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Base Erosion and Profit Shifting and Interest Expenditure

In this article, the author examines the implications for the utilization of interest expenditure in tax planning given the OECD Base Erosion and Profit Shifting initiative.

1. Introduction

The generation of interest expenditure is one of the most common strategies used by multinational enterprises (MNEs) with regard to international tax optimization. Intra-group debt financing and the location of external borrowing provide cost-efficient ways in which to disconnect profits from their origin, to remit them to wherever is appropriate and to take advantage of tax rate differentials worldwide. The OECD, therefore, considers the use of interest expenditure to be one of the "key pressure areas" of the Base Erosion and Profit Shifting (BEPS) initiative.[1]

In contrast to other issues in the BEPS initiative, such as the challenges posed by the digital economy, the interest expenditure problem is by no means new. There is a long tradition of anti-avoidance legislation in this area. From the 1980s, tax legislators[2] worldwide have been aware of thin capitalization as a concept and now almost every country has specific anti-avoidance rules aimed at the financing of groups. However, although thin capitalization rules have not converged in a coordinated way over time, either in their factual preconditions or in their legal consequences, some trends, such as an increasing number of earnings-stripping regimes and the replacement of reclassification by non-deductibility, can be distinguished. The consistent tightening of the existing rules is perhaps the most significant development.[3] Despite these trends, there are numerous conflicting thin capitalization concepts and the design of such rules differs widely. Thin capitalization rules are also subject to constant amendment, which indicates that there is no simple solution to the issue and possibly no solution at all, unless the lack of tax neutrality between debt and equity is removed.

Much has been written on thin capitalization. In 1998, the OECD Report on "Harmful Tax Competition" addressed base erosion attributable to thin capitalization.[4] Ten years later, the 2008 International Fiscal Association (IFA) Congress considered "New tendencies in tax treatment of cross-border interest of corporations".[5] This raises the question of whether or not there is anything to add to the debate. What can be the possible benefit from the BEPS initiative regarding profit shifting and base erosion arising from the use of interest expenditure?

The answer lies in coordination. As noted previously in this section, since most countries have already adopted extensive thin capitalization rules, the biggest problem is the distortions caused by uncoordinated actions of national legislators.[6] This is, therefore, a genuine opportunity for the BEPS initiative to become a mutually beneficial course of action, which avoids both double non-taxation and double taxation. Taking into consideration the conflicts of interest in this area, harmonization seems to be an unrealistic objective. However, agreed and mutually applied best practice would, in itself, be a significant advance.

This article analyses the reasons for, the scope of and the legal environment regarding base erosion and profit shifting via the utilization of interest expenditure with a view to suggesting possible solutions.

2. The Problem and Its Origins

Group financing structures allow profits to be allocated to low-tax jurisdictions and expenses by high-tax jurisdictions. This is primarily as a result of the following two strategies:[7]

(1) intra-group financing (thin and fat capitalization and the use of financing companies in tax havens); and
(2) the (external) debt financing of cross-border acquisitions and equity contributions that places debt in high-tax jurisdictions so as to finance tax-exempt or deferred dividends.[8]

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1. OECD, *Addressing Base Erosion and Profit Shifting* p. 48 (OECD 2013), International Organizations' Documentation IBFD.
2. A few countries, such as Canada, adopted thin capitalization rules even earlier in the 1970s.
3. P. Hiny, *General Report*, in *New Tendencies in Tax Treatment of Cross-Border Interest of Corporation*, IFA Cahiers de Droit Fiscal International, vol. 93b, sec. 2. (Sdu Fiscale & Financiële Uitgevers 2008), Online Books IBFD.
4. OECD, *Harmful Tax Competition. An Emerging Global Issue* p. 62 (OECD 1998).
5. IFA, *supra* n. 3. *See also*, almost 20 years ago, D.J. Piltz, *General Report*, in *International Aspects of Thin Capitalization*, IFA Cahiers de Droit Fiscal International, vol. 81b (Kluwer 1996).
6. J. Owens, *The Taxation of Multinational Enterprises: An Elusive Balance*, 67 Bull. Intl. Taxn. 8, sec. 5. (2013), Journals IBFD.
7. For a detailed discussion of the different possible cases, *see*, for example, T. Edgar, J. Farrar & A. Mawani, *Foreign Direct Investment, Thin Capitalization, and the Interest Expense Deduction: A Policy Analysis*, 56 Can. Tax J. 4, pp. 815-821 (2008).
8. For an in-depth study on interest expenditure with regard to outbound investment, *see* J.R. Hines Jr., *The Tax Treatment of Expenses Incurred to Earn Foreign Source Business Income: Principles, Policies, and Options*, Research Report Prepared for the Advisory Panel on Canada's System of International Taxation (Aug. 2008).

There are various legal and economic reasons why financing structures are commonly used to optimize taxation.

Almost all domestic corporate tax systems treat debt and equity differently. In general, interest is deductible and reduces the tax base, whereas dividends (remuneration in respect of equity) are non-deductible at the level of the distributing company. The taxation of dividends in the hands of the recipient shareholder depends on whether the shareholder is an individual or corporate. With regard to personal income tax, dividends, in most cases, result in some form of mitigated economic double taxation. In contrast, inter-corporate dividends are, in principle, tax exempt under domestic participation exemptions. Accordingly, in a purely domestic context, there may be no difference in treatment of inter-corporate loans and equity payments, which are both taxed once, interest taxed in the hands of the parent, and dividends taxed at the level of the subsidiary. However, in the international context, differences in taxation allow groups to determine whether the applicable tax rate is that of the source country, where the subsidiary is located, or that of the parent's residence country and to exploit tax rate differentials.

Tax planning utilizing financing structures requires the following two conditions:
(1) the deductibility of interest as opposed to the non-deductibility of dividends; and
(2) tax rate differentials.

Even small differences in taxation can give rise to tax planning, as, due to the private law integrity of transactions, the establishing of tax-optimal financing structures gives rise to only low transaction costs and there are almost no legal or economic restrictions of intra-group choices as between debt and equity. The international implications of the taxation of capital income seem to be more important for individual taxpayers, but also encourage the establishment of financing group companies in low-tax jurisdictions.

Theoretically, the deductibility of interest in the source country could be compensated by imposing a withholding tax on the interest of non-resident parents. However, only a few countries tax the interest of non-residents. The Interest and Royalties Directive (2003/49)[9] prevents Member States from levying withholding tax on intra-group loans. Article 11(2) of the OECD Model[10] also limits withholding tax to a low rate of 10%. Some countries even waive the right to tax the interest of non-resident creditors in their domestic tax laws and many agree in tax treaties not to levy withholding tax.

In contrast, dividends are not only non-deductible, but are, in principle, subject to a withholding tax in the source country, albeit reduced to 5% or lower in most tax treaties under article 10(2)(a) of the OECD Model. With regard to EU companies, no withholding tax is levied on inter-company dividends if the participation meets the threshold of 10% stated in the Parent-Subsidiary Directive (90/435).[11] Consequently, in practice, no, or at least no significant, withholding tax is typically imposed on intra-group dividends.

The location of external debt in high-tax jurisdictions so as to finance the low(er) taxation of foreign profits presents further opportunities to exploit tax rate differentials where interest is deductible from the other income of the parent. National legislators have become more aware of the tax planning related to the location of external debt, which may result in a negative tax rate,[12] as an increasing number of countries have adopted the exemption method with regard to double tax relief. However, even under the credit method, tax rate differentials can facilitate the tax-driven location of external debt due to the opportunities relating to the deferral of the payment of tax offered by retaining profits in lower-taxed subsidiaries.

To date, no common strategy has evolved to counter the foregoing. Country practice is even more heterogeneous with regard to inbound investments. In general, expenses related to tax-exempt dividends are deductible, thereby reflecting the position that such a tax exemption is only provided to prevent economic double taxation. This view might, at least from a revenue perspective, be challenged in respect of dividends taxed abroad. A potential solution would be to restrict the deduction of interest attributable to foreign tax-exempt income. However, the case law of the Court of Justice of the European Union (ECJ or "Court"),[13] the Member States are restricted in distinguishing between domestic and cross-border dividends. Other countries, not so restricted by EU law, deny the deduction of interest related to foreign income by allocation systems that, by their very nature, are complicated and open to manipulation. However, there are some countries that accept such a deduction without restriction to the extent that the interest is related to tax-exempt foreign dividends.

There are, therefore, two different issues that must be considered separately, despite their overlaps:
(1) related-party debt and the intra-group option between debt and equity; and
(2) the location of external borrowing financing tax-exempt or tax-deferred dividends.

The two issues must be distinguished, as they have different causes and, though this is disputable, require different remedies.

Tax planning in respect of intra-group debt financing has its origin in the differences in the tax treatment of debt and equity. These differences can be readily exploited because

9. Council Directive 2003/49/EC of 3 June 2003 on a Common System of Taxation Applicable to Interest and Royalty Payments made between Associated Companies of Different Member States p. 49, OJ L 157 (2003), EU Law IBFD [hereinafter: EU Interest and Royalties Directive].
10. *OECD Model Tax Convention on Income and on Capital* (22 July 2010), Models IBFD.
11. Council Directive 90/435/EEC of 23 July 1990 on the Common System of Taxation Applicable in the Case of Parent Companies and Subsidiaries of Different Member States, OJ L 225 (1990), EU Law IBFD [hereinafter EU Parent-Subsidiary Directive].
12. *See*, for example, Edgar, Farrar & Mawani, *supra* n. 7, at p. 831. *See also* M.A. Sullivan, *The Effects of Interest Allocation Rules in a Territorial System*, Tax Notes Intl. (5 Sept. 2012).
13. *See*, for example, NL: ECJ, 18 Sep. 2003, Case C-168/01, *Bosal Holding BV v. Staatssecretaris van Financiën*, ECJ Case Law IBFD.

within a group, debt and equity are apparently fully substitutable, as, economically, intra-group debt and equity have much in common with regard to risk and the lack of informational asymmetries.

