The
Debt Equity Bias
Reduction Allowance
(DEBRA)
initiative

What is DEBRA?

- An initiative to mitigate the tax induced debt-equity bias in corporate investment decisions.
- The Commission announced this proposal in the Communication Business Taxation for the 21st Century.

What is the tax debt bias?

In many corporate tax systems:

- interest payments on debt-financing are tax-deductible
- the costs related to equity financing are not deductible

Asymmetric tax treatment of financing costs => bias in investment decisions towards debt financing

Reasons to act at EU level

- The tax debt-equity bias is widespread across the EU.
- Member States can introduce measures to tackle the tax induced debt-equity bias at national level.
- Country specific rules can lead to misallocation of investments in the single market if companies base their investment decisions on the availability of debt bias mitigating measures.
- Country specific rules also imply higher compliance costs for businesses active in cross border operations in the single market.

This initiative on neutralizing the debt-equity bias will…

- …provide for a common approach to mitigating the debt bias;
- …take the form of an allowance that provides for the deductibility of notional interest on new equity (increases in equity);
- …create a harmonized tax environment for businesses that encourages equity-based investments and help further remove distortions in the single market;
- …encompass a sound anti-abuse framework to tackle tax avoidance practices;

European Commission

Questions

- Do you think that an EU-wide initiative which tackles the tax debt-equity bias would…

1. be a useful tool to support the recovery of companies from the COVID-19 crisis and incentivise investment through equity in the transition towards a greener and digitalised economy without creating distortions in the single market?

2. be beneficial for enterprises operating in the single market across countries?

Notional interest rate

- Reference to a market interest rate for risk-free investments (irf) and a possible risk premium (x).
- The **risk premium** could be a fixed percentage (2% for instance) **updated** annually in accordance with a **formula** that would take the evolution of the risk-free interest rates into account, **using an adjustment factor**.
- Alternatively, the notional interest rate could be determined with reference to an index of market risk.

Questions

1. Do you agree that the notional interest rate could be determined based on a combination of a risk-free market interest rate and a credit risk premium?

2. If so, do you have any views on how best to calculate the credit risk premium?

Allowance base

- Allowance base = net equity increase in a given tax year
- Net equity = the difference between the equity of a taxpayer and the tax value of its participation in the capital of associated enterprises (incl. its own shares)
- Equity would be defined as in Annex III to Directive 2013/34/EU of the European Parliament and of the Council

Question

1. Do you agree with the base definition provided above?

Other elements

- SMEs face more difficulties in accessing certain forms of equity financing.
- Possibility to grant a higher notional interest rate for SMEs.
- Eligible SMEs would be those which meet the definition of Art. 3 of the Accounting Directive, and are not part of a group of companies which, at consolidated level, exceeds at least two of the three limits of this same Art. 3.

Questions

1. In view of better addressing financing issues that pertain to Small and Medium Enterprises (SMEs), do you think that a higher notional interest rate could be granted to SMEs?
2. If yes, how much higher do you think the notional interest rate should be for SME, compared to the notional interest rate applied to other enterprises?

Anti-abuse framework

- Measures providing allowances for equity can be abused if not coupled with an adequate anti-tax avoidance framework.
- Guidance on notional interest deduction regimes by the Code of Conduct Group (2019).
- It is based on past decisions of the Code of Conduct Group concerning notional interest deduction (NID) regimes.
- The DEBRA initiative would encompass a general anti-abuse provision and a number of specific anti-abuse rules (SAARs) based on this guidance by the Code against, amongst others, cascading a single equity injection through different subsidiaries of a group.

Question

1. For a tax allowance for corporate equity, do you agree that such a proposal should include robust rules to protect it against being misused for aggressive tax planning purposes?

Thank you very much for your participation!

European Commission