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Evaluation of financing expense limitation application in scope of BEPS and ATAD regulations

Prior to the introduction of the Decision no. 3490, Article 41 of Income Tax Code (ITC) and Article 11 of Corporation Tax Code (CTC) stipulated that, in enterprises whose current liabilities exceed the equity, up to 10% of the total amount of expenses and costs incurred (such as interest, commission, maturity differences, delay interests, dividends, exchange rate differences) relating with the excess amount would be treated as non-deductible expenses for the Turkish company. These Articles authorized the President to set the limit of the nondeductible financial costs and expenses, which may not be more than 10% of the total of these costs.

Through this decision, the President has set the rate of non-deductible financial costs and expenses as 10% for the purposes of these Articles. Article 11 of the CTC excludes credit institutions, financial institutions, financial leasing, factoring and financing companies from this restriction. The Decision is effective as of the date of issuance and will be applied to the earnings of the taxable years starting as of 1 January 2021 and onwards.

Various countries are implementing different rules through their laws for limiting the tax deductible payments.In terms of putting limits on interest payments countries are taking measures like increasing the tax burden, taking the imputed interest rates as basis over loans from group companies and implementing rules rejecting a certain portion of interest expenses.

Distinctive and effective suggestions in line with the country risks are provided within the BEPS Action Plan 4 targeting to limit interest expenses and bringing more transparency over the practices of borrowing transactions.

The suggestions of BEPS are basically as follows:

- De Minimis Threshold: De Minimis Threshold is applied on low risk operations that are out of the scope of fixed ratio and group ratio. In the BEPS Action Plan 4, it is suggested that this threshold should be set by taking the net interest expenses of all operations in a local group by countries as basis.

- Fixed ratio rule: For the detection of interest expenses to be deducted from tax base, setting a fixed ratio range of 10-30 % by tax authorities and deducting the matching amount of earnings before interest taxes depreciation and amortization’s (EBITDA) from the tax base. Since the fixed ratio rule is taken to the center stage and advised as an implementation in BEPS Action Plan 4, it’s examined more in details below.

- Group ratio rule: In the circumstance that the imputed fixed ratio suggested are determined lower by the tax authority, BEPS 4. Final report suggests the usage of group ratio rule so as to provide convenience for companies with high debt/ equity ratios linked to non-tax reasons.

- Carry forward and carry back of disallowed interest and unused interest capacity: BEPS Action Plan 4 contains suggestions on the usage of unused interest capacity or nondeductible interest expenses through carryback or carryforward by multinational companies. Within the context of BEPS Action Plan 4, advisory provided below are presented to the countries;

• to carry forward disallowed interest expense only

• to carry forward disallowed interest expense and unused interest capacity

• to carry forward and carry back disallowed interest expense.

As per the fixed ratio rule, operational deductible financing expenses are calculated by multiplying the EBITDA and the fixed ratio. It’s suggested that interest expenses exceeding the deductible amount of interest expense should not be included in the tax base.

Besides BEPS, the EU ATAD requires Member States to implement a fixed ratio rule, designed to limit the ability of entities to deduct for tax purposes net borrowing costs in a given year to a maximum of 30% of Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA)