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Series: ATAF’s International Taxation and Technical Assistance Publication
INTRODUCTION

About this Suggested Approach

ATAF members have reported that the use of third party and related party interest is one of the most prevalent and simple of the profit-shifting techniques used in Africa and poses a significant risk to African tax bases. The fluidity and fungibility of money makes it a relatively simple exercise to adjust the mix of debt and equity in a controlled entity.

Most countries tax debt and equity differently for the purposes of their domestic law. Interest on debt is generally a deductible expense of the payer and taxed at ordinary rates in the hands of the payee. Dividends, or other equity returns, on the other hand, are generally not deductible and are typically subject to some form of tax relief (an exemption, exclusion, credit, etc.) in the hands of the payee. While, in a purely domestic context, these differences in treatment may result in debt and equity being subject to a similar overall tax burden, the difference in the treatment of the payer creates a tax-induced bias, in the cross-border context, towards debt financing. The distortion is compounded by tax planning techniques that may be employed to reduce or eliminate tax on interest income in the jurisdiction of the payee.

In the cross-border context, the main tax policy concerns surrounding interest deductions relate to the debt funding of outbound and inbound investment by groups. Parent companies are typically able to claim relief for their interest expense while the return on equity holdings is taxed on a preferential basis, benefiting from a participation exemption, preferential tax rate or taxation only on distribution. On the other hand, subsidiary entities may be heavily debt financed, using excessive deductions on intragroup loans to shelter local profits from tax. Taken together, these opportunities surrounding inbound and outbound investment potentially create competitive distortions between groups operating internationally and those operating in the domestic market.

Most African countries are capital importers and will be net borrowers rather than net lenders. Taxpayers in African countries are usually the subsidiaries referred to and will usually be net payers of interest rather than net payees. The tax deductibility of interest payments and potential profit shifting through excessive interest payments is therefore of high priority to most African countries.

In some cases African countries have no specific interest deductibility rules to address this profit shifting risk and only have a general deduction rule which limits the tax deductible interest to that interest which has been incurred wholly and exclusively in the production of taxable income. Such a rule provides little protection against the tax planning strategies used to profit shift through excessive interest payments by injecting needed funding into the enterprise by way of debt rather than equity.

Many African countries have tried to address such strategies through legislation that restricts the tax deductible interest by applying a fixed ratio rule linking interest deductibility to the level of equity in an entity, typically through thin capitalisation rules based on a debt/equity test. The main advantage of such a test is that it is relatively easy for tax administrations to obtain relevant information on the level of debt and equity in an entity and it also provides a reasonable level of certainty to groups in planning their financing. However, set against these advantages are a number of important disadvantages. A rule which limits the amount of debt in an entity still allows significant flexibility in terms of the rate of interest that an entity may pay on that debt. Also, an equity test allows entities with higher levels of equity capital to deduct more interest expense, which makes it relatively easy for a group to manipulate the outcome of a test by increasing the level of equity in a particular entity.

In recent years, countries have increasingly introduced fixed ratio tests based on an entity’s interest/earnings ratio, which has been found to be a better tool to combat base erosion and profit shifting. In these tests, the measure of earnings used is typically earnings before interest, taxes, depreciation and amortisation (EBITDA). Most countries presently use a tax measure of EBITDA.

This fixed ratio approach issue of an entity’s interest/taxable earnings ratio was recommended in the Action
4 Report of the G20/OECD BEPS (Base Erosion and Profit Shifting) Project. Through its Cross Border Taxation Technical Committee ATAF actively participated in the BEPS project’s work on Action 4 and are of the view that the recommendations in the Action 4 report provides an appropriate basis for drafting interest deductibility rules in Africa.

The Suggested Approach is based on a fixed ratio rule which limits an entity’s net interest deductions to a fixed percentage of either its taxable income or its profit, measured using earnings before interest, taxes, depreciation and amortisation (EBITDA) based on tax numbers. This is a straightforward rule to apply and ensures that an entity’s interest deductions are directly linked to its economic activity. It also directly links these deductions to an entity’s taxable income, which makes the rule reasonably robust against planning.

