Analysis

Deductibility of finance costs across Europe

SPEED READ **In most European countries, the deductibility for tax purposes of finance costs, such as interest expenses, is restricted or denied in certain circumstances. While there are common approaches between jurisdictions when restricting deductibility, the detailed rules and ultimate impact on deductibility can differ considerably. In addition, the recent economic crisis has led to new rules on deductibility in many European countries, with a general shift from restricting only related party finance costs to a cap on deductibility for both internal and external debt. This article gives a general overview of the deductibility of finance costs in the major European jurisdictions.**

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The tax deductibility of finance costs is an important issue for businesses and tax authorities. In broad terms, businesses want finance costs, like most other business expenses, to be deductible when calculating taxable profit. However, it is possible to manipulate the provision of finance within a business, particularly multinational businesses, to obtain a tax advantage and tax authorities are all too aware of this.

Consequently, while most jurisdictions operate on the basic assumption that finance costs are tax deductible, this deductibility is typically subject to a variety of rules targeted at restricting such deductions in certain circumstances. More recently, the economic downturn has brought to light the perils of excessive debt financing (motivated in part by the tax deduction benefit), as well as more generally increasing the need for governments to maximise tax collection. This has led to the introduction of further restrictions on the deductibility of finance costs.

This trend towards restricting tax deductions for finance costs has occurred across Europe, although each country has taken a slightly different approach to the issue. This article seeks to set out the current position on the deductibility of finance costs across most of the major European jurisdictions, as well as to identify general themes and approaches on this issue.

This trend towards restricting tax deductions for finance costs has occurred across Europe

General approach to the deductibility of finance costs

In most European jurisdictions, the base position is that finance costs such as interest are treated as a trading expense incurred in earning profits and are therefore normally deductible for tax purposes.

However, the following general rules are commonly applied to restrict or deny interest deductions in certain scenarios:

- thin capitalisation rules;
- interest capping rules; and
- interest treated as a distribution.

Thin capitalisation rules

Thin capitalisation rules typically apply only to related party finance transactions, such as loans between members of a corporate group. Where intra-group funding is required by a member of a corporate group, there is usually a choice between providing such funding by way of equity subscription or intra-group loan. Typically, dividends paid on share capital are not tax deductible for the paying company, whereas interest charged on an intra-group loan would be. Consequently, from a tax perspective it is usually more tax-efficient to provide intra-group finance by way of interest-bearing loan. However, this can lead to companies being funded with much higher levels of debt than would be available from a third party funder (when considering the assets of the company).

This 'thin capitalisation' of group companies is unacceptable in most countries, and rules exist to deny interest deductions on the excessive (i.e. non-arm's length) element of intra-group loans. Some jurisdictions leave the determination of the excessive interest element to be based on the facts of the relevant transaction, while others are more prescriptive and impose a debt-to-equity ratio above which excess interest will not be deductible. See example 1 for an illustration of how such rules operate.

Interest capping rules

Whereas previously many countries relied principally on thin capitalisation rules to restrict excessive interest deductions, recently many countries have been introducing more general caps on interest deductibility. Unlike thin capitalisation rules, these are commonly not restricted to intra-group or related party finance transactions and so operate as a general cap on interest deductibility. Typically, these rules operate to restrict interest deductions on net finance costs that exceed a certain threshold, such as a percentage of EBITDA or a determined rate of return on a taxpayer's assets. See example 2 for an illustration of how such rules operate.

Interest treated as a distribution

In addition to the above provisions, some countries have rules that seek to recharacterise interest payments made to shareholders or other related parties as distributions in respect of equity. These rules typically apply where the payment of interest is linked to profit levels or business results, or exceed a normal commercial rate. See example 3 for an illustration of how such rules operate.

As might be expected across the many different jurisdictions of Europe, the details of how these provisions are applied vary dramatically. Many jurisdictions also have further specific and different rules that restrict or deny interest deductions. The following represents an overview of the main rules on deductibility of finance costs in the jurisdictions discussed.

Austria

Deductibility of financing costs (Austrian Corporate Tax Act (ACTA) s 12): Generally, finance costs on loans and other debts with third parties incurred in the normal operation of a business should be deductible for tax purposes. However, as a general principle of Austrian corporate tax law, costs relating to non-taxable income or non-taxable gains on assets are not deductible. Since dividends are generally not taxable, financing costs relating to the acquisition of corporations were historically not deductible.