Against this, the issue of the deductibility of external interest financing tax-exempt participation income has its origins in the separate entity concept and the asymmetry of taxing rights. Even if debt and equity were treated in completely the same way for tax purposes, this issue would not disappear. The opportunities for tax planning presented by locating external debt in high-tax jurisdictions is also only one aspect. With regard to cross-border business, there is nothing unusual in the fact that a taxpayer may incur interest expenditure in one jurisdiction that contributes to the production of income in another.

However, even without any tax rate differentials and a totally innocent non-tax business strategy, the allocation of external debt in a country that does not have the right to tax foreign dividends remains an issue given inter-nation equity considerations. From the perspective of net income taxation, interest should be deductible in the country of the foreign subsidiary.[14] For a solution, one would need to bring together profit and debt. However, this is difficult to realize if the parent and not the subsidiary is the contracting party in respect of the external debt. Deduction in the country of the subsidiary fails if the parent is the debtor. Non-deductibility of any debt related to tax-exempt dividends could require a taxpayer to adapt the contractual design of the external lending and establish debt push-down strategies, but raising the funds at the level of the subsidiary (by debt-push down structures) is often impossible or only possible using a guarantee of the parent, which would increase capital costs. Consequently, the level of external lending seems to be less substitutable than intra-group financing.

3. Interest Expenditure and the BEPS Action Plan

In considering the reasons for base erosion and profit shifting utilizing financing structures, it is clear that there are extensive overlaps with other areas of the BEPS Action Plan,[15] which need to be carefully separated. These are:

- Hybrid mismatch arrangements (Action 2): the significant variability and the creativity in the design of financial instruments gives rise to particular opportunities to exploit qualification conflicts using hybrid mismatch arrangements. Mezzanine debt or equity structures can be designed either to give rise to double dips or income that is taxed nowhere. Mismatches also arise from differences in anti-avoidance rules, for example, if one country allows the deduction of related-party interest as a result of less restrictive anti-avoidance provisions and that interest is qualified as tax-exempt deemed dividends under the thin capitalization rule of another country. Such qualification conflicts may have been one of the primary reasons for many countries moving from requalification to the non-deductibility of "excessive" debt. Countries with participation exemption systems have also begun to adopt limitations in respect of the exemption, in linking it to the non-deductibility of the payment at the level of the distributing company.
- Controlled foreign company (CFC) rules (Action 3): fat capitalization and group financing companies in low-tax jurisdictions can, to some extent, be countered by CFC rules. As far as possible, such circumstances do not have to be covered by specific anti-avoidance rules limiting the deductibility of interest. Unfortunately, the ECJ in *Cadbury Schweppes* (Case C-196/04)[16] limited the scope of application of CFC rules in line with the standard concept of abuse to wholly artificial arrangements, and not much is required to demonstrate "real" financing activities. Consequently, it may be necessary to provide additional safeguards by specific interest-related anti-avoidance rules that must also satisfy the constraints of the fundamental freedoms as perceived by the ECJ (*see* section 7.4.4.).
- Harmful tax competition (Action 5): the existing domestic rules against thin capitalization should also be examined in the context of Action 5 of the BEPS Action Plan, which is directed against harmful tax competition.[17] Harmful tax competition does not only consist of preferential tax regimes in the form of tax subsidies, but can also be effected by lax anti-avoidance rules containing intentional loopholes.[18] As long as the measures of the BEPS initiative using financing constructions differ so widely as at present, taxpayers can exploit the fact that some countries are "more generous" than others, possibly even taking advantage of mismatches resulting in the paradoxical effect that despite, or rather because of, anti-avoidance rules, interest is not taxed. Regardless of the distortive effect of lax anti-avoidance rules, such rules cannot be dealt with by legal means, such as State aid prohibitions. However, if a significant number of countries were to agree on best practice, this could establish a standard and place countries that do not meet the standard under pressure to justify their rules. In this respect, the OECD should not necessarily seek the most efficient and sophisticated rule covering all possible cases of base erosion and profit

14. M.J. Graetz, *A Multilateral Solution for the Income Tax Treatment of Interest Expenses*, 62 Bull. Intl. Taxn. 11, sec. 2. (2008), Journals IBFD.
15. OECD, *Action Plan on Base Erosion and Profit Shifting* p. 31 (OECD 2013), International Organizations' Documentation IBFD, also available at www.oecd.org/ctp/BEPSActionPlan.pdf.
16. UK: ECJ, 12 Sep. 2006, Case C-196/04, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue* para. 51, ECJ Case Law IBFD.
17. *See* OECD, *supra* n. 4; *See also* P.J. Wattel, *Forum: Interaction of State Aid, Free Movement, Policy Competition and Abuse Control in Direct Tax Matters*, 5 World Tax J. 1, sec. 4. (2013), Journals IBFD.
18. A. Haufler & M. Runkel, *Multinationals' Capital Structures, Thin Capitalization Rules, and Corporate Tax Competition*, Working Paper, CESifo Venice Summer Institute, p. 13 et seq. (2008) and *Firms' financial choices and thin capitalization rules under corporate tax competition*, 56 Eur. Econ. Rev. 6, pp. 1087-1103 (2012); and Owens, *supra* n. 6.

shifting using interest allocations, but, rather, for a prudent approach that could be expected to have widespread support.

- Transfer pricing (Action 9): currently, some countries, such as the United Kingdom,[19] primarily rely on transfer pricing rules to identify excessive debt and/or disguised equity. Both areas are also addressed in tax treaties, i.e. in articles 9, 10 and 11 of the OECD Model.[20] In addition, the interaction of the two regimes must be considered carefully regarding anti-avoidance rules that operate within set safe harbours.

4. Existing Legislation Restricting the Deductibility of Interest Expenditure

Currently, almost all developed countries have measures to counter (cross-border) tax planning using financing structures. Initially, "classical" thin capitalization rules were the prevailing method in respect of related-party debt. However, recently, a trend towards broader restrictions, which also apply to third-party debt, has emerged, but the diversity of regimes is great.[21] Specific measures may be characterized as constantly changing and highly complex. Complexity increases as countries apply not only one, but different restrictions together. There is a high risk of double taxation as a result of this failure of bilateral cooperation. The danger of double non-taxation can, however, be mitigated by the adoption of domestic exchange of information provisions.

Despite the differences in the existing rules, the regimes can, nevertheless, be classified under the following four general headings:

(1) Measures limited to related-party debt, which are often extended to guaranteed and back-to-back debt, including:

  - Qualifying participations with different thresholds: consequently, there are limits to thin capitalization rules in respect of intra-group financing. For Luxembourg, this means a group holding 95% of a subsidiary's capital,[22] for Austria[23] and New Zealand,[24] the required holding is 50%, for Australia, this is at least 40%[25] and, for Germany, before 2008, this was at least 25%.[26] In contrast, the United Kingdom only requires "control", which is defined as the ability to oversee the affairs of the controlled corporation according to the wishes of the controlling corporation.[27]
  - Restrictions on interest paid to non-residents (Australia[28] and Canada).[29]
  - Acceptance of a certain degree of related-party debt, defined by:
    (a) a fixed debt:equity ratio or debt:(domestic) assets ratio, partly combined with a safe haven arm's length test (Australia,[30] Canada[31], the Czech Republic[32] and Luxembourg);[33]
    (b) an interest and/or an earnings before interest, taxes, depreciation and amortization (EBITDA) ratio, i.e. an earnings stripping limitation, but which only applies in combination with other criteria;
    (c) a combination of (a) and (b) (Denmark,[34] France[35] and the United States);[36] or
    (d) less common, the application of transfer pricing provisions, i.e. the arm's length principle, being a multifactor assessment to reveal disguised equity (Austria,[37] Luxembourg[38] and the United Kingdom).[39]
  - The legal consequences also differ. Recently, a significant number of countries have adopted rules that simply disregard the deductibility of interest expenditure. Previously, excessive interest payments were generally reclassified as deemed dividends, but now only few countries still have such rules (Australia,[40] Austria[41] and Luxembourg).[42] The result is the same at the level of the interest paying company. However, the

