

Invest Europe's Supplementary Comments on the Functioning of ATAD I and ATAD II
National Implementation Insights and Practical Concerns from the PE/VC Industry

Building upon our earlier letter, this document provides additional technical insights, focusing on the practical implications of Member States' implementation of ATAD I and ATAD II—particularly the interest limitation (earnings stripping) rules and hybrid mismatch provisions. Drawing from national implementation data and industry experience, we highlight where divergences in the transposition of the directives are creating uncertainty, compliance burdens, or unintended tax consequences for private equity and venture capital structures.

While Invest Europe fully supports the policy objectives underpinning both directives, it is essential that their design and enforcement reflect the commercial and structural realities of the investment ecosystem to avoid hampering productive capital flows into European businesses.

1. Divergent Implementation of ATAD I Earnings Stripping Rules

The intended harmonization goal of Article 4 of ATAD I has not been fully realized, as national transpositions have introduced material divergences in scope, thresholds, exemptions, and relief mechanisms. These discrepancies create complexity not only for private equity and venture capital funds but for all cross-border businesses. For PE/VC structures in particular—given their multijurisdictional nature and reliance on leveraged financing—these inconsistencies increase uncertainty, compliance burdens, and the risk of unintended tax outcomes, as previously noted.

a) EBITDA Thresholds and Safe Harbours

Article 4(1) sets a general limit on the deductibility of net interest expenses, capping them at 30% of the taxpayer's EBITDA. To provide relief for smaller taxpayers, Article 4(3)(a) allows Member States to implement a de minimis safe harbour threshold of up to €3 million, below which the interest limitation rule does not apply. This safe harbour is applicable across all jurisdictions implementing ATAD, irrespective of the taxpayer's capitalisation status.

The application of the 30% EBITDA rule varies by Member State:

- **Netherlands** limits deductibility to 24.5% of EBITDA, departing from the EU maximum and constraining leverage-driven growth, especially for funds operating in the Dutch mid-market buyout space.
- **France** maintains the 30% EBITDA rule, but applies a reduced deductibility cap of 10% for the entities defined as those with a debt- to-equity ration exceeding 3:2,

disproportionately affecting PE-backed companies using standard leveraged financing models.

- **Spain** and **Netherlands** also deviate by providing a lower safe harbour of €1 million, compared to the widely adopted €3 million threshold in jurisdictions like **Germany, Austria** and **Ireland**. On the other hand, **Italy** does not apply any safe harbour threshold, further increasing divergence.
- From 2025, **Luxembourg** introduces the concept of a “single-entity group” for the purposes of the interest limitation rules. These are entities that are neither part of a consolidated group for financial accounting purposes nor qualify as standalone entities. A new exclusion under the interest limitation rule—an equity escape clause—is available to such single-entity groups. Under this rule, a single-entity group may, upon request, deduct the full amount of its exceeding borrowing costs if it can demonstrate that its equity ratio is equal to or greater than that of its wider group.

b) Stand-Alone and Group Ratio Exemptions

The option to exclude stand-alone entities (Article 4(3)(b)) or apply group ratio exemptions (Article 4(5)) is unevenly applied:

- **Austria, Germany, Ireland, Belgium,** and **Luxembourg** offer the stand-alone exclusion, benefiting smaller domestic portfolio companies of PE funds. Conversely, countries such as France, Netherlands, Italy, and Spain do not provide a stand-alone exclusion, creating a compliance burden for local operating entities that are demonstrably independent and not part of a consolidated group.
- **Germany, France, Luxembourg,** and **Ireland** permit group ratio tests, allowing higher deductibility if the consolidated group’s equity/asset structure supports it. **Belgium, Netherlands, Italy,** and **Spain** do not offer this relief, potentially penalizing structurally conservative fund structures in those jurisdictions.

c) Carry-Forward and Carry-Back Mechanisms

Article 4(6) of ATAD I allows Member States to implement carry-forward and carry-back mechanisms for disallowed interest or unused interest capacity. While carry-forward of disallowed interest is commonly permitted, treatment of unused capacity and carry-backs varies significantly, creating potential asymmetries and distortions across fund structures.

Carry-forward of disallowed interest deduction:

- **Luxembourg, Netherlands,** and **Germany** allow indefinite carry-forward of disallowed interest, providing long-term flexibility for PE firms with cyclical earnings.

