

Lex Mundi Virtual Global Tax Meeting

Plenary Session One - Earnings Stripping

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US Earnings Stripping

Pre-2018

- Focus on payments of interest to related foreign shareholders
- Only applied where D:E ratio exceeded certain thresholds

2018

- Generally applicable 30% limitation on deductibility of interest

Proposed

- Limit interest deduction for US member of a global reporting group to the proportionate share of the whole group's net interest expense.
- Designed to prevent over leverage in the US

Continuing

- Code includes multiple limitations on interest deductibility that continue to apply

General Rule

Annual business interest deduction limitation

- Business interest income
- 30% adjusted taxable income
- Floor plan interest expense

Excess business interest expense carried over indefinitely

Excess limitation for year is eliminated

- No benefit in future years

Calculating Adjusted Taxable Income

Start with taxable income

- No NOL deduction
- Ignore business interest expense limitation
- Add back depreciation, amortization and depletion (through 2021)
- On sale of property, partnership interests or stock of member of consolidated group, reduce ATI for depreciation, amortization or depletion allowed or allowable in 2018-2021 tax years
 - Limited to gain on property, stock or partnership interest, or depreciation, amortization or depletion allowed or allowable
 - May reduce negative adjustment (essentially increasing limitation) if can show that prior year additions did not increase the deductible business interest expense (e.g., had sufficient limitation anyway, or had no business interest expense in that period)

Application to Partnerships

Apply limitation at partnership level

- If business interest expense does not exceed the limitation, allocate to partners and no further limitation at partner level
- Partner adjusted taxable income increased by the unused portion of the partnership's adjusted taxable income (*i.e.*, excess taxable income)
- Excess business interest expense (*i.e.*, in excess of the partnership's limitation) carried forward at partner level

Regulations reserved on tiered partnerships

Proposed legislation would apply limitations at partner level

Self-Charged Interest

Applies to partner loan to partnership

- Does not apply to indirect partner loan to partnership

Special rule to avoid lending partners from being subject to limitation

Application to Controlled Foreign Corporations (“CFCs”)

Applies in determining interest expense for Subpart F and GILTI

CFC group election

- Apply limitation on group basis
- Group includes one or more chains of CFCs connected by 80% ownership
- Individual can be parent (as well as corporation, S corporation and CFC, but not US partnership)
- Clarified that if US shareholder directly owns multiple CFCs, shareholder can make the group election even though no “chains” of CFCs involved
- Applies to ownership through partnerships (even though that would break consolidation in corporate context)

Computation

Separately compute

- Business interest expense
- Business interest expense carryforwards
- Business interest income
- Adjusted taxable income

Then combine to come up with group limitation

Although adjusted taxable income generally cannot be negative, for purpose of determining group adjusted taxable income, an individual member's adjusted taxable income may be negative (prevents overstating the limitation)

Include intra group transactions

- Not if principal purpose is to increase business interest income or adjusted taxable income

Introduction to EU Earnings stripping

EU Directive (Interest limitation rule (“Earnings stripping rule”) - ATAD):

Exceeding borrowing costs only tax deductible

- In the tax period
- In which they are incurred
- Only up to 30% of the taxpayer's earnings before interest, tax, depreciation and amortisation (EBITDA)

Borrowing costs is more than just interest

EU Earnings stripping

Allowed to treat as taxpayer:

- Entity permitted/required to apply the rules on behalf of group (defined under local law)
- Entity in group, defined under local law, which does not consolidate results of its members for tax purposes
- Exceeding borrowing costs and EBITDA at group level (comprise all

EU Earnings stripping

- Computation EBITDA
- Adding back to the income subject to corporate tax adjusted amounts for exceeding borrowing costs, depreciation and amortisation
- Tax exempt income excluded from EBITDA