19. UK: Income and Corporation Taxes Act 1988 sch. 28AA, National Legislation IBFD.
20. For instance, inappropriately low interest rates fall within the scope of article 9 of the *OECD Model* (2010) and not article 11(6), which only applies to inappropriately high interest rates.
21. For an overview, but one that is not fully up to date, *see* A.P. Dourado and R. de la Feria, *Thin Capitalization Rules in the Context of the CCCTB*, Oxford U. Centre. Bus. Taxn., Working Paper Series, WP 08/04, pp. 2-16 (2008) and IFA, *supra* n. 3.
22. PwC, *Worldwide Tax Summaries – Corporate Taxes 2013-14*, pp. 1198 and 1200.
23. Id., at p. 124.
24. C. Elliffe, *Trans-tasman Thin Capitalization Rules and Treaties*, 28 Austrl. Tax Forum, p. 611 (2013).
25. PwC, *supra* n. 22, at p. 105.
26. *See* DE: *Körperschaftsteuergesetz* [Corporate Income Tax Law] (KStG), sec. 8a(3), National Legislation IBFD, as amended by the Korb II Gesetz, BGBl. I 2003, p. 2840 (in force from 2004 to 2007); and sec. 34 (6a) KStG. *See also* A. Koerner, *The New German Thin Capitalization Rules: Tax Planning; Incompatibility with European Law*, 32 Intertax 8/9, pp. 401-415 (2004).
27. PwC, *supra* n. 22, at p. 2132.
28. Id., at p. 105.
29. Id., at p. 335.
30. Id., at p. 105, being a debt:equity ratio of 3:1. Australian government proposals made at the time of the writing of this article would reduce the ratio to 1.5:1, but interest is, nonetheless, deductible if the arm's length test can be satisfied.
31. Id., at p. 318. The debt:equity ratio has recently been reduced from 2:1 to 1.5:1.
32. Id., at p. 252, being a debt:equity ratio of 4:1. Back-to-back loans are also considered to be related-party loans.
33. Id., at p. 1197, being an arm's length test and a debt:equity ratio of 85:15.
34. Id., at p. 540 et seq., being: (1) a debt:equity ratio of 4:1, consolidation rules and related-party debt, including "external bank debt if group member companies or shareholders have provided guarantees to the bank"; (2) 3.5% of certain assets of the group; and (3) 80% of the Danish company's tax group's taxable earnings befor interest and taxes (EBIT) income. Failure to pass any of tests (1) to (3) results in non-deductibility.
35. Id., at p. 658, being: (1) a debt:equity ratio of 1.5:1; (2) 25% of operation income; and (3) the corporation is in a net borrowing position. All of the tests have to be failed for deductibility to be denied.
36. E&Y, *Worldwide Corporate Tax Guide 2013-14*, p. 1433, US: Internal Revenue Code, sec. 163 (j). In addition to debt:equity ratio of 1.5:1, this includes an excess limitation carry-forward and an interest carry-forward.
37. PwC, *supra* n. 22, at p. 125.
38. Id., at p. 1200. In practice, this amounts to a debt:equity ratio of 85:15.
39. Id., at p. 2132.
40. Id., at p. 125.
41. Id., at p. 101.
42. Id., at p. 1200.

effect of both concepts differs at the level of the recipient. Reclassification as deemed dividends usually only changes the level of taxation, as the deemed dividends are tax exempt under typical participation exemption systems, whereas qualification as non-deductible expense is not reflected by a corresponding exemption at the level of the recipient.

(2) General interest barriers (related-party and third-party debt): a smaller group of countries (France,[43] Germany,[44] Italy,[45] Spain[46] and the United Kingdom,[47] which all have general interest barriers in addition to their thin capitalization rules)[48] extended their originally related-party thin capitalization rules to general interest barriers, applying to related-party and third-party debt. The objective of these rules is twofold, i.e. countering:
- profit shifting associated with inbound direct investments by way of intra-group debt arrangements; and
- (excessive) debt financing in respect of outbound investments. Details differ to a great extent. Interest and/or EBITDA safe havens (Germany,[49] Italy[50] and Spain)[51] can be found, as can debt:equity ratios, both in combination with different safe harbours, for example, comparing the indebtedness of a single corporation with the indebtedness of the group as a whole (the United Kingdom).[52] The legal consequence is the non-deductibility of the interest (New Zealand).[53]

(3) Non-deductibility of interest related to tax-exempt dividends: currently, only a few countries (the Czech Republic[54] and the Slovak Republic)[55] deny or restrict the deductibility of interest related to tax-exempt (foreign) dividend. In France, under the *Carrez* Amendment,[56] interest expenditure in respect of the acquisition of participation or shareholding acquisitions of EUR 1 million or more are not deductible. However, this rule does not apply if decisions relating to the acquisition were taken, or control over the acquired company is exercised, in France. The provision is, therefore, intended to prevent foreign investors acquiring targets using a French leveraged company. In Austria, under general interest financing, tax-exempt dividends are deductible. However, only interest and other costs, such as fees and legal advice, relating to the debt-financed acquisition of shares from related parties or controlling shareholders are not deductible to restrict intra-group debt-push-down models.[57] At the time of the writing of this article, the Australian government had proposed abolishing the deductibility of such interest relating to the acquisition of foreign affiliates for income years commencing on or after 1 July 2014.[58] In the United States, even though foreign income is taxable under the credit method, also apply interest allocation rules are also applied that seek to restrict interest attributable to foreign income.[59]

(4) Withholding taxes on interest: various types of withholding taxes are applied to ensure the taxation of interest paid to external financiers. Emerging and developing countries levy withholding taxes on all interest paid to foreign investors (Brazil,[60] China[61] and India)[62] and some negotiate the right to do so in tax treaties (Croatia[63] and Portugal).[64] In addition, some countries, such as Brazil,[65] Nicaragua,[66] Portugal[67] and Serbia,[68] apply a higher withholding tax rate to recipients located in tax havens. Other countries, though not taxing the interest of foreign investors in general, levy withholding taxes paid to lenders situated in tax havens or non-cooperative states, for example, Latvia (tax havens),[69] and the Czech Republic[70] and France (non-cooperative states).[71] Such taxation is not dependent on whether or not the beneficiary is a related party. There is also a practice of levying withholding taxes if the recipient is a foreign group member that is not situated in the European Union or in a country with which a tax treaty has been concluded (Denmark).[72] However, levying withholding taxes regularly is only a practice used in addition to the limitation on the deduction of interest expenditure noted previously, for example, by countries that have implemented thin capitalization rules, such as Brazil,[73] China[74] and Serbia.[75]

43. Id., at p. 654.
44. Id., at p. 699.
45. Id., at p. 969.
46. Id., at p. 1866.
47. E&Y, *supra* n. 36, at p. 1374.
48. *See also* the proposal for a general limitation of interest expenditure in respect of the United States, with reference to the German model in *The President's Economic Recovery Advisory Board, Tax Reform Report*, 2010, pp. 72-74.
49. PwC, *supra* n. 22, at p. 699.
50. Id., at p. 963.
51. Id., at p. 1866.
52. E&Y, *supra* n. 36, at p. 1374.
53. Id., at p. 1443, being a debt:assets ratio of 60% and, additionally, a company must have more than 110% of the debt percentage of the worldwide group. *See* Elliffe, *supra* n. 24, at p. 612.
54. PwC, *supra* n. 22, at p. 524.
55. Id., at p. 1812.
56. Id., at p. 653 and O. Parawan, *New Restriction on Interest Deductibility of Acquisition Debt*, 23 Intl. Tax Rev. 5, p. 25 (June 2012).
57. Id., at p. 122 and AT: *Körperschaftsteuergesetz* (Corporate Income Tax Law) (KStG), sec. 11, National Legislation IBFD.
58. Id., at p. 102.
59. For the functioning and effects of this rule, *see* Hines, *supra* n. 8, at pp. 5-8 and K.A. Froot & J.R. Hines Jr., *Interest Allocation Rules, Financing Patterns, and the Operations of U.S. Multinationals*, in *The Effects of Taxation on Multinational Corporations* p. 279 and seq. (National Bureau of Economic Research 1995).
60. PwC, *supra* n. 22, at p. 277 et seq.
61. Id., at p. 404 et seq.
62. Id., at p. 858 et seq.
63. Id., at p. 488, with lower rates in tax treaties.
64. Id., at p. 1632 et seq., with lower rates in tax treaties.
65. Id., at p. 277.
66. Id., at p. 1460.
67. Id., at p. 1632.
68. Id., at p. 1772.
69. Id., at p. 1137 et seq..
70. E&Y, *supra* n. 36, at p. 321 et seq.
71. Linklaters, *Paris Tax Alert* p. 2 (Aug. 2013).
72. PwC, *supra* n. 22, at p. 542.
73. Id., at p. 274.
74. Id., at p. 402.
75. Id., at p. 1771.

5. The Extent of the Problem and the Lack of Adequate Empirical Evidence

Given the long-existing practice of countries implementing rules restricting tax planning using interest expenditure, a profound knowledge on the efficiency of such measures could be expected to exist. This leads to the issue of empirical evidence. What is the extent of the problem? Which rules are, on the one hand, efficient in countering abusive tax planning and, on the other, do not curb foreign direct investment and have no negative effects on the economic behaviour of taxpayers?

There is significant evidence that MNEs react to tax rate differentials using financing structures.[76] Inter-company loans are becoming increasingly important in relation to the extent of tax rate differentials between the lending and the borrowing companies within a multinational group.

However, to some extent, the problem may be overstated:

- The location of external debt seems to be much less sensitive to tax rate differentials than intra-group lending.[77] A key issue in the location of external debt, being as important as the tax rate, is whether or not there is sufficient tax capacity to offset the interest.
- Intra-group financing also seems to be less important than often assumed. Heckemeyer and Overesch (2011) report that, using a meta-analysis, only 28% of profit shifting consists of intra-group financing, the much larger part being transfer pricing.[78] Büttner and Wamser (2007) assume as a reason the substantial costs of adjusting capital structures as a method of profit shifting.[79]
- The attractiveness of debt as a profit shifting mechanism may, however, have fallen recently given the temporary low-interest environment that requires very large funds to generate significant tax advantages.

