



- DEBRA - The Debt Equity Bias Reduction Allowance

THE PROBLEM

- In many corporate tax systems:
 - interest payments on debt are tax-deductible
 - the costs related to equity are not tax-deductible
- => bias in investment decisions towards debt financing
- => excessive debt accumulation
- => lower stability and growth

The EU Answer to the Tax Debt-Equity Bias

DEBRA :

- initiative to mitigate the tax induced debt-equity bias in corporate investment decisions;
- common rules across the single market;
- announced in the Communication on Business Taxation for the 21st Century.

Impact assessment

- The proposal is accompanied by an impact assessment (IA) conducted by the Commission that benefits from input by several stakeholders, including MS, the Joint Research Center, professional organisations and a number of Commission DGs.

OPEN PUBLIC CONSULTATION



01/07/21 – 07/10/21

Respondents mainly
from Belgium,
Germany and France

OPEN PUBLIC CONSULTATION

- Some respondents to the open public consultation pointed out that equity financing is insufficient in the EU.
- In particular, capital markets are very hard to reach for SMEs.
- A respondent highlighted the fact that because European businesses are still widely financed by bank loans, they are more vulnerable to shocks than American businesses which tend to have easier access to other sources of financing.
- All respondents think that an EU initiative would be beneficial for enterprises operating across countries in the single market

5 policy options assessed in the IA

Policy options	Allowance base and equity definition
Option 1	Notional interest deduction on all equity
Option 2	Notional interest deduction on new equity (year on year increase in equity)
Option 3	Notional interest deduction on all corporate capital, i.e. equity and debt. Current deduction on debt related interest is disallowed. But debt is included in the base for the notional allowance.
Option 4	Deduction of interests paid on debt is fully disallowed. No allowance of any kind is granted.
Option 5	Notional interest deduction on new equity (as under Option 2) AND partial limitation of interest paid on debt

DEBRA – an overview

- Allowance on incremental equity for ten years (*Article 4*)
- Deduction of net interest payments limited to 85% (*Article 6*)
- If the tax deductible interest under ATAD 1 is lower compared to 85%, the rules for deductibility of Art. 4 ATAD 1 apply to the difference between the two amounts (*Article 6*)
- Scope: all **non-financial undertakings** (*Article 2*)
- Encompasses a sound anti-abuse framework

Why equity allowance + interest limitation?

- Equity allowance (*Article 4*) reduces cost of equity
- Interest limitation (*Article 6*) increases cost of debt

→ **Equity bias is limited from both sides**

- Equity allowance (*Article 4*) reduces tax base of corporate income tax
- Interest limitation (*Article 6*) increases tax base of corporate income tax

→ **Limited fiscal cost**

Equity

- = paid-up capital
- + share premium accounts
- + revaluation reserve and other reserves
- + profit or loss brought forward

(Compared to the standard definition of equity, profit and losses of the year are excluded)

Allowance base

- **Allowance base** = increase in a tax year compared to the previous tax year of **net equity**
- **Net equity** = equity of a taxpayer **minus** the sum of the
 - tax value of the taxpayer's participation in the capital of associated enterprises and
 - the taxpayer's own shares

The notional interest rate

Notional interest rate = risk free rate + risk premium

- Risk free rate defined by *EIOPA currency specific risk free rate* for 10y maturity
- Risk premium is 1 % *for large firms*, 1.5% *for SMEs*

Allowance granted for 10 years

- Reduces fiscal impact
- Upholds incentives for new equity
- Unlimited duration => over time measure getting closer and closer to stock-based measure
- Ten years approximates the average maturity of loans

Why ATAD+ DEBRA ILR and not simply ATAD?

- DEBRA applies 85% of interest limitation to all firms.
 - debt bias reduction and cost reduction measure
- ATAD 1 Art. 4 is an anti-abuse rule, implemented differently in Member States, with some degree of divergence, and applicable only to a limited set of companies
 - As a second step, the limitation of exceeding borrowing costs under Art. 4 of ATAD 1 is computed on the net borrowing costs remaining after the application of the 85% ILR.

Carve out the financial sector

- Financial sector regulated with capital requirements
- Financial sector mostly not affected by interest limitation rule
 - Inclusion of financial sector would result in asymmetrical treatment compared to non-financial sector

Anti-abuse framework

- Proposal provides for a comprehensive anti-abuse framework against abuse of the measure (*Article 5*).
- This framework is based on the Code of Conduct Group guidance on notional interest deduction regimes.
- Commission had exchanges with some NID MS tax administrations on the anti-abuse framework to better understand the impact in terms of costs and benefits of the various anti-abuse measures.
- DG TAXUD also consulted DG COMP on this matter.

Anti-abuse rules (AAR)

- To prevent cascading the allowance through participations => allowance based on net equity (equity minus participations) (*Article 3 and 4.2*)
- To prevent cascading the allowance through intra-group loans or cash (*Article 5.1*)
- To prevent artificial increases in equity resulting from a contribution in kind: value of the asset count to the allowance base only where the asset is necessary for the income generating activity (*Article 5.2*)
- To prevent the re-categorisation of old capital as new capital through group re-organisations (*Article 5.3*)

Thank you for your attention!