Limitation of financial expenses deductibility pursuant to ATAD

25th May 2020

The amendment to the Income Taxes Act, transposing to the national law the EU Anti-Tax Avoidance Directive (ATAD), has been in effect since 1 April 2019, with the exception of the provisions governing exit tax and hybrid mismatches applicable from 1 January 2020.

The rules limiting deductibility of financial expenses shall apply to the tax periods starting on or after 1 April 2019. Exceeding borrowing costs are determined as the difference between the borrowing costs incurred and the borrowing income realized from related and unrelated parties. Borrowing costs (income) mean financial expenses (income), e.g. from loans or borrowings, economically equivalent costs (income), e.g. the interest element of financial lease payments or notional interest amounts in derivative instruments, and other listed costs (income), e.g. selected exchange rate differences or capitalized interest expense.

Exceeding borrowing costs are tax deductible up to CZK 80 million or, if higher than CZK 80 million, up to 30% of tax EBITDA (taxable profit before interest, taxes, depreciation and amortization).

Excluded exceeding borrowing costs can be carried forward to subsequent periods (and used up to the extent of the limit); this option, however, does not pass to legal successors.

Limitation of deductibility does not apply to banks, insurance companies, pension and investment funds and other financial institutions listed in the Act and so-called independent enterprises (which are not part of a group).

The introduction of the limit does not affect the thin capitalization rules, which remain unchanged. The broad definition of exceeding borrowing costs and the complex calculation of the 30% tax EBITDA limit (if the limit of CZK 80 million is exceeded) will certainly bring many interpretation and calculation challenges.

In the future, we will also inform you about the basic parameters of the tax applicable to transfers of assets without a change of ownership ("exit tax"), taxation of a controlled foreign company and hybrid mismatches.

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