Some of these empirical findings could be the consequence of the various national thin capitalization regimes that are already in force. There is empirical evidence that such regimes on the whole work.[80] Less clear is whether these regimes have negative economic effects on foreign direct investment.[81] Despite the considerable history of thin capitalization rules, the subject is understudied. Essentially, a sufficient body of comparative empirical studies is lacking.[82] Insufficient is known regarding the effects of the different concepts and the particular features of the different regimes in use to allow an assessment as to whether or not one country's practice is more efficient than another's.[83] There is some empirical work on traditional thin capitalization rules and the effects of the restrictions of debt:equity ratios,[84] but, for example, there are no studies involving contrasting juxtaposition of rules applying only to inter-company lending and general interest barriers. The latter, due to their recent introduction and the lack of available data, have so far not attracted much attention.

As in many countries the tax return data necessary to evaluate the existing anti-avoidance rules are, in general, not available to the public and, if at all, only in a restricted way for academic use, the OECD should ask national authorities to provide details of the effects of their various national rules.[85] This would be especially so for countries that have amended their rules recently so as to permit an immediate comparison of the effects of the different concepts.

6. Objectives and Requirements

The BEPS initiative concentrates on securing a commensurate tax burden by restraining abusive techniques that artificially segregates taxable income from the activities that generate such income to exploit differences in tax

76. *See* R. Altshuler & H. Grubert, *Repatriation Taxes, Repatriation Strategies and Multinational Financial Policy*, 87 J. Pub. Econs. 1, pp. 73-107 (2003); M.A. Desai, C.F. Foley & J.R. Hines Jr., *A Multinational Perspective on Capital Structure Choice and International Capital Markets*, 59 J. Fin. 6, pp. 2451-2487 (2004); T. Büttner & G. Wamser, *Intercompany Loans and Profit Shifting – Evidence from Company-Level-Data"*, CESifo Working Paper No. 1959 (2007) and *Internal Debt and Multinational Profit Shifting: Empirical Evidence from Firm-Level Panel Data*, 66 Natl. Tax J. 1, p. 77 et seq. (2013); V.M. Jog and J. Tang, *Tax Reforms, Debt Shifting and Tax Revenues: Multinational Corporations in Canada*, 8 Intl. Tax & Pub. Fin. 1, p. 5 (2001); and Dourado & De la Feria, *supra* n. 21, at p. 17 et seq.; and C. Fuest et al., *Profit Shifting and "Aggressive" Tax Planning by Multinational Firms: Issues and Options for Reform*, 5 World Tax J. 3, sec. 4. (2013), Journals IBFD.
77. There is, however, empirical evidence that MNEs tend to place external borrowing in high-tax jurisdictions. *See* Desai, Foley & Hines, *supra* n. 76 and Edgar, Farrar & Mawani, *supra* n. 7, at p. 824 et seq.
78. *See* J.H. Heckemeyer & M. Overesch, *Multinationals' Profit Response to Tax Differentials: Effect Size and Shifting Channels*, ZEW Discussion Paper No. 13-045 (2013). *See also* L.P. Feld, J.H. Heckemeyer & M. Overesch, *Capital Structure Choice and Company Taxation: A Meta-Study*, CESifo Working Paper Series, No. 3400 p. 27 (2011) and 37 J. Bank. & Fin. 8, pp. 2850-2866 (2013).
79. Büttner & Wamser, *Intercompany Loans and Profit Shifting – Evidence from Company-Level-Data*, *supra* n. 76.
80. *See* M. Overesch & G. Wamser, *Corporate Tax Planning and Thin-Capitalization Rules: Evidence from a Quasi-Experiment*, 42 Applied Econs. 5, pp. 563-573 (2010); T. Büttner et al., *The Impact of Thin-Capitalization Rules on the Capital Structure of Multinational Firms*, 96 J. Pub. Econs. 11-12, pp. 930-938 (2012); A. Haufler & M. Runkel, *Multinationals' Capital Structures, Thin Capitalization Rules, and Corporate Tax Competition*, Working Paper, CESifo Venice Summer Institute (2008); and Büttner & Wamser, *Internal Debt and Multinational Profit Shifting: Empirical Evidence from Firm-Level Panel Data*, *supra* n. 76, at p. 80 et seq.
81. *See* T. Büttner et al., *supra* n. 80. *See also* T.A. Gresik, D. Schindler & G. Schjelderup, *Foreign Direct Investment, Tax Havens and Multinationals*, Working Paper (Jan. 2014), which demonstrates that thin capitalization rules encourage foreign direct investment.
82. On a normative basis, but without empirical comparison, *see* C.-P. Knöller, *The Efficacy of Thin Capitalization Rules and Their Barriers: An Analysis from the UK and the German Perspective*, 39 Intertax 6/7, p. 317 (2011) and A. van den Berg van Saparoea, *Optimizing the Interest Deduction Rules – A Never-Ending-Story*, 49 Eur. Taxn. 1, sec. 1 (2009), Journals IBFD.
83. For a first paper in this direction, *see* J. Blouin et al., *Thin Capitalization Rules and Multinational Firm Capital Structure*, IMF Working Paper 14/12 (Jan. 2014), but only in respect of data up to the end of 2004.
84. For the reduction of the debt:equity ratio of the previous German thin capitalization rules (sec. 8a, KStG), *see* G. Wamser, *The Impact of Thin Capitalization Rules on External Debt Usage: A Propensity Score Matching Approach*, CESifo Working Paper No. 62 (2008) and A. Weichenrieder & H. Windischbauer, *Thin Capitalization Rules and Company Responses*, CESifo Working Paper No. 2456 (2008).
85. The reluctance of national tax legislators to give account for their actions is remarkable. For instance, when the German tax legislator in 2007 (effective from 2008) introduced the highly controversial general interest barrier, an evaluation was announced, which has at the time of the writing of this article, not occurred.

rates.[86] The focus is on the behaviour of taxpayers.[87] Securing an "adequate" level of taxation of profits and interest primarily requires rules countering "aggressive" tax planning or, taking an even narrower approach, limiting wholly artificial arrangements with no economic purpose other than the tax effect. Such rules would have to be directed specifically against tax havens and low-tax jurisdictions, as, without international tax rate differentials, there is no incentive for the taxpayer to generate interest instead of dividends.

There is, however, a second line of reasoning. With regard to the revenue of the countries involved, it is also important as to which country has the right to tax the profits and which must allow the deduction of expenditure, so that both obtain a fair share of the tax revenue on internationally earned income. Accordingly, inter-nation equity considerations must be disclosed and taken into account. Ensuring a fair allocation of profits and expenses among the countries involved is independent of tax rate differentials and of the quality of the tax planning of taxpayers. In doing so, any such rule should, given the logics of path dependency, not fundamentally change the present allocation of revenue, meaning that business profits are taxed in the source country, interest is taxed in the residence country.[88] Both objectives are interrelated insofar as measures to counter tax avoidance should, from the start, be compatible with the prevailing inter-nation equity considerations and not significantly alter current taxing rights. Any ex post correction by way of a clearing system should, therefore, be avoided.[89]

To date, the unilateral measures have primarily focussed on revenue interests. As noted in section 1., a coordinated approach would also have the advantage of avoiding distortions caused by the uncoordinated coexistence of different concepts. Accordingly, neutrality should be the key guideline for coordinated best practice. There is no requirement to punish taxpayers in respect of international tax planning to counter tax arbitrage. Consequently, interest that is considered to be excessive should not result in a higher tax burden than the alternative return on equity and external borrowing in the residence country should not result in an unfavourable treatment compared to borrowing in the source country. Compatibility with the ability-to-pay principle and consistence with the concept of taxation of net income[90] involves that, on the one hand, interest expenditure should not be deducted twice, but, on the other, that it cannot be disregarded and must be recognized somewhere. Countries seeking to prevent double non-taxation should, therefore, be equally aware of not causing double taxation.

One should also be highly cognizant of the cost of administration and compliance of such an anti-avoidance rule, as most of the more recently adopted legislation has attained a level of complexity that taxpayers can hardly comply with making a reasonable effort. As taxpayers need rules that they can comply with, tax authorities should be aware of the practical aspects of enforcement. The German interest barrier, for example, which is a reference point for many countries in respect of their own reform proposals, is so complex in its application that it cannot be enforced in a sufficiently equal manner. A highly complicated rule could serve the purpose of deterrence, but one has to take into consideration differently resourced tax authorities in the OECD member countries if such a rule is not to lose creditability. Another significant problem for taxpayers and tax authorities alike is the constant alteration of existing rules. Stability should, therefore, also be a major objective.

7. Legal Framework

7.1. Introductory remarks

Any solution to the base erosion and profit shifting must fit in with the existing regulatory environment and must consider the extent of any necessary changes carefully. In this context, the legal framework and its elasticity determine the policy and legislative cost of reform. The following three layers of restrictions and alignment are required:
(1) domestic law (*see* section 7.2.);
(2) treaty law (*see* section 7.3.); and
(3) EU law (*see* section 7.4.).

7.2. Domestic law

Worldwide, domestic corporate income tax systems are based on the non-deductibility of dividends at the level of the distributing company, thereby avoiding economic double taxation by the granting of relief, in respect of intergroup dividends primarily by way of a participation exemption, at the level of the receiving company. Even though the non-deductibility of dividends is the key reason for the difference in the treatment between debt and equity, it seems to be unlikely that countries would reverse a key element of their domestic tax systems in a coordinated manner. A less insurmountable obstacle seems to be the decision of some countries not to exert their taxing jurisdiction to the interest of non-resident investors.