A fixed ratio rule provides a country with a level of protection against base erosion and profit shifting, but such an approach does not take into account the fact that groups operating in different sectors may require different amounts of leverage, and even within a sector some groups are more highly leveraged for non-tax reasons. The Suggested Approach therefore, provides the option of combining a fixed ratio rule with a group ratio rule which allows an entity to deduct more interest expense in certain circumstances.

The Suggested Approach also provides for further options depending on a country’s specific policy objectives. These include an option to remove entities which pose the lowest risk from the scope of a general interest limitation rule by applying a De Minimis threshold based on a monetary value of net interest expense. Taxpayers falling below this threshold may deduct interest expense without restriction.

Rules which link interest deductions to EBITDA raise issues where an entity’s interest expense and earnings arise in different periods. This may be the result of volatility in earnings which means the ability of a company to deduct interest changes from year to year, or because an entity has incurred interest expense to fund an investment which will give rise to earnings in a later period. To reduce the effect of these issues, there is an option in the Suggested Approach which permits taxpayer’s to carry forward disallowed interest expense or unused interest capacity for use in future periods. It is suggested countries consider imposing limits on such carry forwards.

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SUGGESTED APPROACH

to Drafting Interest Deductibility Legislation

NOTE

Text in red denotes optional wording.

Text in blue denotes issues where a country will need to take a policy decision.

1. Interest Deductibility Legislation

Section XX

1. Notwithstanding any other provision of this Act, no deduction shall be allowed for the purpose of ascertaining the taxable profits of any company [Optional wording]: that is a member of a group of companies, except a company whose main business is banking or insurance, in respect of-

Option 1
(a) Any amount of net interest expense in respect of any period that exceeds 10 – 30 percent of the taxable profits/tax EBITDA of the company

Option 1A
(a) Any amount of interest in respect of any period that exceeds 10 – 30 percent of the taxable profits/tax EBITDA if the company's net interest expense exceeds 10 -30 percent of the taxable profits/tax EBITDA of the company

Option 1B
(a) Any amount of interest expense in respect of any period that exceeds 10 – 30 percent of the taxable profits/tax EBITDA of the company

b) For the purposes of this section net interest expense means,
   i) The interest paid or accrued by the company during the period minus
   ii) the amount of interest included in the taxable income of such company for that period.

c) For the purposes of sub-section (b) interest includes: interest on all forms of debt; payments economically equivalent to interest; and expenses incurred in connection with the raising of finance] [Optional wording]: where the interest arises from a transaction directly or indirectly with a related person. These should include, but not be restricted to, the following:
   i. payments under profit participating loans
   ii. imputed interest on instruments such as convertible bonds and zero coupon bonds
   iii. amounts under alternative financing arrangements, such as Islamic finance
   iv. the finance cost element of finance lease payments
   v. capitalised interest included in the balance sheet value of a related asset, or the amortisation of capitalised interest
   vi. amounts measured by reference to a funding return under transfer pricing rules
   vii. where applicable notional interest amounts under derivative instruments or hedging arrangements related to an entity's borrowings
   viii. certain foreign exchange gains and losses on borrowings and instruments connected with the raising of finance
   ix. guarantee fees with respect to financing arrangements
   x. arrangement fees and similar costs related to the borrowing of funds.

d) For the purposes of this section, tax EBITDA means the sum of:
   i. Taxable profits, and
   ii. Net interest expense, and
   iii. Depreciation, and
   iv. Amortisation
Alternative Sub-section 1

Option 2
(a) Any amount of net interest expense in respect of any period that exceeds the greater of:
   i. 10 -30 percent of the taxable profits/tax EBITDA of the company, or
   ii. The group’s net interest ratio multiplied by the company’s tax EBITDA or EBITDA

Option 2A
(a) Any amount of interest expense in respect of any period that exceeds the greater of sub-section (a)(i) or (ii) if the company’s net interest expense exceeds the greater of:
   i. 10 -30 percent of the taxable profits/tax EBITDA of the company, or
   ii. The group’s net interest ratio multiplied by the company’s tax EBITDA or EBITDA

Option 2B
(a) Any amount of interest expense in respect of any period that exceeds the greater of:
   i. 10 -30 percent of the taxable profits/tax EBITDA of the company, or
   ii. The group’s net interest ratio multiplied by the company’s tax EBITDA or EBITDA
   
(b) For the purposes of sub-section (a) net interest expense means,
   i) the interest paid or accrued by the company during the period, minus
   ii) the amount of interest included in the taxable income of such company for that period.