This position changed in 2005 when new legislation was enacted that provided for the deductibility of interest payments relating to the acquisition of shareholdings of at least 10% held for at least one year, provided that the shareholding was part of business property (ACTA s 11). Consequently interest payments, but not other financing costs (such as arrangement fees, banking or legal fees), are deductible. However, due to perceived abuse, in 2011 the legislation was amended to deny deductibility for interest costs relating to the acquisition of shares from related parties or controlling shareholders (Budget Accompanying Act (BAA) 2011).

Thin capitalisation rules: There are no express thin capitalisation regulations, but there is a general requirement that group financing has to be on an arm's length basis. There are no formal 'safe harbour' debt-to-equity ratios, with the arm's length level of financing costs being based upon the factual position of the taxpaying company. However, in practice the Austrian fiscal authorities tend to accept a debt-to-equity ratio of between 3:1 and 4:1.

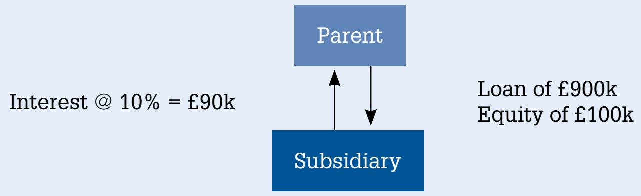
Belgium

Deductibility of financing costs (Belgium Income Tax Code (BITC) 1992 art 49): In principle, interest costs are deductible in Belgium, provided that they are made in order to generate or maintain taxable income and are at arm's length.

However, interest payments made directly or indirectly to specified non-resident beneficiaries or foreign establishments (beneficiaries established in tax havens or beneficiaries that can benefit from a preferential tax regime) are subject to a rebuttable presumption that they are not made 'at arm's length'. This means that, in principle, they will not be deductible. However, if the taxpayer can prove that the interest payments are related to genuine commercial operations and do not exceed normal limits, deduction of the interest payment will be allowed, subject to the specific rules below.

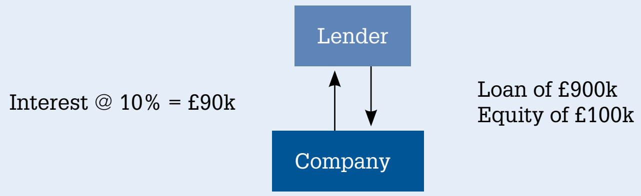
Thin capitalisation rules (BITC 1992 arts 92 and 198): In respect of financing provided by entities resident in no or low tax jurisdictions or intra-group financing, there is a formal thin capitalisation debt-to-equity ratio of 5:1. Interest payments in excess of the 5:1 debt:equity ratio are not tax deductible. For the purposes of this debt-to-equity ratio, debt will include all loans, bonds and other debts (although debt issued by public offering and loans made by financial institutions are

Example 1: Thin capitalisation rules



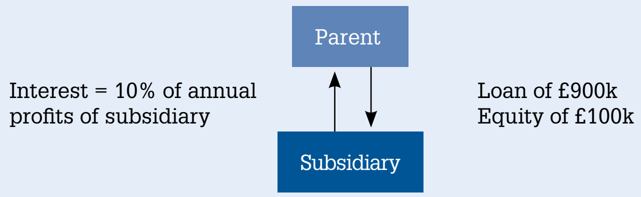
The subsidiary is 100% financed by the parent, with 10% equity and 90% debt (carrying an interest rate of 10%).
Local laws apply a debt-to-equity ratio of 5:1. Therefore, interest on any debt that is in excess of 5 x equity is not deductible.
5 x equity (£100k) = £500k.
Interest deductions are therefore restricted to interest at 10% on £500k = £50k.
The balance of the interest payable above £50k (£40k) is therefore not deductible.

Example 2: Interest capping



Local laws impose a cap on the amount of interest which can be deducted for tax purposes. This cap is set at 30% of the company's EBITDA. In this example, it is assumed that the company has an EBITDA of £200k.
The interest cap would therefore be 30% of £200k = £60k.
Therefore, only £60k of the £90k interest payable is deductible for tax purposes.

