New interest deduction limitation: are interests still fully deductible?

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The new Belgian interest deduction limitation was created in the framework of the transposition of the European Anti-Tax Avoidance Directive (ATAD). The purpose of the ATAD is to prevent the further erosion of the taxable base as a result of interest deduction.

Before the new interest deduction limitation, Belgium had quite a favourable interest deduction regime. What is the impact of ATAD?

From when?

The new regulation on the interest deduction limitation has been included in the new article 198/1 of the 1992 Income Tax Code (ITC92). This will be applicable to financial years starting from 1 January 2020.

This means Belgium is one year late, because the transposition of the Directive should be effective as of 1 January 2019. Member States can ask for a postponement of this deadline if they already have a regulation that is just as effective as the new measure. Belgium has made use of this possibility. It alleges that the postponement is justified based on the *thin cap* rule, deduction depending on market interest, and the general anti-abuse regulation. The question is whether these arguments are sufficient for the European Commission.

Scope of the interest deduction limitation

Both Belgian legal persons that are subject to corporation tax and Belgian entities that are subject to tax for non-residents fall within the scope of the new interest deduction limitation.

Article 198/1, §6 ITC92 does provide for a few exceptions. For instance, financial institutions and companies whose only activity is the performance of public-private partnership (PPP) projects are outside the scope. In this context, financial institutions include credit institutions, investment companies, insurance companies and pension institutions. In a bill that has not yet been adopted, leasing companies are also considered credit institutions.

Furthermore, the new interest deduction limitation does not apply either to companies that are not part of a group, have no establishments abroad, hold no direct or indirect stake of at least 25% in another company and whose shareholder does not hold a direct or indirect stake of at least 25% in one or more companies.

Financing cost surplus

The new interest deduction limitation implies that the net interest costs are no longer deductible to the extent that they exceed either the minimum threshold of 3 million euros or 30% of taxable EBITDA. Net interest costs are also referred to as the financing cost surplus.

The financing cost surplus is obtained by subtracting financing costs from financial income. Financial income is the total of interest income and economically equivalent income that is included in the income of the tax period and is not exempt under a double taxation treaty. Financing costs are the total of interest costs and economically equivalent costs that constitute a deductible professional cost and are not connected to a permanent establishment whose profits are exempt under a double taxation treaty.

An exception is made for PPP projects and loan agreements entered into before 17 June 2016. The latter exception only applies on condition that no fundamental changes have been made to the loan agreement after this date. Examples of fundamental changes are a change in parties, interest rate, duration or refinancing.

Calculation of taxable EBITDA

Taking into account the above-mentioned threshold amounts, it is important to know how taxable EBITDA is calculated. The calculation is as follows:

Taxable income for the tax period after the first calculation

+ Tax-deductible amortisations and depreciations

+ Financing cost surplus, except non-deductible part

- Income to which the dividends received deduction applies

- Income to which the innovation deduction applies (85%)

- Income to which the patents deduction applies (80%)

- Profits exempt under a double taxation treaty

- Profits obtained from the performance of a qualifying public-private partnership project

- Group contributions that are deducted from the taxable base in the framework of tax consolidation

Transfer of financing cost surplus?

If due to an exceedance of the threshold amounts during a tax period the financing cost surplus cannot be deducted, transfer to a later a tax period is possible. The amount transferred is added to the financing cost surplus of this later tax period in order to calculate the limitation in accordance with the threshold amounts.

What happens with a group?

If a company belongs to a group, the financing cost surplus, taxable EBITDA and the minimum threshold are determined based on a consolidation that is only applied to calculate these concepts. In other words, this consolidation is not used for any other tax purposes. What must be understood by a group is what is defined as a group in the current thin cap rule (Art. 198, § 3 ITC92).

As the aim is to tackle international profit shifts, interests and economically equivalent costs or profits payable to or by another Belgian company or entity of the group are, in principle, excluded from the calculation of the financing cost surplus. Only those falling under the above-mentioned exceptions (e.g. financial institutions) can be included in the calculation.

In the calculation of taxable EBITDA, costs and profits payable to or by a Belgian company or entity of a group are also eliminated. Costs payable to another Belgian group entity must be added to the taxable EBITDA of the individual legal person liable for tax. On the other hand, profits obtained from another Belgian group entity must be subtracted.

In order to be able to put this into practice, all group transactions must be identified via the profit and loss account. Afterwards, the rules explained above can be applied in the calculation of the financing cost surplus and taxable EBITDA.

Where the 3 million minimum threshold in a group is concerned, this must be distributed across the group. A Royal Decree will need to determine the distribution key. Furthermore, there is a possibility for the transfer of unused deduction capacity, i.e. the positive difference between the threshold amount and the financing cost surplus, to other, non-excluded group members.

Conclusion

In any case, the new interest deduction limitation is more stringent than the current regulation. It is clear that the interest deduction limitation is a complication for group entities. As long as the minimum threshold remains at 3 million, this will mainly affect larger companies. Currently there are no signs that Belgium might lower its threshold, although the ATAD leaves this decision up to the Member States.

Nesrine Jelti
info@atern.io

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