Finland: Government proposal (150/2018 vp) on interest deductibility restrictions

The Finnish Government proposal concerning implementation of EU ATAD I-directive (2016/1164) has been issued on 27 September 2018 and subject to legislative process, will come into force 1 January 2019. The scope of the interest deductibility restrictions as well as the definition of interest in taxation are expanded in the Bill. Interest expenses paid to third parties will be within the scope of the interest deductibility restrictions. Finland will not implement all the exceptions permitted by the directive.

Key features of the new legislation

The restrictions on interest deductibility would be expanded from interest paid by group companies and permanent establishments to apply to interest paid by "non-independent" companies and interest paid to third parties.

The definition of related parties would be changed to "group undertakings/companies", the definition of group undertakings remains at 50% direct or indirect control.

Independent companies are completely outside the scope of the restrictions, including in respect of external interest. Independent companies are defined as those where no party has a 25% influence or control stake in another party. Further, a natural person as the owner will also be determining in considering if a company is independent.

The restrictions would also apply to general and limited partnerships.

The restrictions would extend to the sources of income taxed under the Income Tax Act and the Farm Income Tax Act. As a result, the new restrictions would also apply to real estate companies.

The restrictions would extend to all expenses related to obtaining financing. Therefore, the range of interest expenses subject to restriction would expand from pure interest expenses.

Interest expenses to group undertakings would be deductible if total net interest expenses (including group undertakings and third parties) do not exceed EUR 500,000 in a tax year. If net interest expenses exceed this threshold, the limitations would be applied to the total amount and not just the amount exceeding the threshold.

The restrictions would continue to be calculated based on adjusted taxable income and the maximum deduction allowed would be 25% of the adjusted taxable income. The adjusted taxable income is described as "taxable EBITD" and is calculated as taxable income including group contributions, adding back interest expenses and tax depreciation (in practice the change in terminology from taxable EBITDA to taxable EBITD does not affect the calculation as all tax depreciation or amortization is added back to taxable income).

Annual interest expenses paid to third parties would always be deductible up to EUR 3,000,000 (if expenses are otherwise at arm's length and related to the company's business).

As is currently the case, a back-to-back arrangement would mean that a loan taken from a third party would be considered a group loan. Additionally, security for a loan given by another group company in the form of a loan receivable leads to a third party being considered as a group loan.

Non-deductible financing expenses would be carried forward without an expiry date and ownership changes would not effect the carry forward. In practice the order in which interest expenses carried forward and other interest expenses are deducted should be closely monitored.

Exceptions

The financial services sector and certain public infrastructure projects would not be in the scope of the restrictions. The excluded infrastructure projects are still under consideration.

The exemption from the restrictions by comparing the equity ratio (equity divided by gross assets) of the Finnish taxpayer to the group ratio would remain. However, the group's consolidated and the Finnish taxpayer's balance sheet should be prepared using the same accounting standards or the group's balance sheet be converted to be equivalent to the taxpayer's balance sheet in order for the balance sheet comparison test to be applicable.

Grandfathering

Interest expenses on third party loans taken before 17 June 2016 are outside the scope of the new legislation, provided that the terms of the loan remain unchanged from 17 June 2016.

Interest expenses on third party loans, capitalized before 31 December 2018 can be deducted after the change in restrictions.

Changes to the draft legislative proposal issued in January 2018

The financial services sector would not be in the scope of the restrictions.

Certain infrastructure projects are left outside the scope of the restrictions.

The current balance sheet comparison test would not be removed.

Exceptions allowed by the directive not implement in Finland

The EU directive would have allowed all interest expenses up to 3 000 000 euros to be deducted. In the proposal, this threshold is not applied to interest expenses paid to group companies.

The EU directive would have allowed the threshold of deductible interest expenses to be increased to 30% of EBITD. The Government Bill leaves the threshold at the current level at 25% of EBITD.

The EU directive would allow infrastructure projects to be outside of the scope of the restrictions if they produce, develop and/or maintain property of common interest. However, in the Government Bill, infrastructure projects are defined more strictly to exclude only social housing projects from the interest restrictions.

The EU directive does not require considering back-to-back and securities for a loan given by another group company to a third party loan to be considered as a group loans.

Other observations

Even though the balance sheet comparison test remains, it might in practice be challenging to be exempted based on the test. The balance sheets being compared should be prepared in accordance with the same accounting standards or a conversion needs to be done. In groups where the consolidated balance sheet is prepared according to international accounting standards (e.g. IFRS or US GAAP) this conversion might prove to be complicated.

It seems that the definition of interest for taxation would not incorporate finance lease payments.

Financial consideration paid to mutual real estate companies or housing companies would not be considered as their interest income nor as the shareholders interest expense.

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