(c) Interest includes: interest on all forms of debt; payments economically equivalent to interest; and expenses incurred in connection with the raising of finance [Optional wording]: where the interest arises from a transaction directly or indirectly with a related person. These should include, but not be restricted to, the following:
   i. payments under profit participating loans
   ii. imputed interest on instruments such as convertible bonds and zero coupon bonds
   iii. amounts under alternative financing arrangements, such as Islamic finance
   iv. the finance cost element of finance lease payments
   v. capitalised interest included in the balance sheet value of a related asset, or the amortisation of capitalised interest
   vi. amounts measured by reference to a funding return under transfer pricing rules
   vii. where applicable notional interest amounts under derivative instruments or hedging
   viii. certain foreign exchange gains and losses on borrowings and instruments connected with the raising of finance
   ix. guarantee fees with respect to financing arrangements
   x. arrangement fees and similar costs related to the borrowing of funds.

(d) For the purposes of this section, tax EBITDA means the sum of:
   i. Taxable profits, and
   ii. Net interest expense, and
   iii. Depreciation, and
   iv. Amortisation

(e) For the purposes of this section EBITDA means the sum of:
   i. Net profit before tax, and
   ii. Net interest expense, and
   iii. Depreciation, and
   iv. Amortisation
(f) For the purposes of Section XX, a group of companies means:

i. The company’s ultimate parent company, and all companies that are fully consolidated in the parent’s consolidated financial statements, or

ii. Where the company is itself the ultimate parent company, all companies that are fully consolidated in that company’s consolidated financial statements.

iii. Where consolidated financial statements are not prepared, any two companies, where one controls the other, or

iv. Where consolidated financial statements are not prepared, all companies that are under common control of another company or individual, group of individuals, including family members of such individuals or a partnership

v. This section shall apply also in respect of interest expense incurred in respect of a loan made to a company directly or indirectly from a shareholder who is an individual, or a partner or a family member of that individual.

(g) For the purposes of this section:

i. Group net interest means the total third party net interest expense of the group of companies to which the company belongs.

ii. Group net interest ratio means the group net interest divided by the total EBITDA of the group of companies to which the company belongs.

(h) For the purposes of subsection (g) above net interest expense means:

i) the interest paid or accrued by the group during the period, minus

ii) the amount of interest received or receivable by the group for that period

Additional optional provisions:

(i) This section shall not apply to a company that is a member of a group of companies composed solely of companies resident in [COUNTRY] OR

(j) This section shall not apply to a company that is a member of a group of companies composed solely of companies resident in [COUNTRY] and none of the companies are subject to any of the following Parts or Sections of the Income Tax Acts [Country to add relevant parts or sections]

(k) In cases where interest is paid or payable directly or indirectly to a person resident outside [COUNTRY] in a jurisdiction considered by the Commissioner-General/Commissioner to provide a taxable benefit in relation to that interest no deduction shall be made in respect of that interest and such interest shall not be included for the purposes of sub-section (b)(i).

(l) Where under section XX (K) no deduction is made in respect of an amount of interest and foreign tax is payable by the recipient in relation to that interest of an amount that is calculated by reference to that interest then the taxable income of the company shall be reduced by the amount of that foreign tax.

