Procedure file

Basic information

CNS - Consultation procedure Directive	2022/0154(CNS)	Awaiting final decision
Debt-equity bias reduction allowance and limiting the deductibility of interest for corporate income tax purposes Subject 2.70 Taxation 3.45.04 Company taxation		

Key players

European Parliament	Committee responsible	Rapporteur	Appointed
	ECON Economic and Monetary Affairs		21/06/2022
		NIEDERMAYER Luděk	
		Shadow rapporteur	
		REGNER Evelyn	
		BOYER Gilles	
		GRUFFAT Claude	
		BECK Gunnar	
		HOOGEVEEN Michiel	
		GUSMÃO José	
Council of the European Union			
European Commission	Commission DG	Commissioner	
	Taxation and Customs Union	GENTILONI Paolo	

Key events

11/05/2022	Legislative proposal published	COM(2022)0216	Summary
09/06/2022	Committee referral announced in Parliament		
28/11/2023	Vote in committee		
04/12/2023	Committee report tabled for plenary, 1st reading/single reading	A9-0387/2023	

16/01/2024	Results of vote in Parliament		
16/01/2024	Decision by Parliament	T9-0006/2024	Summary

Technical information

Procedure reference	2022/0154(CNS)
Procedure type	CNS - Consultation procedure
Procedure subtype	Legislation
Legislative instrument	Directive
Legal basis	Treaty on the Functioning of the EU TFEU 115
Stage reached in procedure	Awaiting final decision
Committee dossier	ECON/9/09050

Documentation gateway

Legislative proposal		COM(2022)0216	11/05/2022	EC	Summary
Document attached to the procedure		SEC(2022)0204	12/05/2022	EC	
Document attached to the procedure		SWD(2022)0144	12/05/2022	EC	
Document attached to the procedure		SWD(2022)0145	12/05/2022	EC	
Document attached to the procedure		SWD(2022)0146	12/05/2022	EC	
Economic and Social Committee: opinion, report		CES2917/2022	26/10/2022	ESC	
Committee draft report		PE738.463	06/12/2022	EP	
Amendments tabled in committee		PE739.748	19/01/2023	EP	
Committee report tabled for plenary, 1st reading/single reading		A9-0387/2023	04/12/2023	EP	
Text adopted by Parliament, 1st reading/single reading		T9-0006/2024	16/01/2024	EP	Summary
Commission response to text adopted in plenary		SP(2024)81	15/04/2024	EC	

Additional information

Research document	Briefing	04/10/2022

Debt-equity bias reduction allowance and limiting the deductibility of interest for corporate income tax purposes

PURPOSE: to provide tax incentives for equity to help companies grow, become stronger and more resilient.

PROPOSED ACT: Council Directive.

ROLE OF THE EUROPEAN PARLIAMENT: the Council adopts the act after consulting the European Parliament but without being obliged to follow its opinion.

BACKGROUND: the current pro-debt bias of tax rules can incentivise companies to take on debt rather than increase equity to finance their growth.

Tax debt-equity bias arises from the different treatment of debt and equity financing costs for tax purposes and is a problem common to business across EU Member States. Despite this, only 6 Member States have taken tax measures to approximate the tax treatment of debt and equity.

The complete lack of relevant tax debt bias mitigating measures in 21 Member States along with the existence of significantly different measures in another six Member States may create distortions to the function of the internal market and can affect the location of investment in a significant manner.

An EU initiative would add value and ensure legal certainty and allow reducing compliance costs for business as taxpayers. It is also expected to boost competition in the single market by ensuring that all businesses, regardless of where they are located, have similar incentives towards appropriate financing.

This proposal is a follow-up to the Commission's Communication on Business Taxation for the 21st Century towards a strong, efficient and fair business tax system in the EU. It also contributes to the Capital Markets Union (CMU) Action Plan which aims to help companies raise the capital they need and improve their capital position, particularly during a period of recovery which involves higher levels of deficit and debt, as well as an increased need for equity investment.

This proposal also replies to the European Parliaments expectation that the Commission would put forth a proposal for a debt-equity bias reduction allowance, including effective anti-avoidance provisions to avoid any allowance on equity being used as a new tool for base erosion.

