I encourage the choice not to implement a group escape. However, not implementing a group escape and not providing any exclusion of loans from before 17 July 2016, the most minimal carry forward rule and no exception for financial undertakings is an accumulation of tight implementation of art. 4 ATAD. As was argued by the NOB, taxpayers might not be able to get rid of debt agreements that have been closed in the past years easily. Consequently, the taxpayers are confronted with disallowance of interest deductibility that affects the economical health of a company.

4.6 Conclusion

In summary, the government has announced that it will develop legislation in line with the Anti Tax Avoidance Directive with the following elements as part of the interest limitation:

1. The fixed ratio benchmark will be 30% of the EBITDA;
2. A *de minimis* threshold of 1 million.
3. No group escape will be implemented; and
4. No grandfathering clause that excludes debt from before 17 June 2018.

Implementing the legislation according to the above elements would mean that the Netherlands goes beyond the minimum standard that is imposed by the Anti Tax Avoidance Directive. Although, the reactions to the consultation in July 2017 gave insight to the advantages and disadvantages of the two different group escapes, the Dutch State Secretary for Finance confirms that no group escape will be implemented. Stakeholders also call for attention to the effect of the interest limitation rule to the Dutch business climate, but the most recent developments do not include an exclusion for specific loans. Finally, if the Netherlands were to implement this draft legislation, the interest limitation rule would be in line with art. 4 ATAD. In my opinion, the government

[84] *Kamerstukken II* 2017/18, 25087, 188, p. 5.

should evaluate the interplay of the different elements of the interest limitation rule. I refer to the fact that the government has announced not to introduce a group escape, no grandfathering rule and the simplest carry forward rule. Introducing a fixed ratio benchmark of 30% of the EBITDA seems like a solid base to tackle base erosion and profit shifting.

Chapter 5 Conclusion

5.1. Introduction

The final chapter of this thesis will provide a summary of the previous chapters on the BEPS-project, art. 4 ATAD and the implementation of the interest limitation rule in the Netherlands. This will be followed up by a final conclusion to answer the research question: "*Is the draft legislation for the implementation of art. 4 ATAD in the Netherlands in line with the recommendations of Action 4 of the BEPS-project? If not, what amendments to the draft legislation should be considered?"*.

5.2 Summary

The process of globalization has dominated the past decades. This process has developed itself as a great driver of the integration of national economies. Consequently, cross-border activities have put pressure on current tax rules. In the context of exploitation of gaps and mismatches in tax rules, the OECD has developed the Inclusive Framework on BEPS. One of the main threads to base erosion and profit shifting is the excessive deduction of interest. The OECD aims to address this risk with Action 4, which calls for development of a common approach to facilitate convergence of individual national rules in the area of interest deductibility.

The OECD has introduced the best practice approach as main tool to address base erosion and profit shifting via interest payment and payment economically equivalent to interest. The fundament of the best practice approach is the fixed ratio rule. This is a limitation based on a ratio of net interest to EBITDA and may be set within the corridor of 10 to 30 percent. To ensure that the fixed ratio sufficiently tackles BEPS countries should set the fixed ratio benchmark sufficiently low and implement more targeted provisions. Disallowance of interest can lead to double taxation, therefore the countries can choose to implement a group ratio rule. This enables entities to deduct interest to the group ratio if it is higher than the fixed ratio benchmark. For entities that pose a sufficiently low risk to BEPS, the OECD allows a *de minimis threshold* to exclude these. The combination of these elements with more targeted provisions should provide a solid framework against BEPS and embodies the goals of the OECD to converge national tax rules in the area of interest deductibility.

The European Commission introduced the ATAD to address aggressive tax planning, boost transparency and create a level playing field for all businesses in the European Union. The best practice approach that was developed under the BEPS-project is translated into art. 4 ATAD. Similar to the best practice approach the ATAD prescribes an interest limitation based on the fixed ratio rule. The most significant contrast to the BEPS-framework is that the ATAD is a minimum directive. All Member States need to implement legislation that is in accordance with this minimum level of protection, but are also allowed to introduce stricter variations. Towards the implementation of the interest limitation, the BEPS project gives more direction and recommendations of the interplay of the elements of the best practice approach. Since the ATAD leaves space for the Member States to implement the directive as best fits their national economy, the objective of securing a coherent and coordinated transposition of the BEPS-measures may be hard to reach.

The Netherlands has published draft legislation that is almost identical to the Anti Tax Avoidance directive. However, no clear decision had been made on what type of group escape the Cabinet wishes to introduce. A clear statement in the draft legislation that the legislator did not include any escapes for financial entities, public infrastructure project and loans from before 17 July 2017. The draft legislation was developed in accordance with the minimum standard of art. 4 ATAD. The legislators chose to leave finalization to the new Cabinet. After it was published for consultation, stakeholders responded to the consultation. In their opinion the effect of the group ratio rule could be of great influence on certain types of business and should therefore be evaluated. Moreover, according to the stakeholders the reasons not to include any escapes are mainly budgetary.