(m) This section shall not apply to a company if the total net interest expense incurred by members of the group of companies that are resident in [COUNTRY] is less than US$XXX, unless that total net interest expense is paid directly or indirectly to a person resident outside [COUNTRY] in a jurisdiction considered by the Commissioner-General/Commissioner to provide a taxable benefit in relation to that interest

(n) Interest for which a deduction is denied under this section may be carried forward and treated as incurred during the next taxable period. Interest so denied may be carried forward for no more than X years. This sub-section shall not apply in respect of interest denied under sub-section (k) above [delete if not applying sub-section (k)].
EXPLANATORY NOTES

1. Section XX (1) The suggested approach would not be appropriate for the banking and insurance sector as the fixed ratio rule and group ratio rule are unlikely to be effective in addressing BEPS risks relating to the banking and insurance sectors for a number of reasons. In particular, banking and insurance groups are important sources of debt funding for groups in other sectors and as such many are net lenders by a significant margin. This means that the main operating companies in these groups, and the groups overall, will often have net interest income rather than net interest expense. As the fixed ratio rule and group ratio rule apply to limit the level of an entity’s net interest expense, these rules would have no impact on important entities within banking and insurance groups.

In addition, the fact that interest income is a major part of a bank or insurance company’s income means that EBITDA would not be a suitable measure for economic activity across a group in these sectors. Finally, the financial statements of banking and insurance groups typically differ from those of groups in other sectors, which in particular could impact the operation of a group ratio rule.

Countries should consider introducing targeted rules to address base erosion and profit shifting in these sectors.

2. Section XX (1) The legislation is worded so as it only applies to companies that are part of a multinational enterprise. The rule would not therefore apply to stand alone companies which is aligned to the recommendations of the BEPS Action 4 report. ATAF consider the risk to a country’s tax base is very low from this limitation in scope. The most likely risk is where there is a loan to the company from a shareholder. However such loans are brought within the scope of the legislation by Section XX(1)(f)(v) “This section shall apply also in respect of interest expense incurred in respect of a loan made to a company directly or indirectly from a shareholder who is an individual, or a partner or a family member of that individual.

3. Section XX (1) (a) provides three options for the fixed ratio rule; Option 1, Option 1A and Option 1B. The differences between the options is as follows:

Option 1 will result in only disallowing the net interest expense that is in excess of the fixed ratio not the total interest in excess of that ratio. This is the approach used in the BEPS Action 4 report.

The simplified example below illustrates how the rule operates:

<table>
<thead>
<tr>
<th>Interest paid or accrued</th>
<th>11 million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net interest expense</td>
<td>10 million</td>
</tr>
<tr>
<td>Fixed ratio</td>
<td>8 million</td>
</tr>
</tbody>
</table>

Disallowance = 2 million (10 million, the excess net interest less 8 million the fixed ratio)

Option 1A disallows all of the excess interest expense (i.e. the gross interest expense) not just the net interest expense.

This means in the above example the disallowance will be 3 million (11 million, the gross interest paid or accrued less 8 million the fixed ratio limit). This option still uses the Action 4 recommended approach of determining whether there should be a disallowance by comparing the net interest expense to the fixed ratio. However in this option if the net interest exceeds the fixed ratio the disallowance is the amount of interest paid or accrued that exceeds the fixed ratio rather than the amount of the net interest expense that exceeds the ratio. This approach therefore differs from the Action 4 recommended approach in terms of the quantum of interest expense disallowed for tax purposes.

Option 1A may mean in certain circumstances a relatively small increase in interest receivable could lead to a significant change in the disallowance.

The following examples illustrates this issue:

<table>
<thead>
<tr>
<th>Interest paid or accrued</th>
<th>10 million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net interest expense</td>
<td>7 million</td>
</tr>
<tr>
<td>Fixed ratio</td>
<td>6 million</td>
</tr>
</tbody>
</table>
Under Option 1A the disallowance will be 4 million. If the interest receivable increased by 1 million from 3 million to 4 million then the position would be:

<table>
<thead>
<tr>
<th>Interest paid or accrued</th>
<th>10 million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net interest expense</td>
<td>6 million</td>
</tr>
<tr>
<td>Fixed ratio</td>
<td>6 million</td>
</tr>
</tbody>
</table>

There would be no disallowance as the net interest expense does not exceed the fixed ratio. This means in this circumstance a 1m increase in interest receivable leads to a reduction of 4m in the amount disallowed.

Option 1B operates in exactly the same way as Option 1 except that it is the total interest paid or accrued (i.e. the gross interest expense) not the net interest expense that is compared to the fixed ratio. If the gross interest expense exceeds the fixed ratio the disallowance is the amount of gross interest expense that exceeds the fixed ratio rather than the amount of the net interest expense that exceeds the ratio.