CONTENT: with a view to addressing the tax-induced debt-equity bias across the single market in a coordinated way, this directive lays down rules to provide, under certain conditions, for the deductibility for tax purposes of notional interest on increases in equity and to limit the tax deductibility of exceeding borrowing costs. It applies to all taxpayers that are subject to corporate tax in one or more Member State, except for financial undertakings. Since small and medium enterprises (SMEs) usually face a higher burden to obtain financing, it is proposed to grant a higher notional interest rate to SMEs.

This measure will support businesses by introducing an allowance that will grant to equity the same tax treatment as debt. The proposal stipulates that increases in a taxpayer's equity from one tax year to the next will be deductible from its taxable base, similarly to what happens to debt.

By eliminating the tax distortion in favour of debt, the proposal aims to avoid over-reliance on debt and encouraging the re-equitisation of businesses.

The Commission considers that the preferred option should have a positive economic impact. Its main direct benefit is that it will promote higher capital ratios and thus reduce insolvency risks.

By increasing equity investments across the EU, this option is expected to indirectly promote the development of innovative technology. Equity is particularly important for fast-growing innovative companies in their early stages and scale-ups willing to compete globally. The green and digital transition requires new and innovative investments that will benefit from the measure.

Debt-equity bias reduction allowance and limiting the deductibility of interest for corporate income tax purposes

The European Parliament adopted by 324 votes to 132 with 155 abstentions, following a special legislative procedure (Parliaments consultation), a legislative resolution on the 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.

The proposed directive lays down rules on the deduction, for corporation tax purposes, of an allowance on increases in equity capital and on limiting the tax deductibility of additional borrowing costs.

Parliament approved the Commission's proposal with amendments to assist SMEs.

Allowances on equity

According to Members, an allowance on equity should be deductible, for:

- 10 consecutive tax periods, from the taxable base of an SME or medium-sized group for corporate income tax purposes up to 30% of the taxpayers earnings before interest, tax, depreciation and amortisation (EBITDA);

- 7 consecutive tax periods, from the taxable base of any large undertaking or large group for corporate income tax purposes up to 30% of the taxpayer's EBITDA.

Member States should ensure that taxpayers are able to carry forward, for a maximum of 3 tax periods, the part of the allowance on equity which exceeds the percentages of EBITDA laid down in a tax period.

If the deductible allowance on equity is higher than the taxpayers net taxable income in a tax period, Member States should ensure that the taxpayer may carry forward the excess of allowance on equity as follows:

- for a maximum of 3 tax periods, where the taxpayer is a large undertaking or a large group;

- without time limitation, where the taxpayer is an SME or a medium-sized group.

The proposal stated that the base of the allowance on equity should be calculated as the difference between the level of net equity at the end of the tax period and the level of net equity at the end of the previous tax period, in other words, the year-on-year increase in net equity. According to Members, the allowance on equity should be equal to the base of the allowance multiplied by the 10-year risk-free interest rate for the relevant currency, increased by a risk premium of 1% for SMEs.

Limiting the deductibility of exceeding borrowing costs

To effectively address the tax-related debt-equity bias in a manner sustainable for the Unions public finances, Members considered that an allowance for equity financing should be accompanied by a rule limiting the deductibility of exceeding borrowing costs for groups that are not medium-sized groups and undertakings that are not SMEs. However, given the adverse economic conditions stemming from the COVID-19 crisis and from the Russian war of aggression against Ukraine, that limitation rule should only be introduced as of 2027.

Report and review

By 31 December 2028, the Commission should present a report to the European Parliament and to the Council on the implementation and impact of this Directive accompanied, if appropriate, by a legislative proposal to amend this Directive.

That report should pay special attention to SMEs, in particular assessing whether the special conditions available to SMEs have proven to be sufficient to increase the attractiveness of equity financing to them.

Transposition

Each Member State should, before it transposes this Directive into national law, make public an assessment of the estimated fiscal costs of the measures to be adopted and the resulting decrease in the effective tax rate for companies, and take proper measures to protect tax revenues if needed.

Member States should ensure that the measures they adopt to transpose this Article into national law comply with the guidance provided by the Code of Conduct Group (business taxation) on notional interest deduction regimes.

Transparency

GRUFFAT Claude	Shadow rapporteur	ECON	16/03/2023	OXFAM INTERNATIONAL EU ADVOCACY OFFICE