Example 3: Interest treated as deduction



Here, the subsidiary receives a loan of £900k from its parent.
The interest on this loan is calculated by reference to the profits of the subsidiary.
Under local law, profit related interest is recharacterised for tax purposes as a distribution and consequently the interest on the loan is not deductible for tax purposes.

excluded). Equity will be determined based upon the sum of the taxed reserves at the beginning of the taxable period and the paid-in capital at the end of the taxable period.

The rules also include an anti-avoidance provision which provides that where a loan is granted by a non-affiliated company but guaranteed or funded by a third (affiliated) party (bearing the risk of the loan), this third (affiliated) party will be deemed to have granted the loan.

In addition to these prescribed provisions, financing costs are subject to the Belgian transfer pricing regime, such that interest payable to related persons or enterprises established abroad, that is not on arm's length terms, will not be tax deductible.

Interest treated as a distribution (BITC 1992 art 92): Interest payable to certain shareholders and directors which exceeds a normal market rate and/or the sum of reserves taxed at the beginning of the fiscal period and the total of paid-in capital at the end of the period will be reclassified as a dividend distribution.

France

Deductibility of financing costs (French Tax Code (FTC) art 212, II): The French tax rules currently provide that, in principle, interest expenses are fully deductible in the year they accrue, provided the debt is incurred in the business interests of the company and duly recorded in the company's accounts.

Thin capitalisation rules: The basic position is that interest paid by a company on shareholders' loans is deductible from the company's taxable income, provided that certain conditions are met, notably:

- the share capital is fully paid up; and
- the interest does not exceed the annual average of the rates applied by banks to loans with an initial two-year minimum period (e.g. the rate was fixed at 3.39% for the financial year 2012).

A higher interest rate may be applied only if the borrowing company can prove the rate applied is on an arm's length basis.

In addition to the interest rate limitation, the deduction of the interest paid by a French company on indebtedness owed to 'related parties' is limited to the highest of the following three ratios:

- interest accruing on an amount equal to 1.5 times the company's shareholder equity (the debt-to-equity test);
- 25% of the taxpayer's adjusted ordinary income (defined as current income before tax, related-party interest, depreciation and amortization, and certain lease payments) (the interest coverage test); and
- interest received from related parties (the related-party interest test).

Interest exceeding the highest ratio set out above cannot be deducted in the financial year in which it is incurred, but it may be carried forward into following financial years. These provisions also apply to any financing for which a related party grants a guarantee or security.

By way of exception to the above, interest paid to related parties may be fully tax deductible:

- if the annual amount of interest paid to related parties is less than €150,000; or
- the overall debt-to-equity ratio of the group to which the borrowing company belongs is equal to or higher than its own overall debt-to-equity ratio.

Interest capping rules (FTC art 212 bis; Finance Law 2013 art 23): According to the Finance Bill for 2013, the deductibility of financial expenses (including external debt) for companies subject to corporate income tax is capped as follows:

- 85% for the financial years 2012 and 2013; and
- 75% as from financial year 2014.

To protect small and medium-sized companies, the above caps do not apply if the total amount of the net financial expenses incurred is below €3m per financial year. The same threshold is applied to tax consolidated groups by reference to the aggregate financial income and expenses of the group.

Other anti-avoidance rules are as follows:

Specific rules for tax consolidated groups (FTC art 223B, 7eal; amending Finance Law 2012 art 16): A specific scheme known as 'l'amendement Charasse' limits the interest deductibility on debt (including external debt) incurred to acquire related party shares following the inclusion of both entities in the same French tax consolidated group.

When the shares of a target company which becomes a member of the tax group are purchased from shareholders who directly or indirectly control the group (non-group parents), or from non-group companies that are controlled by non-group parents (non-group sister companies), a portion of the interest expense incurred by the tax group on the acquisition debt will not be deductible from the group profits for a nine year period.

The 'amendement Charasse' does not apply:

- when the shares of the new member of the tax group are sold between two companies that are already members of the same tax group; or
- when the shares of the new member were previously acquired by a controlling shareholder from a third party and were immediately sold again to another company within the group.

Anti 'debt push down' rules (FTC art 209, 1X): For fiscal years starting on or after 1 January 2012, an anti-avoidance rule commonly known as the 'Carrez rule' aims to limit the deductibility of interest expenses relating to an acquisition of shares, when the acquiring company cannot prove that the shareholding is managed from France. If an acquiring company cannot demonstrate that the acquired shareholding is managed from France, a portion of the annual interest relating to the acquisition may be treated as non-tax deductible for an eight-year period after acquisition.