Option 1B differs from the Action 4 recommended approach in two ways. The fixed ratio is compared to the gross interest expense not the net interest expense and secondly the disallowance is the amount of gross interest expense that exceeds the fixed ratio rather than the amount of the net interest expense that exceeds the ratio (the same as Option 1A).

The following example illustrates how option 1B operates in comparison to Option 1 and Option 1A.

<table>
<thead>
<tr>
<th>Interest paid or accrued</th>
<th>11 million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net interest expense</td>
<td>7 million</td>
</tr>
<tr>
<td>Fixed ratio</td>
<td>10 million</td>
</tr>
</tbody>
</table>

- Under Option 1B as the gross interest expense exceeds the fixed ratio by 1m (11m – 10m) there would be a disallowance of 1m.

If a country decides to use only a fixed ratio rule it is will be necessary to decide which of Option 1, Option 1A or Option 1B to apply.

4. Section XX (1) proposes that the fixed ratio rule is based on a corridor of between 10% and 30% of the taxable profit or tax EBITDA. The 10% to 30% corridor is the recommended approach set out in the Action 4 BEPS approach and many countries already have rules with a percentage within this range. Examples are:

- **Finland**: 25 per cent of EBITD calculated based on the taxable profit and loss account.
- **Germany**: 30 per cent of taxable EBITDA.
- **Greece**: 30 per cent of EBITDA, phased-in system according to which the percentage will reduce from 60 per cent in 2014 to 30 per cent in 2017.
- **Italy**: 30 per cent of EBITDA, adjusted by adding rental payments under finance lease transactions.
- **Norway**: 30 per cent of taxable EBITDA.
- **Portugal**: 30 per cent of EBITDA, adjusted by excluding certain items such as income resulting from shares eligible for the participation exemption or attributable to a permanent establishment outside Portugal to which the option for exemption is applied. Phased-in system according to which the percentage will reduce from 70 per cent in 2013 to 30 per cent in 2017.
- **Spain**: 30 per cent of operating profits adjusted by adding certain items such as depreciation and amortisation and financial income from equity investments.

It should be noted that generally the countries above have lower bank base interest rates than
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to Drafting Interest Deductibility Legislation

most African countries and therefore countries with high base rates might consider having a higher ratio. However such countries should note that a higher ratio might increases the BEPS risk. When setting the percentage countries will need to balance the need to address BEPS and the need to encourage foreign direct investment.

For the determination of the appropriate percentage a country might consider conducting a simulation exercise to review the tax impact of different percentages.

5. Section XX (1) proposes that a country uses either taxable profits or taxable EBITDA in the calculation of the fixed ratio. The Action 4 BEPS report recommends the use of tax EBITDA. However some African countries have reported that they would find it more administratively convenient to use taxable profits.

If a country decides to use taxable profits it will need to consider whether this is the appropriate term according to the terminology used in its domestic tax legislation and whether it needs to be defined. If a country decides to use tax EBITDA Section XX (1) (d) provides a proposed definition.

6. Section XX (1) (c) If a country wishes to only take into account intra-group interest expense and receipts when calculating the fixed ratio the optional wording in the blue highlight will need to be included in the legislation.

7. The BEPS Action 4 report states that “Recognising that some groups are highly leveraged with third party debt for non-tax reasons, the recommended approach proposes a group ratio rule alongside the fixed ratio rule. This would allow an entity with net interest expense above a country’s fixed ratio to deduct interest up to the level of the net interest/EBITDA ratio of its worldwide group”

The alternative sub-section (1) in this paper provides for a group ratio rule alongside the fixed ratio rule and also provides the same options for the use of net interest expense or gross interest expense as set out for the option of a fixed ratio only and no group ratio rule.

Option 2 follows the principle of Option 1 by only disallowing the net interest expense that is in excess of the greater of the fixed ratio or group ratio.

Option 2A follows the principle of Option 1A disallowing all of the interest expense that is in excess of the greater of the fixed ratio or group ratio.