7.3. Treaty law

A significant opportunity for coordinated action by the OECD is that treaty law (which, at present, is, due to the reverse allocation of taxing rights in respect of business

86. OECD, *supra* n. 15, at p. 13 and seq.
87. Only Action 5 of the BEPS initiative addresses the role of the national legislators encouraging tax planning.
88. The OECD does not intend to change the allocation of income between source and residence country, but, rather, to secure the present allocation of taxing rights. Preserving this allocation is a concession to revenue interests in place, though, from an inter-nation equity perspective, it might be better not to distinguish between debt and equity, but, rather, allocate the taxing rights in a parallel fashion. In this respect, *see* W. Schön, *International Tax Coordination for a Second-Best World (Part II)*, 2 World Tax J. 1, sec. 4.5. (2010), Journals IBFD.
89. Council Directive 2003/48/EC of 3 June 2003 on Taxation of Savings Income in the Form of Interest Payments, art. 12 OJ L157 (2003), EU Law IBFD, was sub-optimal in that Austria, Belgium and Luxembourg were, for a transitional period, allowed to levy a withholding tax on the interest of non-residents, but had to transfer 75% of the revenue to the residence Member State.
90. Stressing the importance of this, *see* Hines, *supra* n. 8, at p. 1.

profits and interest,[91] one of the primary sources of the problem and an obstacle for unilateral solutions) could become part of the implementation process of a best practice model. In this regard, the OECD Model could be amended to include a thin capitalization rule that applied correspondingly in both treaty states, thereby avoiding double taxation and double non-taxation. The OECD could also promote a multilateral convention to amend existing tax treaties, which would otherwise have to be renegotiated in tedious long-running one-to-one process or overruled by domestic legislation.

7.4. EU law

7.4.1. The fundamental freedoms and the tax directives

The most restrictive constraints would arise in respect of EU law. Notwithstanding the fact that EU Law, in general, only applies cross-border between the Member States of the European Union and the European Economic Area (EEA), it will affect the entire BEPS initiative if the Member States are not otherwise to be isolated. Any coordinated approach must address, therefore, such restrictions. However, EU secondary law, such as the tax directives, can be amended to deal with base erosion and profit shifting. Tax directives are not final, even though the requirement for unanimity makes amending them an arduous and a time-consuming task. In this regard, it should also be noted that the BEPS initiative depends on the willingness of all parties to cooperate. Accordingly, if the Member States were to accept an OECD best practice model, they should be able to reach the necessary unanimity to amend the tax directives. The more important constraints arise from primary EU law with regard to the fundamental freedoms and ECJ case law, which, generally, prevents Member States from adopting restrictive rules applicable only in cross-border circumstances where such rules are not strictly limited to the narrow tax avoidance as defined by the Court (*see* section 7.4.4.).

7.4.2. Avoidance and the tax directives

The Interest and Royalties Directive (2003/49)[92] stipulates the traditional allocation of taxing rights in line with most tax treaties by preventing the source country from taxing inter-corporate interest and royalty payments, subject to a participation of at least 25% in the capital of the paying company. In combination with the Parent-Subsidiary Directive (90/435), the Interest and Royalties Directive (2003/49) confirms the distortions between debt and equity and tax opportunities for planning.

However, the Interest and Royalties Directive (2003/49) is only intended to deal with the treatment of a non-resident creditor in the source country. In this respect, the ECJ recently concluded that the deductibility of interest at the level of a debtor can be restricted.[93] Accordingly, interest barriers do not fall within the scope of the Interest and Royalties Directive (2003/49).

The Interest and Royalties Directive (2003/49) also contains reservations allowing the Member States to counter tax fraud and tax avoidance. In this regard, article 4(1)(a) of the Interest and Royalties Directive (2003/49) exempts the thin capitalization legislation of the source country that reclassifies interest into dividends from the scope of the Directive. Such deemed dividends might, however, fall within the scope of the Parent-Subsidiary Directive (90/435) (*see* subsequently in this section). In addition, article 5 of the Interest and Royalties Directive (2003/49) allows the taxation of interest at the level of the creditor in respect of transactions where "the principal motive or one of the principal motives is tax evasion, tax avoidance or abuse".

The Interest and Royalties Directive (2003/49), therefore, prevents the imposition of a general withholding tax on interest.[94] However, the Interest and Royalties Directive (2003/49) neither prevents Member States from denying or restricting the deduction of interest at the level of the borrower under a general rule nor applying an anti-avoidance provision, potentially in form of a withholding tax on the interest of the non-resident creditor. Domestic thin capitalization rules are also not precluded.[95] However, in designing such anti-avoidance provisions, Member States are restricted by the fundamental freedoms (*see* section 7.4.4.). In addition, the effect of EU primary law would not be circumvented were the Interest and Royalties Directive (2003/49) to be amended by a uniform broad anti-avoidance rule, as the concept of abuse in the Directive cannot deviate from the ECJ's understanding of the fundamental freedoms.[96]

The Parent-Subsidiary Directive (90/435) has less effect on the restriction of debt financing. However, with regard to interest that is reclassified as deemed dividends, in the

91. Article 10 of the *OECD Model* (2010): 5% or 15% withholding tax on dividends, reduced in some tax treaties to 0% on substantial holdings; and article 11 of the *OECD Model* (2010): withholding tax on interest restricted to 10%, but, in most tax treaties, reduced to 0%.
92. Art. 1 (1) and (7) and art. 3 (b) EU Interest and Royalties Directive, *supra* n. 9.
93. DE: ECJ, 21 July 2011, Case C-397/09, *Scheuten Solar Technology GmbH v. Finanzamt Gelsenkirchen-Süd*, ECJ Case Law IBFD. In support of this, *see* T.J.C. van Dongen, *Thin Capitalization Legislation and the EU Corporate Tax Directives*, 52 Eur. Taxn. 1, sec. 2.3.2. (2012), Journals IBFD, who goes further in this direction in that he considers any kind of thin capitalization legislation as falling outside the scope of the EU Interest and Royalties Directive, as the Directive only addresses debtors and not creditors.
94. An interesting proposal for "circumventing" this constraint is made by O. Lodin, *Intragroup Lending in Sweden – A Vehicle for International Tax Arbitrage*, Tax Notes Intl p. 177 (18 July 2011) by restricting the deductibility of interest at the level of the debtor, but providing a credit for the tax levied on the interest in the residence country of the creditor. This mechanism would result in similar effects like a general withholding, though would not fall in the scope of the Directive because it addresses only the level of the debtor.
95. *See*, for example, M. Distaso & R. Russo, *The EC Interest and Royalties Directive – A Comment*, 42 Eur. Taxn. 4, sec. 4. (2004), Journals IBFD.
96. G. Kofler & M. Tumpel, *"Abuse" in Direct and Indirect Community Law: A Convergence of Standards*, in *Value Added Tax and Direct Taxation: Similarities and Differences* p. 471 (M. Lang, P. Melz & E. Kristoffersson eds., IBFD 2009), Online Books IBFD, questioned by S. Martinho Fernandes et al., *A Comprehensive Analysis of Proposals To Amend the Interest and Royalties Directive – Part 2*, 51 Eur. Taxn. 11, sec. 4.2. (2011), Journals IBFD and unclear following NL: ECJ, 17 July 1997, Case C-28/95, *A. Leur-Bloem v. Inspecteur der Belastingdienst/Ondernemingen Amsterdam 2* para. 41 et seq., and DK: ECJ, 5 July 2007, Case C-321/05, *Hans Markus Kofoed v. Skatteministeriet* para. 38 et seq., ECJ Case Law IBFD.

author's opinion, article 5(1) of the Parent-Subsidiary Directive (90/435) ensures that there is no additional withholding tax applied in the country of the distributing company and that the country of the parent must grant either an exemption or a credit to avoid double taxation in respect of the (deemed) dividends.[97]

7.4.3. *Debt financing and the proposed CCCTB Directive*

Even though its adoption may well still be sometime in the future, one should also take a look into the anti-avoidance provisions in the Common Consolidated Corporate Tax Base (CCCTB). A draft of a uniform anti-avoidance rule that is intended to counter the generation of interest expenditure is in the proposal for a Council Directive of 11 March 2011.[98] The CCCTB with its formulary apportionment approach is aimed at preventing profit shifting by financing structures, as it would abandon current separate accounting and disregard income allocation under contractual arrangements. Accordingly, the Directive proposal provides anti-avoidance legislation to counter debt financing only in relation to third countries. Article 81 of the Directive proposal contains a disallowance of interest deductions paid to an associated enterprise resident in a third country where either the statutory corporate income tax rate is less than 40% of the average statutory corporate income tax rate in the Member States or the interest is subject to a preferential regime where it is taxed substantially lower than under the general system or there is no agreement on exchange of information comparable to the EU standards.[99] This provision has been criticized as being too generous.[100] Consequently, in the compromise proposal of May 2013, the original Directive proposal was amended by way of a restrictive general interest limitation rule,[101] with two different thresholds, one asset- and one profit-related. This amendment bears all the hallmarks of the German tax authorities, even though it differs in concept from the German interest barrier. As a unanimous adoption of the Directive proposal seems to be unlikely, this aspect may not be crucial, but it is unclear as to whether or not such a tough rule would be acceptable to all of the Member States.

