

2013: deduction limitation for excessive participation interest

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1. Introduction

1.1. Anti-abuse regulation

As per January 1, 2013, a new anti-abuse rule that restricts the deductibility of interest relating to the financing of participations will enter into force. This article 13L of the Dutch Corporate Income Tax Act 1969 (CITA) aims to disallow the deduction of interest due - and expenses made - in respect of loans that are deemed to relate to the financing of participations in subsidiaries (e.g. investments in subsidiaries, as referred to in article 13 CITA), insofar as they qualify as 'excessive interest expenses'.

1.2. Bosal-gap

This anti-abuse rule is introduced to close the so-called 'Bosal-gap'. This refers to a 2003 EU court case, in which the EU Court of Justice decided that a Dutch provision in the CITA that disallowed a deduction for costs in relation to a foreign participation – whilst such costs were deductible if they relate to Dutch tax resident participations - was incompatible with EU law. As a consequence of this decision, in general interest expenses relating to participations are deductible, whilst the income from such participations is tax exempt.

1.3 Existing (holding) structures

Some existing structures and/ or (proposed) transactions may need to be reconsidered in view of the possible adverse impact of the implementation of article 13L CITA as of 2013. In any case, all Dutch (holding) companies with participations and debt should review the current financing of their participations. This memorandum highlights certain aspects of the new legislation for general reference only and does not constitute any (tax) advice.

2. Calculation of the non-deductible interest expenses under 13L CITA

2.1. Determination of the excessive interest expenses

As a starting point, for the application of article 13L CITA, it is assumed that the average acquisition price of participations is financed with the average fiscal equity of the company that holds the participations. The excess acquisition price of the participations is deemed to be financed with debt (called 'participation debt'), and may thus result in 'excessive interest' expenses. Article 13L CITA determines that interest and costs relating to the financing of participations are non-deductible, insofar as this 'excessive interest amount' exceeds a franchise of € 750,000 per year, resulting in the following formula:

$$\text{Excessive (non-deductible) interest expenses} = ((\text{Acquisition price of participations} - \text{Fiscal Equity}) / \text{All debt}) \times (\text{all interest and related costs}) - \text{€750,000}$$

The figures in the formula above (except for the interest and related costs), are computed at the average of the amounts at the beginning and at the end of the fiscal year.

2.2 Example calculation 13L CITA

It is assumed that company X has the following fiscal values(in mln):

Acquisition price participations: EUR 800

Fiscal Equity: EUR 500

All debt: EUR 900

Total interest expenses (and related costs): EUR 60

Participation debt is: 800 (Acquisition price of participations) – 500 (fiscal equity)= 300

Excessive non-deductible interest expenses of company X are: (300 (participation debt) / 900 (all debt)) x 60 (all interest and related costs) – 750,000 (franchise) = EUR 19,250,000

To determine the exact amount of non-deductible 13L CITA interest of a company, the specific situation and facts should be taken into account. Furthermore, the fiscal equity and the acquisition price of a participation should be calculated in accordance with the specific regulations as mentioned in article 13L CITA.

3. Existing holding structures /exceptions

3.1 90% rule

In case a Dutch holding company previously acquired some participations in a financial year that started before or at January 1st 2006, a grandfathering rule may (optionally) apply. Based on this grandfathering rule, when applying the abovementioned formula the company may reduce the acquisition price of those participations with 90%. It should be noted that certain exceptions may apply to this 90%-rule, on the basis of which the full acquisition prices nevertheless should be taken into account in the abovementioned formula.

3.2. Operational activities

Under certain conditions, an increase of the acquisition price of the participations is not taken into account in the calculation of the 'non-deductible interest' as per the aforementioned formula. This is e.g. the case if the increase of the acquisition price of all respective participations relates to an increase of the overall business activities of the Dutch company, e.g. an expansion of the operational activities of the company (or its group), for example an increase of the production-, distribution- and sales activities.

3.3 Active financing activities

Another exception could apply if the Dutch holding company performs so-called 'active financing activities' within its group. If the Dutch holding company fulfils all conditions for application of this exception, the loans taken up for these active finance activities are not taken into account for the calculation of the excessive interest expenses.

3.4. Reorganisations

Article 13L CITA does not aim to hinder real economic reorganisations of the group. Therefore, article 13L provides for specific rules for the calculation of the amount of excessive interest expenses in case of reorganisations.

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