Option 2B follows the principle of Option 1B disallowing all of the interest expense that is in excess of the greater of the fixed ratio (using the interest paid or accrued not the net interest expense) or group ratio.

8. The Action 4 BEPS report states at Paragraph 280 that when applying a group ratio rule an entity’s EBITDA may be calculated using tax or accounting principles. Each of these approaches has advantages and disadvantages. The report considers those advantages and disadvantages in Examples which are set out below and are based on the following scenario.

Applying a group ratio to an entity’s tax-EBITDA or accounting-EBITDA

<table>
<thead>
<tr>
<th>Financial reporting</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net interest expense</td>
<td>EBITDA</td>
</tr>
<tr>
<td>USD</td>
<td>USD</td>
</tr>
<tr>
<td>Group (100 million)</td>
<td>1 billion</td>
</tr>
<tr>
<td>A Co (20 million)</td>
<td>100 million</td>
</tr>
</tbody>
</table>

Group net third party interest/EBITDA ratio = (USD 100 million / USD 1 billion) x 100 = 10%
Example 1 - Determining EBITDA using tax principles
In this example, A Co’s interest capacity is calculated by applying the group’s net third party interest/EBITDA ratio of 10%, to A Co’s tax-EBITDA of USD 80 million. This limit can be applied directly to A Co’s net interest expense for tax purposes. Out of A Co’s total net interest expense of USD 18 million, USD 8 million is tax deductible and USD 10 million is disallowed.

The calculation of EBITDA using tax principles is consistent with that recommended under the fixed ratio rule. It is also straightforward for groups to apply and tax authorities to audit, and as an approach to tackle base erosion and profit shifting it has the benefit that an entity’s interest deductions are linked to its level of taxable income. This means that where an entity’s taxable income is higher than its accounting income, its ability to deduct interest expense will be correspondingly greater. Similarly, if an entity undertakes planning to reduce its taxable income, it will be able to deduct less net interest expense.

Example 2 - Determining EBITDA using accounting principles
In this example, A Co’s interest capacity is calculated by applying the group’s net third party interest/EBITDA ratio of 10%, to A Co’s accounting-EBITDA of USD 100 million. This limit can be applied directly to A Co’s net interest expense for tax purposes. Out of A Co’s total net interest expense of USD 18 million, USD 10 million is tax deductible and USD 8 million is disallowed.

Under this approach interest capacity is calculated using only accounting information. This is straightforward for groups to apply and tax authorities to audit. However, a possible concern remains if there is a significant difference between the calculation of net interest expense under tax and accounting rules. For example, an entity could incur a significant interest disallowance if the definition of interest it applies for tax purposes is wider than that for accounting purposes (because interest capacity has been calculated using the narrower accounting definition).

Example 3 – Adjusting an accounts-based limit on deductions for differences in tax and accounting definitions of interest
This example illustrates an approach to reduce the impact of differences between an entity’s net interest expense for tax purposes and for accounting purposes. Under this approach, the accounts-based limit on interest deductions calculated in Example 8b is compared with the entities net interest expense for accounting purposes, to determine what percentage falls within the limit. Where this figure is 100% (i.e. all of the entity’s accounting net interest expense is within the limit), then all of the entity’s net interest expense for tax purposes is deductible, with no disallowance. Where the percentage is less than 100%, the corresponding percentage of the entity’s net interest expense for tax purposes is deductible, with the remainder disallowed (i.e. if 90% of the entity’s accounting net interest expense falls within the limit, 90% of the entity’s tax net interest expense would be deductible).

Applying this approach to A Co, the group’s net third party interest/EBITDA ratio of 10% is applied to A Co’s accounting-EBITDA of USD 100 million to produce an accounts-based limit on net interest expense of USD 10 million. This limit is compared with A Co’s net interest expense for accounting purpose of USD 20 million, 50% of which falls within the limit. This percentage is then applied to A Co’s net interest expense for tax purposes. Therefore, out of A Co’s total net interest expense for tax purposes of USD 18 million, USD 9 million is deductible and USD 9 million is disallowed.

