

This dissertation focuses on the so-called thin capitalization from the perspective of tax law. A company is said to be thinly capitalized when its capital is made up of much greater proportion of debt than equity, i.e. its gearing is high. Specific rules aimed to discourage thin capitalization often require that the debt-to-equity ratio meet a specific ratio in order for the company to be allowed to deduct interest expenses.

Thin capitalization is a problem from a tax perspective because the returns on equity capital and debt capital are treated differently for tax purposes. Returns to shareholders on equity investments are not deductible for the paying company, being distributions of profit rather than operating expenses. On the other hand, returns to lenders on debt – most commonly in the form of interest – are normally deductible for the payer in arriving at profits assessable to corporate tax. This can result in attempts by multinational enterprises to present what in substance is equity investment in the form of debt, and thereby receive more favorable tax treatment. The effect of funding a company or companies with excessive intercompany or parentally guaranteed debt is – potentially – excessive interest deductions. Legislation on thin capitalization seeks to counteract such excessive tax deductions because these ultimately jeopardize countries' budget revenues.

The Czech Republic enacted thin capitalization rules in 1993, and has been constantly updating and amending these ever since. In 2010, the thin capitalization rules disallow financial costs related to loans from related parties which exceed four times company's equity. All costs incurred on profit participating loans are also disallowed. Disallowed interest is reclassified as dividends and is subject to withholding tax. This does not apply to tax residents of EU and EEA, and the tax rate may be mitigated or even eliminated by applicable double tax treaties.

From the content point of view, the dissertation starts with discussion of the general concept of thin capitalization and approach to it by various countries. It continues

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by providing historical overview of the thin capitalization rules in the Czech Republic, and follows by analyzing the rules applicable in 2010. After a brief discussion of the interpretation of these rules by the Ministry of Finance, the dissertation focuses on the jurisprudence of the Czech Supreme Administrative Court related to the thin capitalization and problems with the application of the thin capitalization rules in practice. The next part of the dissertation provides a comparison with rules of thin capitalization in selected countries. It concludes with a discussion about the future of the thin capitalization rules globally and in the Czech Republic.