

European Commission
Directorate-General for Taxation and Customs
Union.

Luxembourg, 29 July 2022

Object: Debt-equity bias reduction allowance (DEBRA) – Public consultation on a proposal for a Council Directive on laying down rules on a debt-equity bias reduction allowance and on limiting the deductibility of interest for corporate income tax purposes

Dear Madam,
Dear Sir,

The Association of the Luxembourg Fund Industry (ALFI) is the representative body of the Luxembourg investment fund community and counts among its members not only investment funds, asset management firms but also a large variety of service providers of the financial sector.

ALFI appreciates the opportunity to provide its views on the debt-equity bias reduction allowance (DEBRA) as proposed by Council Directive laying down rules on a debt-equity bias reduction allowance and on limiting the deductibility of interest for corporate income tax purposes (the draft Directive) and is pleased to share its comments herewith.

ALFI welcomes the carve out granted to financial undertakings and in particular through Article 2 (c), (d), (i) and (j) to Undertaking for Collective Investment in Transferable Securities (UCITS) and UCITS management companies as well as to Alternative Investment Fund Managers and Alternative Investment Funds either managed by an AIFM or supervised under the applicable national law. ALFI understands the carve-out is based on regulatory equity requirements applicable to some financial undertakings to prevent under-equitisation.

Limitation to interest deduction (Article 6)

ALFI further welcomes the approach that consists in introducing an allowance on equity to address the debt equity bias by enabling the tax deductibility of notional interest on new equity whilst still allowing the deductibility of interest payments.

The deductibility of interest is however limited to 85% of exceeding borrowing costs (i.e. interest paid minus interest received) with a mechanism for the taxpayer entitled to deduct only the lower of an amount corresponding to 85% of such costs incurred during the tax period and an amount (amount b) determined in accordance with Article 4 of Directive (EU) 2016/1164¹ (ATAD).

ALFI would like to raise awareness on the fact that it is crucial to ensure that the provisions of ATAD and the draft Directive remain consistent and that no discrepancies may create interpretation or implementation issues.

Thus, ALFI calls for these rules (i.e., the allowance on equity combined with the additional limitation to interest deduction) to be optional rather than mandatory for taxpayers that are subject to corporate income tax and that do not intend to make use of the allowance on equity under the draft Directive. Considering the interest limitation rule introduced through ATAD is already in force, the legibility of the applicable provisions and the legal security of taxpayers would be ensured through making the DEBRA rules optional.

In addition, the 85% limitation refers to the exceeding borrowing cost as defined in ATAD (Article 2, point (2)) however without expressly referring to or introducing exceptions as the ones included in ATAD, such as debt funding long-term public infrastructure projects², standalone entities³ or loans entered into before a certain date⁴ or thresholds of exceeding borrowing costs below which the taxpayer may be given the right to deduct all such costs.⁵ ALFI calls for the same exceptions to be included in the draft Directive (in particular if these rules are not made optional) in order to ensure the legibility of the applicable provisions and legal certainty for taxpayers and also avoid an increased tax compliance burden.

Risk premium

Article 4 point 2 provides that “[...] *The allowance on equity shall be equal to the base of the allowance multiplied by the 10-year risk-free interest rate for the relevant currency and increased by a risk premium of 1% or, where the taxpayer is an SME, a risk premium of 1.5%.*”

The suggested rates may appear as being rather low and thus not likely to fully address the debt equity bias. ALFI is of the opinion the applicable rate should instead be defined according to the arm's length principle in relation with the underlying assets held as supported by transfer pricing analysis or third parties financing analysis. It would thus be suggested to apply the rates indicated in Article 4 point 2 of the draft Directive only in the absence of such analysis and as the default rule.

Anti-Abuse Rules

Article 5 point 1 (a) provides that appropriate measures should be taken to ensure that the base of the allowance on equity does not include the amount of any increase which is the result of granting loans between associated enterprises.

¹ Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (OJ L 193, 19.7.2016, p. 1).

² Article 4(4)(b) of ATAD

³ Article 4(3)(b) of ATAD

⁴ Article 4(4)(a) of ATAD

⁵ Article 4(3)(a) of ATAD

The example provided under point 5 of the Explanatory Memorandum of the draft Directive indicates that the above-mentioned anti-abuse measure would “[...] exclude from the base of the allowance equity increases that originate from (i) intra-group loans, (ii) intra-group transfers of participations or existing business activities and (iii) cash contributions under certain conditions. Thus, for example, as regards intra-group loans, the measure should prevent that an equity injection granted to company A located in Member State A is used to grant a loan to a related company B located in Member State B. This is because in such case, company B would also use this money to inject equity in another related company C, located in Member State C. This would lead to multiplying the allowance on equity with only one genuine equity increase at group level.”

Considering the objective of this measure that is to avoid multiplying the allowance on equity, it would be important to understand how this rule would apply where an investor that injects equity is an investment fund that provides funding (in the form of equity and loans) to a holding entity held by the fund and that amount is subsequently lent by the holding entity to one or several subsidiaries or injected as equity in those subsidiaries.

Participation exemption rule

ALFI calls for a clarification that notional deductions under the draft Directive do not fall in the scope of the anti-hybrid rule set forth by Article 4(1), point (a) of Directive 2011/96/EU (the Parent Subsidiary Directive) introduced by Council Directive 2014/86/EU of 8 July 2014 amending the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States. It should be ensured that a notional deduction is not considered as a hybrid payment or the exemption on dividend received is not denied because the paying entity has benefited from a notional deduction.

Claw-back rules

ALFI calls for the possibility to ensure that entities can continue to fully benefit from the deduction provided by the interest limitation rule as set forth by ATAD (i.e. no application of the 15% limitation under the draft Directive) in case a claw back measure applies. The same should apply where an entity has not taken advantage of the tax deduction of notional interest on new equity as provided for by the draft Directive.

Exchange of information

Article 6 provides for a list of information to be communicated by the tax authorities of Member States to the Commission “within 3 months from the end of every tax period”. One may wonder whether this may actually be feasible as in several Member States annual accounts and income tax returns have longer filing and /or publication deadlines, e.g. 6 months, as from the end of a financial year. It would be important to clarify to which period the information to be communicated within 3 months should refer, or extend this 3-month period as from the end of the tax period if the information to be communicated refers to the end of that same tax period.

We are grateful in advance for your attention and remain at your disposal for any additional information or any assistance you may wish to receive.

Sincerely yours,

ALFI