The rules do not apply if:

- the total fair market value of the shares owned by the French acquiring company does not exceed €1m;
- the acquisition of the shares has not been

financed by debt either at the level of the French acquiring company or at the level of a French or foreign company of the same group; or
- the debt-to-equity ratio of the group is equal to or higher than the debt-to-equity ratio of the acquiring company.

In order to avoid double taxation arising from the combination of the above rules on deductibility, the thin capitalisation rules apply first, followed by the Carrez rules and then the interest cap.

Germany

Deductibility of financing costs: In Germany, interest on debt is generally deductible for tax purposes if it is incurred as a result of a company's business operations.

Thin capitalisation rules: Germany's thin capitalisation rule was abolished in 2008 and replaced with the interest capping rule described below. However, interest payable to non-resident companies belonging to the same group is, in addition to the interest capping rule, also subject to transfer pricing regulations that require the finance relationship to be on arm's length terms.

Interest capping rules (Income Tax Code (ITC) s 4h; and Corporate Income Tax Code s 8a): The 'interest ceiling rule' denies deductions for net interest expenses (on internal and external debt) that exceed 30% of taxable EBITDA. This rule normally only applies to entities that belong to a consolidated group or where the borrower's equity ratio is more than 2% lower than the equity ratio of the worldwide group. The interest capping rules do not apply to net interest expenses that are below €3m.

When calculating relevant interest expenses, not only actual but also deemed interest expenses are included, such as non interest-bearing shareholder loans. Excess interest can be carried forward indefinitely and excess EBITDA can be carried forward for five years (subject to certain restrictions).

The scope of the interest capping rules is extended beyond consolidated groups and the groups where the equity ratio is not satisfied in respect of 'shareholder debt financing' which is 'harmful'. Harmful shareholder debt financing arises if a company incurs interest expenses exceeding 10% of its total net interest expenses in respect of debt owed to shareholders that directly or indirectly hold more than 25% of the company's nominal or share capital (with shareholders including related parties and, in certain circumstances, third parties).

Other relevant rules are as follows:

Interest add-back under German Trade Tax Act, (s 8(1)): 25% of the overall interest expenses for debts are added back to the profits when determining the assessment basis for trade tax. 'Interest expenses for debt' is defined under the German Trade Tax Act and includes liabilities to suppliers and current account payables. Therefore, 25% of interest expenses for debts are subject to trade tax. Trade tax is a municipal tax with a rate that varies from 7% to 17.12%.

Excess withdrawals from partnerships (ITC, s 4(4a)): Interest expenses of partnerships can be restricted where total withdrawals from a partnership exceed the total profits and deposits of the partnership on an annual basis. In such circumstances, interest expenses equal to broadly 6% of the excess withdrawal (aggregated with previous excess withdrawals) will not be deductible. This is subject to certain exclusions.

Ireland

Deductibility of financing costs (Taxes Consolidation Act (TCA) 1997 s 81): As a general rule, a full deduction against taxable income is available in Ireland for interest and other financing costs incurred in the course of the borrower's trade.

Deductibility of financing costs incurred for non-trading purposes (TCA 1997 s 247): Where interest and financing costs are not deductible in calculating trading profits but the loan satisfies certain criteria, the interest expense may be treated as a charge on income and deducted from a company's total profit. In order to qualify for relief as a charge on income, the loan must be used (by the investor company) to:

- acquire any part of the ordinary share capital of:
  - a trading company or a company whose income consists mainly of rental income; or
  - a company the business of which consists wholly or mainly of holding stocks, shares or securities in a trading company or a company whose income consists mainly of rental income; or
- lend money to such a company; or
- pay off another loan which was applied for to meet either of these purposes.

The funds invested must also be used in full by the investee company for business purposes. The investor company must own at least 5% of the ordinary share capital of the investee company (or an associated company). The borrower company and the investee company must have at least one common director. Relief is only available in respect of yearly interest which has actually been paid (and not accrued). A number of relatively complex anti-avoidance provisions apply to deny relief for interest as a charge.