7.4.4. *Fundamental freedoms and specific anti-avoidance rules*

The tightest restrictions on anti-avoidance rules arise from ECJ case law.[102] Restrictions of the fundamental freedoms can be justified by an overriding reason in the public interest, such as countering tax evasion and avoidance,[103] but the ECJ case law applies a very narrow concept of tax avoidance.[104] National anti-avoidance rules must be specifically targeted against "wholly artificial arrangements" that do not reflect economic reality and the sole purpose of which is to avoid tax normally payable on the profits generated by activities carried out on the national territory.[105] Such rules cannot go beyond what is necessary to restrict wholly artificial arrangements. With this in view, the ECJ always requires that the taxpayer is able to demonstrate that tax savings were not "the main purpose or one of the main purposes of the transactions".[106] Specific anti-avoidance rules containing irrefutable presumptions have been always been held to be disproportionate. Accordingly, the scope for anti-avoidance rules applied only in cross-border circumstances is very limited.

One could consider intra-group debt financing as being the epitome of the strategies adopted to disconnect the taxation of profits from where the profit-generating economic activities are carried out, thereby jeopardizing the balanced allocation of taxing rights between Member States. However, the ECJ does not consider intra-group debt to be artificial in nature,[107] but, rather, accepts the

97. *See* Van Dongen, *supra* n. 93, at secs. 3.3. and 3.4.
98. Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB) COM(2011) 121/4, EU Law IBFD.
99. Council Directive 2011/16, EU of 15 February 2011 on Administrative Cooperation in the Field of Taxation and Repealing Directive 77/799/EEC, EU Law IBFD.
100. C. Spengel, *Commentary* on P. Pistone, *The Limits to Interest Deductibility: An Ad Hoc Anti-abuse Rule in the Proposal for a CCCTB Directive*, in *Corporate Income Taxation in Europe: The Common Consolidated Tax Base (CCCTB) and Third Countries* p. 309 (M. Lang et al. eds., Elgar 2013).
101. *See* Compromise Proposal, 9180, 13, 2011, 0058 (CNS) of 2 May 2013, art. 14a:
Interest limitation rule
1. A taxpayer can deduct borrowing costs up to the amount of received interest or other taxable revenues from financial assets. Excess borrowing costs are only deductible up to the maximum threshold.
2. Borrowing costs include interest expenses and other costs that a tax payer incurs in connection with the borrowing of funds. Borrowing costs include any difference between the borrowed funds and the maturity amount and the interest element in a leasing contract where the economic owner is entitled to deduct such interest.
3. The maximum threshold is calculated as an amount equivalent to [x pct. – index] of the following items:
(a) The value for tax purposes of individually depreciable fixed assets at the end of the tax year;
(b) The depreciation base of the asset pool at the end of the tax year;
(c) The cost of acquisition, construction or improvement of non-depreciable fixed assets excluding financial assets;
(d) The value of stocks and work in progress at the end of the tax year;
(e) Losses, excluding borrowing costs, incurred in the current tax year and losses carried forward according to Article 43.
4. Deductible borrowing costs as calculated according to paragraphs 1-3 and excess unrelieved borrowing costs from previous years are only deductible in the current tax year up to 60% of the positive tax base before deduction of borrowing costs. Excess unrelieved borrowing costs may be deducted in subsequent tax years.
5. Notwithstanding paragraphs 1-4 borrowing costs below EUR 1 million for a single taxpayer can always be deducted.
102. *See*, in particular, DE: ECJ, 12 Dec. 2002, Case C-324/00, *Lankhorst-Hohorst GmbH v. Finanzamt Steinfurt*, ECJ Case Law IBFD and *Bosal* (C-168/01), *supra* n. 13. However, UK: ECJ, 13 Mar. 2007, Case C-524/04, *Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue*, ECJ Case Law IBFD, accepted the UK thin capitalization rules, which are based on an arm's length test and only cover cross-border cases.
103. *See*, for example, UK: ECJ, 13 Nov. 2012, Case C-35/11, *Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue, Commissioners for her Majesty's Revenue & Customs* para. 55, ECJ Case Law IBFD.
104. *See*, for example, analysis by F.A. García Prats, *The "Abuse of Tax Law": Prospects and Analysis*, in *Essays in International and European Tax Law* p. 112 et seq. (G. Bizioli ed., Jovene 2010); R. Karimeri, *A Critical Review of the Definition of Tax Avoidance in the Case Law of the European Court of Justice*, 39 Intertax 6/7, p. 296 (2011); and D. Weber, *Abuse of Law in European Tax Law: An Overview and Some Recent Trends in the Direct and Indirect Tax Case Law of the ECJ – Part 1 and 2*, 53 Eur. Taxn. 6/7 (2013), Journals IBFD.
105. PT: ECJ, 3 Oct. 2013, Case C-282/12, *Fazenda Pública v. Itelcar – Automóveis de Aluguer*, para. 37, ECJ Case Law IBFD.
106. *Cadbury Schweppes* (C-196/04), *supra* n. 16, at para. 62.
107. *See Lankhorst-Hohorst* (C-324/00), *supra* n. 102; *Thin Cap Group Litigation* (C-524/04), *supra* n. 102; and *Itelcar* (C-282/12), *supra* n. 105, even though, one could question whether or not the concept of "wholly artificially" used to verify the freedom of establishment functions could also

underlying loan agreements if the loan would have been granted in the same amount and at the same rate of interest under arm's length standards.[108] Accordingly, in *Thin Cap Group Litigation* (Case C-524/04), the ECJ held that the application of transfer pricing rules according to article 9 of the OECD Model only to cross-border transactions so as to identify and reclassify excessive debt financing was compatible with the fundamental freedoms.

But the relevant criteria are, unfortunately, far from being clear. Recently, in *Itelcar* (Case C-282/12),[109] the ECJ was not satisfied regarding the refutability of the presumption and detailed requirements from the principle of proportionality in respect of the design of anti-avoidance rules regarding consistency and legal certainty. As governments often fail to meet the strict requirements set by the ECJ and are unable to successfully defend anti-avoidance rules restricted to cross-border circumstances before the Court, Member States tend to design rules that also apply to purely domestic cases to avoid infringements of the fundamental freedoms and the need to provide a justification.

8. Policy Options

In theory, the following five policy options are available to counter (international) tax planning using debt instruments:

(1) Fundamental reform eliminating the differences in the treatment of debt and equity in domestic tax systems. A contrasting approach would be incremental reforms aimed only at abusive tax planning, but, under such an approach, tax differences would remain, as would, therefore, the incentive for tax planning. The latter approach would also involve defining unacceptable strategies.

(2) With regard to the political process, a distinction could be drawn between solutions that would have to be adopted uniformly by way of international coordination as opposed to solutions that could be adopted on a national basis, thereby giving some scope to national legislators. The former approach has the disadvantage of inflexibility, especially if adjustments are required later, but allowing considerable scope with regard to implementation would undermine the advantage of the present BEPS initiative.

(3) As tax planning using interest expenditure is relevant for both inbound and outbound investments, legislation could be categorized as either covering inbound and outbound cases uniformly by way of a general interest deduction disallowance for related-party and third-party debt or differentiated between inbound and outbound investments, for example, thin capitalization legislation in respect of related-party debt combined with restrictions for the deduction of interest financing tax-exempt dividends.[110]

(4) From the perspective of the Member States, which are bound by EU Law, it would be very relevant if the legislation were designed to apply not only to cross-border cases, but also to purely domestic ones. This could also be an issue under consideration regarding anti-discrimination clauses in tax treaties.

(5) Finally, rule- and standard-based solutions would have to be distinguished. A standard-based approach, for example, the application of arm's length principle, would allow greater flexibility, but at the expense of higher legal uncertainty. Again, such categories are relevant with regard to ECJ case law, which requires either a case-by-case analysis or at least the possibility to rebut the presumption of anti-avoidance.

9. Possible Reforms

9.1. Eliminating the tax disadvantages of equity

The full integration of corporate income tax, including the implementation of a dividend deduction[111] or an allowance for corporate equity (ACE),[112] would systematically resolve the current disadvantages of equity. A dividend deduction system would have the advantage of taxing dividends and interest in exactly the same way. An ACE system would affect arguments regarding optimal tax theory in practice. However, despite the possible systematic advantages of these approaches, the foregoing are not politically feasible. A dividend deduction or ACE system would also fundamentally interfere with the entitlement of the source country to tax the profits earned in its jurisdiction.[113] With regard to an ACE, the entitlement of the source country to tax would be restricted to pure profits, i.e. profits in excess of the deductible amount of the market-rate interest or the notional interest deduction. Under a dividend deduction system, the source country would have to tax the profit at the level of a shareholder to preserve its share of revenue. Accordingly, source countries would most likely apply withholding taxes on dividends equal to the previous corporate income tax burden.[114] As a result, nothing would be gained.

be applied to mere capital transactions. Against such an approach, *see* A.P. Dourado, *A Single Principle of Abuse in European Union Law: A Methodological Approach to Rejecting a Different Concept of Abuse in Personal Taxation*, in *Prohibition of Abuse of Law; A New General Principle of EU Law?: Studies of the Oxford Institute of European and Comparative Law* p. 473 et seq. (R. de la Feria & S. Vogenauer eds., Hart Pub. 2011), arguing for a uniform test applicable to all of the fundamental freedoms.