On February 2018, the Dutch State Secretary for Finance announced amendments to the legislation that was published in July 2017. The most significant deviations are with respect to the group escape and the threshold. The safe harbor rule will be limited to 1 million euros instead of the maximum allowed threshold of 3 million euros. Additionally, the announcement that the Netherlands will not implement any group escape whatsoever, is a real turn of events. As a consequence, the implementation of the interest limitation rule in the Netherlands is a stricter version than the minimum directive requires.

5.3 Final conclusion

The draft legislation for the implementation of art. 4 ATAD is almost an exact copy of the directive itself. This is mainly due to the fact that the Netherlands had a resigned Cabinet at the time and due to the on going negotiations of the new Cabinet. As opposed to the BEPS-project, the Anti Tax Avoidance Directive is only a minimum directive. This means that it does not take into account the interplay of the elements of the interest limitation rule. The BEPS-project however, does give guidance towards how the elements of the best practice approach should be implemented according to country-specific factors. Personally, I believe that the ATAD gives more space for base erosion and profit shifting than implementation in accordance with the BEPS-project. However, the ATAD overcomes the European Law issues that the OECD discusses in the report.

The OECD touches upon the fact that whereas a country operates a fixed ratio rule and a group ratio rule, a country might need to choose to introduce a lower benchmark fixed ratio. This should make the best practice approach more robust against tax avoidance. On the other hand, where a country, chooses not to introduce a group ratio rule, it might choose for a higher benchmark. This interplay is also prescribed in combination with carry back and carry forward of disallowed interest. Based on these recommendations the Netherlands should either choose for a lower net interest to EBITDA ratio, or decide not to introduce the group fixed ratio. The amendments that were announced in February 2018 by the State Secretary for Finance follow this. In my opinion these developments are effective in terms of addressing BEPS as the Netherlands as it follows the BEPS recommendations. However, due to the minimized options for interest deductions entities with net interest higher than either the threshold or the fixed ratio benchmark are forced to find a solution to excessive debt. This reflects the Dutch business environment negatively as this might not always be possible in the short run.

In conclusion, the amendments to the draft legislation ensure a better level of protection according to the OECD. The Netherlands has chosen not to introduce a group escape at all, which gives space to introduce the highest possible net interest to EBITDA ratio. Moreover, the lower limit to the *de minimis* threshold gives fewer entities the space to escape the fixed ratio rule. In combination with the strictest variation of the carry back and carry forward rules and no further escape for financial entities, public infrastructure projects and loans from before 16 July 2016, the Netherlands implements legislation that is stricter than the minimum standard of the Anti Tax Avoidance Directive and takes into account the recommendations of the OECD. I do recommend that the government reevaluates whether they which to implement a grandfathering rule and exclusion of certain loans to ensure a smoother transition from the current interest limitation rule towards the best practice approach.

Literature

Articles and reports

European Commission, *Anti Tax Avoidance Package,* January 2016.
European Commission. (2016, 28 January). *Fair Taxation: Commission presents new measures against corporate tax avoidance* [Press release] retrieved from http://europa.eu/rapid/press-release_IP-16-159_en.htm.
L. Hillmann & R. Hoehl, 'Interest Limitation Rules: At a Crossroads between National Sovereignty and Harmonization', *European Taxation* 2018/04, vol. 58 p. 143.
M.J.A. van den Honert, 'De zaak-Scheuten Solar Technology', *WFR* 2010/998.
P. Hoogterp, 'Voorkomen buitensporige renteaftrek in Action 4 en art. 4 ATAD', *WFR* 2017/147.
R. A. van der Jagt, NOB reactie internetconsultatie implementatie ATAD1, 21 August 2017, p. 2-7.
Redactie Vakstudie Nieuws, Internetconsultatie conceptwetsvoorstel implementatie ATAD1, 10 July 2017, *V-N* 2017/39.14.
OECD, *Explanatory Statement*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, 2015.
OECD, *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, OECD Publishing, Paris: 2017.

Directives

Parent - Subsidiary Directive (90/435/EEC).
Directive 2003/49/EC.
Directive 2011/96/EU.
Directive (EU) 2016/1164.

Dutch governmental documents

Consultatiedocument implementatie ATAD1 dated 10 July 2017, retrieved from https://www.internetconsultatie.nl/consultatiedocumentatad1.
Kamerstukken II 2017/18, 25087, 188.
Regeerakkoord 2017: 'Vertrouwen in de toekomst', Rijksoverheid, 10-10-2017.

European court of justice

ECJ, 12 May 2011, Case C-397/09, ECLI:EU:C:2011:292 *(Scheuten Solar Technology GmbH/ Finanzambt Gelsenkirchen-Süd)*.