Thin capitalisation rules: There is no specific thin capitalisation rule in Ireland, but the Irish transfer pricing rules apply to limit the deductions available for interest paid to connected companies, if interest payments exceed that which would be agreed between parties acting at arm's length.

Further, where interest is payable to a connected company on a loan used to acquire assets from another connected company, a deduction for the interest may be denied under certain anti-avoidance provisions.

Interest treated as distribution (TCA 1997 ss 110, 130, 246, 452A, 845A): If interest is paid to a non-resident company that is a 75% affiliate of the Irish borrower, it may be recharacterised as a distribution and will no longer be treated

Recently many countries have been introducing more general caps on interest deductibility

as deductible for tax purposes. However, there are a number of scenarios where this rule is not applied, for example, when the interest is payable to a company resident for tax purposes in an EU Member State, or when the interest is yearly and is paid in the course of the borrower's trade.

Further, if interest paid is dependent on the results of the borrower, no deduction is generally available for interest (unless the borrower qualifies under Ireland's securitisation regime). Also, if the interest payable exceeds a commercial rate of return for the principal borrowed, the amount by which the interest exceeds a commercial rate will be recharacterised as a distribution and will not be treated as tax deductible.

Italy

Deductibility of financing costs (Consolidated Text of the Income Tax Law (CTITA) art 92): In general, business expenses such as finance costs may be deducted in calculating taxable income provided they relate to activities necessary for the production of income.

Thin capitalisation rules: Italy's thin capitalisation rule was abolished in 2008 and replaced with the interest capping rule described below. However, interest payable to non-resident companies belonging to the same group is, in addition to the interest capping rule, also subject to transfer pricing regulations that require the finance relationship to be on arm's length terms.

Interest capping rules (CTITA art 96): Deductions for interest and similar expenses (on external as well as internal debt) that exceed interest income are capped each year at 30% of a company's gross operating margin (similar to EBITDA).

Any non-deductible interest expenses may be carried forward and offset against future EBITDA (capped at 30% each year). There is no time limit on carrying forward these non-deductible expenses. In conjunction with this, any excess EBITDA in a particular year can be used to increase the deductible limit in future years.

Tax consolidated groups are permitted to transfer excess interest income and excess EBITDA within the group. Any foreign company owned by a member of the tax consolidated group may also transfer its excess EBITDA within the group, assuming it meets certain stipulations under the rules for tax consolidated groups (including voting rights and accounting requirements).

The ability to carry forward interest payable in excess of 30% of EBITDA is restricted if the company which has accrued such excess amounts undertakes certain merger or demerger operations. In such cases, the excessive interest may be carried forward, provided certain tests (designed to determine whether the company in question is truly operative) are passed, with reference to the two financial years prior to that of the merger or demerger operation and subject to the limits of the net equity recorded in the last balance sheet.

As a general principle, banks, financial institutions, insurance companies and holding companies do not fall within these rules and are permitted to deduct up to 96% of their interest costs.

Other anti-avoidance rules: In the case of certain types of interest payable, provision is made for specific regimes that lay down the absolute non-deductibility or deductibility (within the 30% EBITDA cap) which is limited by additional restrictions:

- Interest payable in relation to real property that is not directly utilised in the performance of corporate activities (i.e. real estate for residential purposes) is completely non-deductible.
- Interest payable deriving from bonds issued by non-listed companies is deductible within the limits of the 'official reference rate' approved by the European Central Bank (which, at the end of 2012, was 0.75%) increased by two-thirds; the amount in excess of that figure is completely non-deductible. The rule is not applicable if the bonds are subscribed for by banks or financial institutions, rather than shareholders of the company.

Interest payable on loans from foreign companies resident in countries having privileged fiscal regimes (including those not belonging to the same group) are only deductible if it can be demonstrated that: (i) the foreign company carries out a genuine commercial activity; or (ii) the loan has been made for valid economic reasons.

Poland

Deductibility of financing costs (Act on Corporate Income Tax (CIT) 1992 arts 15 and 16): Interest paid on debt (loans and credits) and associated finance costs are generally tax deductible for the debtor when paid, as long as the debt was taken for the purpose of generating taxable revenues or preserving the existing source of revenues.