108. *Thin Cap Group Litigation* (C-524/04), *supra* n. 102, at para. 81 and BE: ECJ, 17 Jan. 2008, Case C-105/07, *NV Lammers & Van Cleeff v. Belgische Staat* para. 30, ECJ Case Law IBFD.
109. *Itelcar* (C-282/12), *supra* n. 105, at paras. 43-45.
110. With regard to such a policy option, *see*, at length, Edgar, Farrar & Mawani, *supra* n. 7, at pp. 803-869, who support a uniform rule applying equally to intra-group debt and to external debt.
111. *See* recently R.S. Avi-Yonah & A.C. Chenchinski, *The Case for Dividend Deduction*, L. & Econs. Working Papers, Paper 27 (2010).
112. *See* Institute for Fiscal Studies (IFS), *Equity for Companies: a corporation tax for the 1990s* (IFS 1991). *See also* L. Lammersen, *Investment Decisions and Tax Revenues Under an Allowance for Corporate Equity*, ZEW Discussion Paper No. 02-47. This is similar to the proposal for a business enterprise income tax (BEIT) advanced by E.D. Kleinbard, *Rehabilitating the Business Income Tax*, 1115 Tax Notes 1213 (2007).
113. As admitted by Avi-Yonah & Chenchinski, *supra* 111, at p. 7 et seq., answered by the imposition of a withholding tax on dividends paid to foreign shareholders.
114. Member States would be prohibited by the EU Parent-Subsidiary Directive from doing so and would, therefore, not agree to a dividend deduction system.

9.2. Multinational interest allocation

As noted in the context of the CCCTB (*see* section 7.4.3.), apportionment systems that disregard underlying contractual arrangements are designed to counter tax planning using loan agreements. From a theoretical perspective, a worldwide allocation system based on assets, as recently convincingly proposed by Graetz (2008),[115] seems to be an ideal solution for resolving the specific problems of cross-border investments, i.e. this would counter tax planning, and secure both an adequate level of taxation without the risk of double taxation or double non-taxation and a fair distribution of the revenue between source and residence country. However, given the experiences with the CCCTB, it would seem to be unrealistic that international consent for such far-reaching changes could be obtained within a reasonable time frame.[116]

9.3. Limitations on the deduction for interest expenditure

9.3.1. *Preconditions*

Any limitation on the deduction of interest expenditure at the level of the debtor in the source country should correspond to a matching exemption of interest at the level of the creditor in his residence country so as to avoid double taxation. Accordingly, whatever national approach is adopted, international coordination is necessary. Only if the residence country were to accept the anti-avoidance concept of the other country would the residence country be willing to give up tax revenue by adopting the tax treatment in the source country.

9.3.2. *CBIT: non-deductibility of all interest expenditure*

The most far-reaching restriction on the deductibility of interest is a comprehensive business income tax (CBIT). Under a CBIT, the treatment of interest would be aligned with the treatment of dividends. Both would be non-deductible at the level of the business, but would be exempt at the level of the recipient, thereby treated both equally. If adopted on a worldwide basis, a CBIT would satisfy capital import neutrality (CIN) and capital ownership neutrality.[117] The system would be easy to administer, as no specification of non-deductible interest expenditure would be necessary. However, even though a CBIT has been considered in the United States,[118] it constitutes a major deviation from the concept of the principle of taxation in accordance with the individual ability to pay and from that of net income taxation, in greatly exceeding what is necessary to counter international tax evasion. It also would result in a complete change in the present attribution of interest to the residence country. Consequently, its adoption would be neither likely nor preferable.

9.3.3. *Limitation on deduction of interest on related-party debt*

9.3.3.1. *General non-deductibility and/or reclassification of related-party debt*

Less far reaching than a CBIT, which would apply without distinction to related-party debt and to external debt, would be a rule treating any shareholder debt as equity, thereby requalifying any interest paid to a related party as dividends. The underlying concept would be that, within groups, debt and equity would be fully substitutable. Such an approach is appealing with regard to neutrality. It would also be fairly easy to administer, even though any regime that would be restricted to related-party debt would require a rule to avoid circumvention by guaranteed or back-to-back loans, but there would be no requirement to control safe havens, for example disputable debt:equity ratios. One could argue that the complete denial of intra-group interest would be a far-reaching encroachment into a company's financial decisions, but it would remove distorting tax effects.

The most important impediment to such an approach would be that it would result in a fundamental change in the revenue distribution between source and revenue countries. If double taxation were to be avoided, the residence country of the parent would have to grant an exemption or credit in respect of the requalified interest. However, external refinance costs would still arise to the parent in the residence country and would have to be fully deductible, despite of the allocation of taxing rights only to the source country. The denial of the deductibility of third-party refinancing debt would also give rise to new distortions and increase the costs of refinancing.

The parent should, therefore, be able to pass down external debt to its foreign subsidiaries as debt so as to allocate, in return, some taxable interest to the residence country of the parent. In addition, such a radical solution would remove the possibility for high-tax jurisdictions to design their rules on cross-border interest expenditure as "breathing wholes" that allowed corporations to transfer some of their profits to mitigate the tax burden of high statutory corporate income tax rates. Otherwise tax rates of source countries would become more important than at present, as fine-tuning by way of (deductible) interest payments would no longer be possible. Consequently, tax rate competition would presumably accelerate.

9.3.3.2. *Non-deductibility and/or reclassification of "excessive" and/or "unacceptable" related-party debt*

The discussion in section 9.3.3.1. leads to the question of the definition of reasonable safe havens in respect of related-party debt and to the legal consequences of "excessive" and/or "unacceptable" debt. As described in section 4., country practice is divided between debt:equity and interest and/or profit-related safe havens. On the one hand, debt:equity ratios have the merit of relative simplic-

115. Graetz, *supra* n. 14.
116. Edgar, Farrar & Mawani, *supra* n. 7, at p. 869.
117. *See* M.A. Desai and J.R. Hines Jr., *Evaluation International Tax Reform*, 56 Natl. Tax J. 3, p. 487 (2003) and *Old Rules and New Realities: Corporate Tax Policy in a Global Setting*, 57 Natl. Tax J. 4, pp. 937-960 (2004).
118. US Treasury Department, *Integration of the Individual and Corporate Tax Systems, Taxing Business Income Once* chap. 4 (1992). This approach has been heavily criticized, for example, in E.M. Sunley, *Corporate Integration: An Economic Perspective*, 47 Tax L. Rev. 3, p. 635 (1992).

ity. Such ratios also reflect an external creditor's view as to how to base a decision to give a further loan on the indebtedness of the corporation. A profit-related qualification of the deductible interest could be better, as it would give greater direct protection against profit shifting, but it could also damage cyclic industries and start-ups and business in an economic crisis. However, and this could be vital, apart from a debt:equity ratio, such a system would be less open to manipulation.[119] A debt:equity ratio must be decided on specific time and, therefore, taxpayers can easily influence the equity position at the reporting date. In contrast, profit is much less prone to tampering. If, therefore, a given interest:profit ratio were to be adopted, the correct reference would be EBITDA, and not earnings before interest and tax (EBIT), as otherwise investing corporations would be unreasonably disadvantaged. There would also be a requirement for several safeguards to avoid economic damage to business in an economic crisis. A carry-forward not only of the EBITDA, but also of unused interest deductions could mitigate this.

A fixed safe haven, be it by a debt:equity ratio or net interest:EBITDA ratio, is to be preferred compared to a solely multifactor test using transfer pricing standards, as it offers reliable guidance for the taxpayer.[120] However, as a fixed safe haven would be designed for standard cases, a multifactor arm's length test[121] could be provided in addition to assist in exceptional circumstances. An additional arm's length tax would add complexity, but, given the high variance of optimal leveraging in different business sectors, it could prevent undue hardship and would allow stricter fixed safe havens.

The economic consequences would depend very much on the legal consequences of such legislation. First, they would apply only to related-party debt. Second, in the case of the non-deductibility and/or reclassification of that interest, which corresponds to a matching exemption at the level of the creditor, the effect would be much smoother than at present, where the application of thin capitalization rules and interest barriers usually results in double taxation.

9.3.3.3. *General limitation on the deduction of interest on related-party and third-party debt*

Debt-financed outbound acquisitions are required to deal with third-party interest related to tax-exempt foreign dividends; otherwise, the residence country of the parent would finance the tax base and revenue of the residence country of the subsidiary. Such restrictions would be reasonable with regard to national tax revenue considerations. In this context, a targeted solution would only inhibit the deduction of interest related to tax-exempt or deferred foreign dividends, whereas interest related to domestic tax-exempt dividend would still be deductible, thereby preventing domestic double taxation. However, within the European Union, this option would be blocked by the decision of the ECJ in *Bosal* (Case C-168/01).

General interest barriers disconnect the deductibility of interest from the purpose of the loan. Such an approach also deals with the problem of thin capitalization and the mismatch of the entitlement of the source country to tax profits and the responsibility of the residence country to allow the deduction of expenses. Interest barriers, allowing each member of the group only a certain portion of the whole group debt to be deducted, could be regarded as imperfect interest allocation rules. This, at least, is the rationale of the German cap on interest, which is based on the concept that interest is non-deductible if the indebtedness of the company claiming the deduction is higher than the average indebtedness of the group.[122]

There are, however, two fundamental objections to general interest barriers.

First, general interest limitations are inherently complex, as, on the one hand, the rules are not aimed at tax avoidance, but, on the other, national legislators, rightly, try to prevent economic damage arising as a result of the non-deductibility of unavoidable interest expenditure. National legislators mitigate any too far-reaching effects by way of exceptions and counter-exceptions. As even highly efficient tax administrations have enforceability limits, existing general interest barriers can hardly serve as role models for a broad application.

Second, the effects of general interest barriers, on the one hand, go beyond what is required to counter abusive tax planning, but, on the other, as the deduction of interest cannot be fully excluded, the problem of the allocation to tax jurisdictions of profits and expenses can only be partly resolved.

