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COVER NOTE

From:	Secretary-General of the European Commission, signed by Ms Martine DEPREZ, Director
date of receipt:	12 May 2022
To:	Secretary-General of the Council of the European Union
Subject:	REGULATORY SCRUTINY BOARD OPINION 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

Delegations will find attached document SEC (2022) 204.

Encl.: SEC (2022) 204

EUROPEAN COMMISSION

SEC(2022) 204

18.3.2022

REGULATORY SCRUTINY BOARD OPINION

Proposal for a Council Directive on laying down rules on a debt-equity bias reduction and on limiting the deductibility of interest for corporate income tax purposes

COM(2022) 216
SWD(2022) 145-146

EUROPEAN COMMISSION
Regulatory Scrutiny Board

Brussels,
RSB

Opinion

Title: Impact assessment / Debt equity bias reduction allowance (DEBRA)

Overall opinion: POSITIVE WITH RESERVATIONS

(A) Policy context

Tax systems in the EU allow companies to deduct interest payments on debt when calculating the tax base for corporate income tax purposes, while costs related to equity financing, such as dividends, are mostly non-tax deductible. This asymmetry potentially favours the use of debt over equity for financing investments and could contribute to an accumulation of debt for non-financial corporations. Over-indebtedness may threaten the stability of the financial system and increase the risk of bankruptcies.

This initiative aims to encourage companies to finance their investment through equity. The impact assessment assesses the possible introduction of an allowance for equity-financed new investments to mitigate debt bias. The proposal also aims to incorporate a number of anti-tax avoidance rules to ensure tax fairness.

(B) Summary of findings

The Board notes the useful additional information provided in advance of the meeting and commitments to make changes to the report.

However, the report still contains significant shortcomings. The Board gives a positive opinion with reservations because it expects the DG to rectify the following aspects:

(1) The report does not sufficiently take into account other determinants of debt-equity choices beyond the debt-equity tax bias. It does not set out the different situations in Member States and their views of the problem.

(2) The report does not sufficiently describe the composition of the proposed options. It does not explain and analyse the choices on different option elements, in particular, equity definitions, determining the notional interest rate and interest limitation rules.

This opinion concerns a draft impact assessment which may differ from the final version.

(3) It does not present in a clear, analytical manner how the options compare in terms of effectiveness, efficiency and coherence. It does not sufficiently justify the preferred option and explain to what extent it achieves the objectives. It does not contain the specific calibrations of the preferred options.

(C) What to improve

(1) The report should discuss how this proposal interacts and complements existing and ongoing EU and international initiatives. It should describe in more detail the initiative's coherence with the upcoming Business in Europe: Framework for Income Taxation. It should outline how this initiative relates to previous experience of addressing the debt-equity bias, in particular the 2016 Proposal for a Common Consolidated Corporate Tax Base. It should provide a better overview of how this initiative relates to existing and ongoing initiatives from third countries.

(2) When analysing the problem, the report should give a broader picture of the relevant factors contributing to the debt-equity bias and outline all relevant parameters influencing the financing decisions of a company. This should also be reflected in the baseline and the impact analysis. At the same time, both in the dynamic baseline and in the impact analysis, the report should outline how other macro-economic policies may affect debt-equity finacing decisions, even when the proposed measures against tax debt-equity bias will be introduced. In particular, the report should explain how higher interest rates may affect debt-equity ratios. It should also better present the rationale behind the heterogeneity of Member States' approaches for addressing (or not addressing) the debt-equity bias.

(3) The report should further develop the description of the options and better illustrate what the available choices are. The report should be clearer at what stage and how key elements such as notional interest rate and the interest limitation rules are to be decided and implemented. It should better discuss the feasibility of the options (in particular the option on non-deductibility of interest payment).

(4) The report should strengthen the impact analysis. It should clarify to what extent the effects on equity investment can be determined distinguishing between reduction of debt versus increases in equity. It should clearly present the macroeconomic impacts, in particular on tax revenues.. It should also provide more context on how a reduced debt-equity bias would affect young companies such as start-ups and distinguish between effects on profitable versus unprofitable companies. Furthermore, the impact section should clearly illustrate the ex post and ex ante dimensions of the debt-equity bias.

(5) The report should compare the options in a clear, analytical and well structured manner in terms of effectiveness, efficiency and coherence. The report should better justify the choice of the preferred option, and strengthen the link between the objectives, options and impacts. It should also better justify and explain how the preferred option overall best meets the all of the general and specific objectives. The report should include the full evidence base and analysis necessary to determine the specific calibrations of the preferred options. It should present the different costs and benefits of the available calibration choices.