There are certain cases where the Polish tax authorities disallow tax deductibility of interest. For example, on interest arising on a loan drawn:

- by a company to pay dividends or in order to pay redemption profits to a company's shareholders; or
- to finance investments on fixed and intangible assets, if paid or accrued within the period in which the investment is made. Instead, such interest increases the acquisition value of the assets, which is subsequently depreciated for tax purposes.

Thin capitalisation rules (CIT 1992 art 16): Deductions for finance costs on financing between related entities (Polish or overseas) are restricted to the extent the borrower's debt exceeds the 3:1 debt-to-equity ratio. Related entities are:

- direct shareholders with at least 25% of the shares in the borrower's share capital; or
- sister companies, provided that the same entity (or individual) holds at least 25% of the shares in the borrower's share capital and 25% in the lender's share capital.

Interest on a loan must also be payable on an arm's

> **This 'thin capitalis-ation' of group companies is unaccept-able in most countries**

Overview of the main rules on deductibility of finance costs

Country	Generally deductible	Thin capitalisation	Interest capping	Interest as a distribution	Other points
Austria	Yes	Related party debt: ■ 1.5 x shareholder equity ■ informal 3:1–4:1 ratio ■ arm's length requirement	No	No	–
Belgium	Yes	Related party/low tax beneficiary: ■ 5:1 ratio ■ arm's length requirement	No	Interest exceeds commercial rate. Interest exceeds aggregate of a reserves/ paid-in capital calculation.	–
France	Yes	Related party debt limited to higher of: ■ 1.5 x shareholder equity ■ 25% of adjusted income ■ interest received from related parties	Capped at 85% for FY 2012 and FY 2013 Capped at 75% from FY 2014	No	'L'amendment Charasse': limits deductibility for debt used to acquire related party shares. 'Carrez amendment': limits deductibility for debt used to acquire shares where acquired shareholding not managed from France.
Germany	Yes	Related party debt: ■ no specific ratio ■ arm's length requirement	Capped at 30% of taxable EBITDA	No	25% interest add back when calculating German trade tax. Restriction on interest deduction for partnerships with excess withdrawals.
Ireland	Yes	Related party debt: ■ no specific ratio ■ arm's length requirement	No	Interest paid to 75% non-resident affiliate. Profit dependent interest. Interest exceeds commercial rate.	–
Italy	Yes	Non-resident related party debt: ■ no specific ratio ■ arm's length requirement	Capped at 30% of gross operating margin	No	Interest deductibility for bonds issued by unlisted companies capped at two-thirds times the official reference rate of the ECB. Interest deductibility for loans from lenders in privileged fiscal regimes can be denied if not for commercial purposes.
Poland	Yes	Related party debt: ■ 3:1 ratio ■ arm's length requirement	No	No	Interest deductibility denied for loans to pay dividends. Interest deductibility denied for loans to finance investments in fixed/intangible assets.
Spain	Yes	No	Capped at 30% of net operating profit	No	–
UK	Yes	Related party debt: ■ no specific ratio ■ arm's length requirement	Capped at aggregate of external finance costs of worldwide group	Profit dependent interest. Interest exceeds commercial rate.	–

length basis. If financing arrangements between related parties differ from those that would be agreed by independent entities, the tax authorities can make an adjustment leading to the restriction on deductions for associated finance costs (CIT 1992 arts 11 and 19).

Spain

Deductibility of financing costs (Spanish Corporation Tax Law (SCTL) art 20): Financing costs in Spain are deductible, subject to new interest capping rules imposed with effect from 1 January 2012, which replaced its previous thin capitalisation rules.

Interest capping rules: With effect from 1 January 2012, 'net financial expenses' up to the higher of €1m on external and internal debt or 30% of a company's 'net operating profit' are not deductible for Spanish corporation tax purposes.

For this purpose: (i) 'net financial expenses' means the excess of financial expenses in respect of financial income; and (ii) 'operating profit' is a statutory term that essentially describes EBITDA.

'Net financial expenses' that cannot be deducted in a tax period may be deducted over the following 18 years, together with the 'net financial expenses' of the relevant tax period and subject to the same limit.

In the event that 'net financial expenses' of a tax period do not reach 30% of the 'operating profit', the difference may be accumulated and added to the limit applicable in the following five tax periods.

In the case of entities that apply the tax consolidation regime, the 30% limit applies to the tax group. However, the 'net financial expenses' of an entity that have been incurred but not yet deducted at the time of its incorporation into the group, will be deductible up to the limit of 30% of its own 'operating profit'.