9.4. Withholding tax on interest

Another method to achieve effects similar to non-deductibility[123] would be a withholding tax equal to the corporate income tax rate of the source country that would be fully creditable, but not refundable in the residence country.[124] In contrast to a limitation of the deductibility of interest expenditure, levying a withholding tax always produces a cash payment, regardless of whether the debtor and/or the lender are loss-making. However, a withholding tax, in general, is compatible with the ability-to-pay principle and the conventional concept of income, as interest is taxed in the hands of the lender. There would remain the problem of the deduction of refinancing costs. If the withholding tax were to be, as it usually is, levied on a gross basis, the costs of refinancing would be non-deductible in the event that the residence country did not refund the withholding tax. However, this problem could be resolved by allowing

119. There are ways in which to "manipulate" interest and/or profit ratios, but the result (the retransfer of the tax base to the jurisdiction where the interest arises or increasing interest to minimize the net interest expenditure) is intended by this legislation. *See*, for example, Knöller, *supra* n. 82, at p. 326.
120. The United Kingdom has adopted an alternative (attractive) approach to increasing legal certainty in concluding Advance Thin Capitalization Agreements if a company provides sufficient information in advance.
121. *See also* Dourado & De la Feria, *supra* n. 21.
122. *See* the "Equity Escape" in *Einkommensteuergesetz* [Income Tax Law] (EStG) sec. 4h, para. 2(c), National Legislation IBFD. Similarly, *see* Graetz, *supra* n. 14, at sec. 2.
123. Edgar, Farrar & Mawani, *supra* n. 7, at p. 845 et seq.
124. *See*, recently, Fuest et al., *supra* n. 76, at sec. 5.

a taxpayer to demonstrate the existence of refinancing expenses in the source country to reduce the tax base for the withholding tax. If such a solution were adopted worldwide or by a significant number of countries, the concerns regarding disadvantages of raising capital[125] would be removed.

If the withholding tax were applied to any interest payment, it would be easy to administer. The introduction of such a general withholding tax would require amendment of the Interest and Royalties Directive (2003/49) and of existing tax treaties.[126] However, as any rational solution requires international consent, this should not result in the exclusion of this solution.

One major obstacle could be that, if levied on all interest (related-party and third-party), a withholding tax would result in a far-reaching change in revenue distribution, as the residence country would only obtain the residual revenue after crediting the withholding tax of the source country. The alternative of a lower withholding tax would allow a split of the revenue between the source and revenue countries, but would be insufficient to counter tax planning effectively,[127] as even fairly small differences in the taxation of equity and debt make tax planning worthwhile. Neutrality of the choice between debt and equity can only be realized if the withholding tax rate is equal to the corporate income tax rate. A withholding tax also provides no answer to the asymmetry between the taxing rights in respect of profits distributed as tax-exempt dividends and the deductibility of the related expenses.

10. Conclusions

10.1. Introductory remarks

The primary objective of this article is to analyse the framework and different options to counter base erosion and profit shifting using interest expenditure. One of the insights generated by this article is the insight that, apart from fundamental reform, there is no ideal solution, neither from a theoretical nor from a practical or political perspective. Any restriction on the deductibility of interest expenditure jeopardizes fundamental principles of taxation and risks distortions. This insight results in rather "conservative" conclusions, based on the perception that some countries already do too much to try to safeguard their national tax base against the deduction of interest expenditure.

From an academic point of view, I would be in favour of a worldwide interest allocation system (*see* section 9.2.), thereby resolving both the problem of intra-group thin capitalization and that of the attribution of profits and expenses between the relevant countries. However, this appears to be too ambitious, at least, for now. Accordingly, the following three potential rules (*see* sections 10.2. to 10.4.) adopt a less far-reaching main objective of the BEPS initiative to reduce abusive tax planning. They are not intended to widen the tax base. The primary advantage of an internationally coordinated action, which is to avoid double taxation and double non-taxation due to inconsistent national strategies, should also not be compromised by over-complex rules.

10.2. Rule against intra-group thin capitalization regarding inbound investments

The primary focus should be on thin capitalization in respect of inbound investments, thereby countering profit shifting by a restriction in the deduction of related-party interest, extended to guaranteed and back-to-back debt, which should apply to participations of 25% and more. As legal consequence, interest should be reclassified as deemed dividends in the source country, with a corresponding treatment as dividends in the residence country. The source country should, despite the qualification as (deemed) dividends, refrain from levying any further withholding tax.[128] I favour a reclassification into deemed dividends rather than non-deductibility, as it best reflects the legal and economic substitutability of intra-group debt and equity. Whereas non-deductibility is inherently connected to the risk of double taxation, reclassification (and the levying of a withholding tax) are, at least systematically, based on a corresponding treatment in the hands of the recipient of the payment, of course, always requiring that the residence country would accept the source country treatment. The problem, however, remains of how to design a safe haven, i.e. whether to use a debt:equity ratio, a debt:(national) assets ratio or a relationship between interest and profit, potentially complemented by an arm's length test.

Given the intra-group substitutability of debt and equity, even a full reclassification of all related-party debt seems to be defensible and attractive due to its simplicity and neutrality effects. However, as discussed in section 9.3.3.1., it would place the burden of allowing the deduction of refinancing interest on the residence country without providing it with the opportunity to tax interest where the third-party debt is handed-down as debt within the group. This could be mitigated by allowing a certain amount of intra-group interest.

The key issue in respect of any legislation limited to "excessive" intra-group interest is the lack of a normative basis for the definition of an adequate level of debt. For this reason, the debt:equity ratio should not be understood as an attempt to set an optimal capital structure, but, rather, as a political compromise in respect of revenue sharing between source and residence countries.

The design of such a safe harbour has been considered in section 9.3.3.2. A fundamental objection to debt:equity ratios is their predisposition to manipulation. The same would be true for an asset-related ratio. If, for that reason, a net interest:profit ratio, defining the deductible interest expenditure in relation to EBITDA, were to be preferred,

125. Schön, *supra* n. 88, at sec. 4.5.3.3.
126. Edgar, Farrar & Mawani, *supra* n. 7, at p. 845.
127. Graetz, *supra* n. 14, at sec. 2.
128. If not already obliged in doing so by the application of the EU Parent-Subsidiary Directive.

it would have to take into consideration cyclic businesses, highly leveraged businesses, as in the real estate sector, and businesses experiencing an economic crisis. Such rules would be complex, but this would be inevitable. A further restriction of a worldwide debt cap could prevent turning equity into debt, thereby additionally restricting the deduction of interest expenditure by a comparison with the group's external debt (the UK model), which again, in turn, would add further complexity.

A fixed safe harbour would have advantages compared to the complex documentation requirements of an arm's length test. Such a test could be provided as an additional optional safe harbour.[129] However, if the rule were to be applied correspondingly in the source and the residence country, it would lose much of its adverse consequences, as double taxation would be avoided. Accordingly, safe harbour rules that usually add complexity would be less important.

10.3. Rule limiting the incentive of the excessive debt financing of outbound investment

Given that it is far less clear to which extent the location of external borrowing is the result of intentional tax rate arbitrage, the approach to outbound investment should be fairly cautious. The allocation of loans at the level of the parent is often done only for economic reasons. In theory, the interest deduction could be pushed down to the foreign subsidiary by way of an intra-group loan. However, one cannot rely on strategies interfering with the economic non-tax circumstances of group financing. Debt pushdown itself would also result in deductible interest only within the limits of thin capitalization rules. One should note that the primary focus of the BEPS initiative is to curb aggressive tax planning and limit intentional tax rate arbitrage. The BEPS initiative should not be piggybacked with other forms of conceptual inconsistencies in international tax law. Consequently, in principle, refinancing interest would have to be fully deductible in the residence country to avoid interest not being deductible anywhere.[130]

However, to mitigate the tax-driven shifting of borrowing to high-tax jurisdictions, the deduction could be restricted in relation of the corporate income tax rate of the source country. For instance, if the tax rate in the source country is 20% and that of the residence country 30%, the deductible interest would be reduced by two thirds. Consequently, the tax effect would be the same as if the borrowing took place in the source country. Admittedly, such a rule would imply tracing rules to link borrowed funds to tax-exempt foreign dividends.[131] Tracing would add complexity and legal uncertainty as a result of the case-by-case approach necessitated, but the conceptual basis is no more than the well-established tracing rules used in a purely domestic context to distinguish between income-earning and personal purposes. However, if a direct attribution were considered to be over-complex due to the fact that interest is general to a business and, therefore, difficult to relate to specific activities,[132] one could consider an apportionment formula.

10.4. Rule on withholding tax on interest paid to lenders in tax havens

Finally, group financing companies in low-tax jurisdictions could be deterred by a withholding tax on interest paid to jurisdictions that either do not exchange information and/or apply a significantly lower corporate income tax rate than the source country. Such a rule would primarily be aimed at "classical" tax havens and complement CFC legislation. It would be applied only as a result of low statutory corporate income tax rates, for example, less than 10%, or by a low-tax burden due to special regimes tailored to attract mobile international interest. In contrast, lending from tax-exempt entities, such as US pension funds, would, in general, not be affected.

129. Also in favour of a combination, *see* Dourado & De la Feria, *supra* n. 21 and Knöller, *supra* n. 82, at 334 et seq.

130. From a home-country welfare efficiency perspective, *see* Hines, *supra* n. 8, at p. 2 on the basis for the concept of international capital ownership neutrality. *See also* D.N. Shaviro, *Decoding the U.S. Corporate Tax* p. 129 et seq. (The Urban Instit. Press 2009).

131. For the previous US interest allocation rules, *see* Froot & Hines Jr., *supra* n. 59.

132. *See* Hines, *supra* n. 8, at p. 1.