Compared with the accounts-based approach in Example 8b, this would mean, for example, where an entity’s net interest expense for tax purposes exceeds that for accounting purposes, it would receive a correspondingly higher interest capacity.
Alternatively, where an entity's net interest expense for tax purposes is lower than that for accounting purposes, its interest capacity would be reduced. In effect, the accounts-based limit on deductions is flexed to take into account differences between net interest expense for tax and accounting purposes.

Countries will therefore need to decide which EBITDA is most appropriate to meet their policy objectives.

9. Many African tax administrations have expressed concerns as to how they would verify the information relating to the group ratio rule where that information is held outside the African jurisdiction. Therefore if a country decides to introduce a group ratio rule alongside the fixed ratio rule the tax administration will need to be able to verify the group ratio reported by the taxpayer. The tax administration will need to obtain sufficient information such as group consolidated accounts to carry out that verification. Much of that information may not be held by the local taxpayer but held abroad. Members may be able in many cases to obtain this through Exchange of Information if it has the Multilateral Convention and/or the AMATAM in force but these do not cover all jurisdictions. Therefore if the member decides to introduce a group ratio rule it may wish to consider introducing a provision stating that additional interest that would be deductible for tax purposes under the group rule will only be allowed as such a deduction if the taxpayer provides to the tax administration the information needed to verify the reported group ratio.

10. Sub-Sections XX (1) (i) and (j) provide for the option of a country excluding from the interest deductibility rules taxpayers that are a member of a group of companies where all of the group companies are all tax resident in the same country as the taxpayer. However sub-section (j) restricts that exclusion to taxpayers that are a member of a group of companies where all of the group companies are all tax resident in the same country as the taxpayer and none of those group companies are subject to a different tax regime in the country. If a country has different tax regimes that exist for companies for example tax pioneer legislation or free trade zones it is recommended that sub-section (j) may be a more appropriate option than sub-section (i).

11. Sub-section XX (1) (k) If a country chooses to have this section it will need to determine what constitutes a beneficial tax regime. Broadly other countries have taken one of the following approaches:
   • Publishing a list of jurisdictions considered to be beneficial tax regimes – this has the advantage of providing certainty but can be politically sensitive.
   • Providing a definition of what constitutes a beneficial regime. Some countries have used a simple statutory tax rate test e.g. where the jurisdiction has a statutory Corporate Income Tax rate of less than X%. This is simple to administer but may lead to some jurisdictions not being included where the statutory rate is higher but it has some very beneficial rules that mean the effective rate for most corporate taxpayers is significantly less than the statutory rate.
   • The Commissioner-General makes the determination on a case by case basis. This provides the tax administration with the most flexibility but creates the most uncertainty for taxpayers.

Countries will need to decide which option it wishes to use if it adopts this section.

12. Sub-section XX (1) (l) provides an option that where no deduction is allowed for an amount of interest due to the provisions of sub-section XX (1) (k) a credit will be given of the amount of any foreign tax paid in respect of that interest as a deductible amount against the taxpayer’s taxable income.
13. Sub-section XX (1) (m) provides an option for a country to introduce a De Minimis provision. Under such a provision entities that have a low level of net interest would be exempt from the rules. It is recommended that such a threshold should be based on the total net interest expense of all group entities tax resident in the local country. This provision will not apply if any of the interest is payable to an entity located in a jurisdiction that provides a taxable benefit on that interest.

14. Sub-section XX (1) (n) provides an option for a country to allow the ‘carry forward’ to future years of any interest disallowed, or of ‘unused capacity’, in the current year. In relation to the carry forward of disallowed interest, if, for example, in year 1, actual net interest is $150, but maximum allowable interest is $100, then $50 interest in Year 1 would be disallowed as a deduction. If, in year 2, actual net interest is $70, and maximum allowable interest remains at $100, then a total of $100 would be allowable as a deduction ($70 from year 2, and $30 brought forward from year 1).

In order to prevent the build-up of large ‘unused interest’, it is recommended that a limit is placed on the number of years unused interest can be carried forward of a maximum 5 years. Countries may wish to consider extending this period for companies engaged in a business which has high upfront capital expenditure and a delayed revenue stream such as mining operations.
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