Note that the limit on the deductibility of 'net financial expenses' does not apply to credit entities ('entidades de crédito').

Additionally, as from 1 January 2012, financial expenses derived from intra-group financing are not deductible when such intra-group financing has been incurred for the purposes of acquiring from a group company a stake in the share capital of a third entity or for the purposes of making a capital contribution in a third entity (unless the transaction has valid commercial reasons).

There has also been a noticeable change in approach, with the implement-ation in a number of jurisdictions of interest capping rules that impact equally on internal and external debt

UK

Deductibility of financing costs: In the UK, interest on debt is generally deductible for tax purposes.

Thin capitalisation rules (TIOPA 2010 Part 4): The UK's thin capitalisation rules were incorporated into its transfer pricing rules in 2004. The regime applies to most transactions between associated persons (including companies, trusts and individuals) and applies even where both parties are UK resident. Where the rules apply, interest on excessive debt (i.e. debt which would not normally be available from a third party lending on an arm's length basis) will be disallowed. There is no fixed debt-to-equity ratio which is laid down as being an acceptable limit.

Interest capping rules (TIOPA 2010 Part 7): In 2009, the UK government introduced a 'worldwide debt cap', which applies to all accounting periods beginning on or after 1 January 2010. The purpose of the rules is to limit the tax deduction for finance expenses which may be claimed by the UK members of a group to the aggregate amount of the external interest and other finance expenses of the worldwide group of which such UK companies are members.

The rules apply only to 'large' groups, i.e. those where at least one member has 250 or more employees, annual turnover of £50m or an annual balance sheet of £43m or more. Qualifying financial services businesses and certain other bodies are excluded from the rules. In addition:

- there is a gateway test for the application of the rules, such that the debt cap cannot apply to groups whose UK net debt is less than 75% of the worldwide group's total external debt; and
- the rules will not apply where the UK net debt of a group is less than £3m.

The debt cap rules operate in addition to the existing thin capitalisation rules described above.

Interest treated as distribution: In certain circumstances, the UK tax authorities have the power to recharacterise payments of interest as a distribution (CTA 2010 s 1000). For example, interest is recharacterised as a distribution where a company borrows money from a shareholder and:

- the interest rate is more than a reasonable rate of return; and
- the interest payments are dependant on the business results of the company or the value of its assets (although this rule does not apply where the recipient of the interest is within the charge to UK corporation tax).

Closing comments

There has clearly been a tightening of interest deductibility rules across Europe since the financial crisis. There has also been a noticeable change in approach, with the implementation in a number of jurisdictions of interest capping rules that impact equally on internal and external debt and therefore alter the fundamental base assumption that finance costs incurred in the course of a trade or business are fully deductible for tax purposes. It will be interesting to see if this growing trend continues across Europe in the future. ■

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Tax-efficient Director and Employee Remuneration

EBTs (employee benefit trusts) have been in the spotlight recently with EBT structures having been subject to intensive review by HMRC. This has led to several cases where employers have chosen to reach agreement with HMRC for settlement of tax and NICs on contributions made to EBTs for their employees. The issues arising when seeking to settle EBT disputes are complex and to discuss these complex issues, alongside troubleshooting EFRBS and capital planning, we are delighted to confirm that Andrew Thornhill QC will be joining us.

Andrew Thornhill QC

There have been calls to simplify government-approved employee share schemes for some time and at long last, changes have been made. We are delighted to confirm that Stephen Woodhouse will provide instructive insights on the new changes and what opportunities and issues these changes give rise to in practice for those responsible for implementing and operating these types of schemes.

Chaired and facilitated by Jonathan Fenn, Partner at Slaughter and May, our experts will examine:

- Troubleshooting issues with EBTs and EFRBS
- Capital planning: the executive treated as shareholder
- Approved share scheme changes

Stephen Woodhouse

Your panel of experts

Jonathan Fenn, Partner, Slaughter and May (Chairman)

Andrew Thornhill QC, Pump Court Tax Chambers

Stephen Woodhouse, Partner, Deloitte

Details

When: Friday 25 October 2013, 8.00–10.00am
Where: Central London
Price: £199 + VAT

To book or for further information email **registrations@lexisnexis.co.uk**