- **France** and **Spain** offer only 5-year carry-forward periods, limiting the benefit in long-term growth or turnaround strategies.

Carry-back of disallowed interest deduction:

- **Italy, Spain, the Netherlands, Belgium and Ireland** provide no carry-back option at all, eliminating the opportunity to offset prior year taxable income in periods of high interest costs. These limitations can disadvantage funds investing in long-term growth or turnaround strategies in those jurisdictions.

d) Treatment of Financial Institutions and Public Infrastructure

- **Luxembourg, Denmark, Belgium, and Italy** exclude financial undertakings from the scope of Article 4(7), aligning with their policy goals to attract fund domiciliation. In contrast, **Germany, France, and Ireland** include financial institutions, creating potential friction for credit funds operating across borders.
- On infrastructure, most jurisdictions—**Austria, France, Luxembourg, Italy, and Ireland**—exclude long-term public infrastructure projects under Article 4(4)(b). However, **Spain and Denmark** do not, undermining investment incentives for large-scale public-private partnership initiatives in those countries.

2. Key Challenges in ATAD II Implementation for PE/VC Structures

a) Acting Together and Associated Enterprises

ATAD II broadens the scope of “associated enterprises” to include entities “acting together” in respect of voting rights or capital. This change significantly increases the compliance and interpretive burden for PE/VC funds:

- For example, a **Luxembourg** SCSp master fund with globally dispersed LPs may be classified as an “associated enterprise” with its holding companies solely on the presumption of acting together—even where no control or intent exists. The **Finnish** Supreme Administrative Court decision (SAC 2023:31) rightly rejected such automatic aggregation of unrelated fund investors, setting a valuable precedent we urge the Commission to consider as a best practice.

b) Third-Country Mismatches

From 2020, ATAD II applies to payments involving non-EU entities. The burden is especially high on funds with non-EU LPs and investments:

- For instance, in structures where **Australian or U.S.** tax-exempt investors treat the fund as opaque, a deduction denial could arise under ATAD II’s third-country mismatch rules, even if no abuse exists. This disproportionately impacts

Luxembourg holding entities that rely on shareholder debt for structuring credit or minority investments.

c) Reverse Hybrid Rules

The reverse hybrid rule (Article 9a, effective January 2022) taxes previously transparent fund vehicles if $\geq 50\%$ of associated non-resident investors treat them as opaque.

- Many **Luxembourg**-based funds structured as SCSp fall into this category.
- Since most PE/VC funds do not qualify as Collective Investment Vehicles (CIVs) due to regulatory scope or investor base, they face exposure to fund-level tax in Luxembourg—especially when investors in countries like **UK** or **Australia** treat the SCSp as opaque and are deemed “associated” via the GP structure.

Recommendations for Improved Implementation

To reduce unintended consequences and increase legal certainty, we recommend the following:

1. **EU-Wide Clarification on “Acting Together”**: Codify that investors in widely held funds are not presumed to act together unless there is evidence of control or abuse, consistent with the OECD BEPS Action 2 rationale and Finnish SAC case law.
2. **Promote Consistency in Safe Harbour and Group Ratio Tests**: Encourage uniform adoption of the €3 million safe harbour and optional group ratio exemption to level the playing field for cross-border funds.
3. **Exclude Widely Held PE/VC Funds from Reverse Hybrid Rules**: Provide a broader fund exception beyond narrowly defined CIVs, recognizing the commercial reality of global investor structures in alternative investment funds.
4. **Facilitate Dialogue on Third-Country Applications**: Engage stakeholders to assess the extraterritorial impact of third-country mismatch rules and adopt proportionality safeguards.

Conclusion

Invest Europe reiterates our strong support for fair and effective anti-tax avoidance rules. However, practical implementation must avoid stifling legitimate investment structures that underpin Europe’s innovation economy. We urge the Commission to consider a more proportionate, harmonized approach to both ATAD I and ATAD II that protects against abuse while enabling capital formation, particularly through private capital markets.



We remain at your disposal to discuss these matters further and would welcome the opportunity to meet with you or your colleagues to explore any of the issues raised in greater detail, should that be helpful.

Yours sincerely,

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