(6) The report should better include and describe diverging stakeholder views throughout the main report and annexes.

The Board notes the estimated costs and benefits of the preferred option(s) in this initiative, as summarised in the attached quantification tables.

Some more technical comments have been sent directly to the author DG.

(D) Conclusion

The DG must revise the report in accordance with the Board's findings before launching the interservice consultation.

If there are any changes in the choice or design of the preferred option in the final version of the report, the DG may need to further adjust the attached quantification tables to reflect this.

Full title	Directive on an allowance to neutralize the tax-debt-equity bias.
Reference number	PLAN/2021/10435
Submitted to RSB on	17 February 2022
Date of RSB meeting	16 March 2022

ANNEX: Quantification tables extracted from the draft impact assessment report

The following tables contain information on the costs and benefits of the initiative on which the Board has given its opinion, as presented above.

If the draft report has been revised in line with the Board's recommendations, the content of these tables may be different from those in the final version of the impact assessment report, as published by the Commission.

1. **Summary of costs and benefits**

Table A3.1. Overview of benefits of preferred option

I. Overview of Benefits (total for all provisions) – Preferred Option		
Description	***Amount***	***Comments***
Direct benefits		
Placing taxation of debt and equity on an equal footing	++	Comparable tax advantage between investment through equity or debt that should benefit businesses and have broader positive financial and economic effects.
Support creation of harmonized tax environment	++	Avoids fragmentation of the single market by eliminating different treatment under different national allowance for equity measures and stronger limitation rules across all Member States for debt deduction. Should benefit businesses operating in single market.
Compliance cost reductions	++	Same administrative rules in all EU Member States compared to existing different compliance rules given several Member States currently have different national measures in place. Should benefit businesses operating in single market.
Help reduce the accumulation of debt by non-financial corporations	++	Higher equity ratios reduce insolvency risks. Stronger interest limitation rules would lessen advantages of debt interest deduction and make debt financing less attractive. Should benefit businesses and have overall positive financial and economic effects.
Encourage equity investments	++	Positive effects on competitiveness, innovation, growth and employment in the EU.
Provide for a comprehensive anti-abuse framework.	++++	Ensure effective measures against aggressive tax planning are used throughout the EU.

Remove distortions in the single market	++++	New investment through equity will receive comparable tax treatment as through debt throughout the EU.
	Indirect benefits	
Reduction in insolvency risk due to higher equity ratios	++	Higher equity ratios reduce the debt burden and make businesses more resilient to changes in the business environment.
Complements other measures to support equity financing (including for SMEs) and furthering capital markets union	++	Companies (including SMEs) will benefit from this measure as it will help incentivise their re-equitisation. More diverse capital structure would support improve broader financial and economic positions.
Complements other policy efforts to de-leverage businesses and mitigate reliance on debt financing for investment	++	High debt/leverage at company level introduces operational strains and heightens risks of insolvency that can have broader financial and economic ramifications, which would be mitigated by the initiative.

Table A3.2. Overview of cost of preferred option

II. Overview of costs – Preferred option								
		Citizens/Consumers		Businesses		Administrations		
		One-off	Recurrent	One-off	Recurrent	One-off	Recurrent	
Allowance for new corporate equity	Direct costs	n.a.	n.a.	Limited implementation costs	Slight increase in compliance costs only when businesses request the allowance.	Low implementation costs for the allowance on equity.	Potentially higher tax admin costs from application of Anti-Avoidance Rules.	
	Indirect costs	n.a.	Lower tax revenues from corporate taxation	n.a.	n.a.	n.a.	n.a.	
Limitation of interest deduction	Direct costs	n.a.	n.a.	No additional reporting requirements so no additional	Debt financing becomes more costly.	Low implementation cost since existing	No additional recurrent costs.	

				one-off costs.		software needs update.	
	Indirect costs	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Costs related to the 'one in, one out' approach							
Total	Direct adjustment costs	n.a.	n.a.	No one-off cost	Slight increase in compliance costs only when businesses request the allowance		
	Indirect adjustment costs	n.a.	n.a.	n.a.	n.a.		
	Administrative costs (for offsetting)	n.a.	n.a.	n.a	n.a.		

Electronically signed on 18/03/2022 13:04 (UTC+01) in accordance with Article 11 of Commission Decision (EU) 2021/2121