EU Earnings stripping

- **Other possible exceptions**

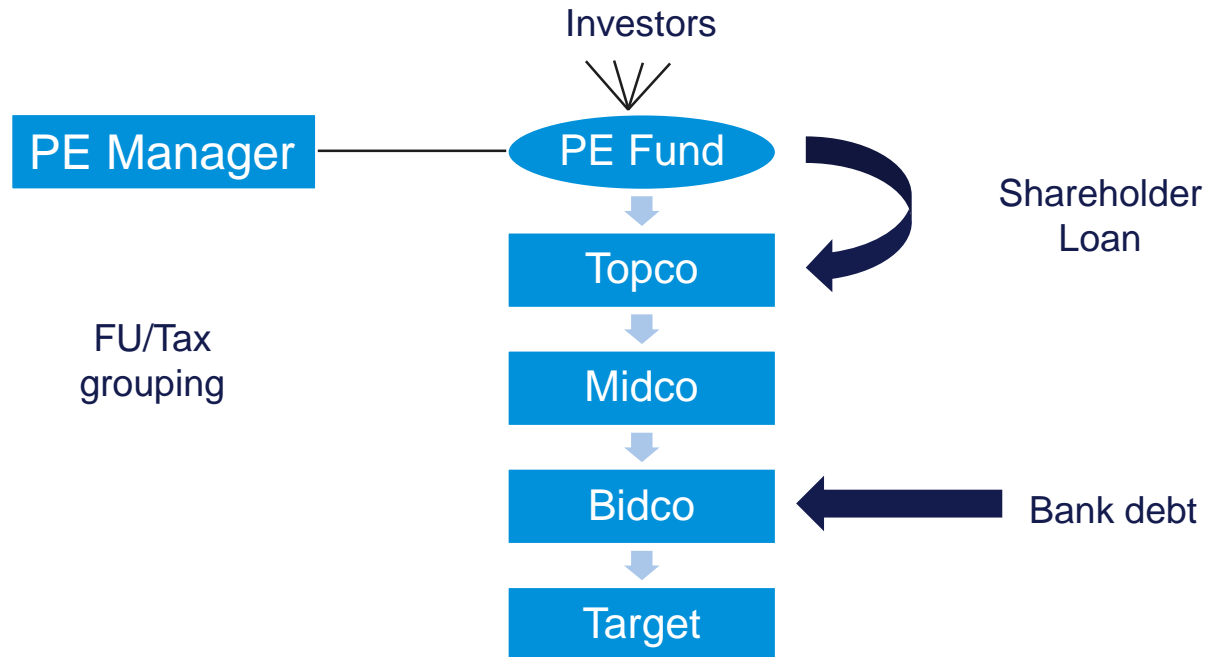
- Threshold up to EUR 3 million (entire group)
- Full deduction for standalone entity (non consolidated financial accountancy purposes – no associated enterprise / permanent establishment)
- Loans concluded prior to 17 June 2016 (no modification)
- Long term public infrastructure project if project operator, borrowing costs, assets and income are in Union)

EU Earnings stripping

Final remarks:

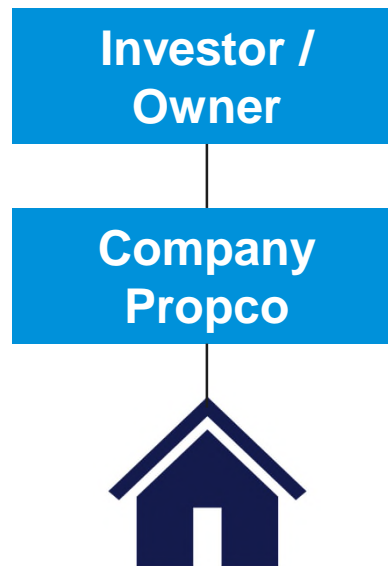
- Carry forward / carry back rules: different mechanisms
- For group different alternatives may apply

Discussion Topics for the break out session



- What is/has been the impact of the earnings stripping rule in your jurisdiction?
- Grandfathering?
- Effect of FU on computation EBITDA?

Discussion Topics for the break out session



- How to own property best? Through one or more companies?

Other questions to be discussed during break out session

- How and what exceptions has your country chosen?
- Does it impact structuring of investments?