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WORKING DOCUMENT

From:	Presidency
To:	Delegations

Subject:	Presidency note on the further examination of the DEBRA proposal
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Delegations will find attached a Presidency note for the DEBRA item on the agenda of the meeting of the Working Party on Tax Questions (High Level) on 23 November 2022.



Presidency steering note

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 (DEBRA)

Exchange of views on the way forward

I. Background

On 18 May 2021, the Commission issued a communication to the European Parliament and the Council entitled “Business taxation for the 21st century”¹. The communication’s overarching aim was to explore how the EU could achieve a “*robust, efficient and fair tax framework that meets public financing needs, while also supporting the recovery and the green and digital transition by creating an environment conducive to fair, sustainable and job rich growth and investment*”.

The communication identified ways in which taxation could support businesses to invest and grow by encouraging and enabling entrepreneurs to take “socially desirable” economic decisions. One way for taxation to have this effect could be to address the fact that companies can deduct interests attached to financing through debt, but not the costs related to financing through equity. This may lead companies to take on debt rather than to retain equity, undermining their financial resilience. One of the initiatives announced in the communication was therefore a legislative proposal creating a debt-equity bias reduction allowance, via an allowance system for equity financing, to be issued in 2022.

It should be noted that an allowance of the kind described in the communication above was already included in the 2016 Commission proposal for a Council Directive on a Common Corporate Tax Base². In fact, the so-called “Allowance for Growth and Investment” included in Article 11 of that proposal aimed to “*tackle the asymmetry whereby interest paid out on loans is deductible (subject to some limits) from taxpayers’ common base whilst this is not the case for profit distributions*” by giving taxpayers “*an allowance for growth and investment according to which increases in their equity will be deductible from their taxable base subject to certain conditions*”.

In the “Business taxation for the 21st century” Communication, it was further announced that the CCTB proposal would be replaced by a new proposal for a new framework for income taxation for businesses in Europe (Business in Europe: Framework for Income Taxation or BEFIT) in the course of 2023. This proposal is planned to contain common rules for determining the corporate tax base to deliver simplification for groups of companies operating in the single market.

¹ COM(2021) 251 final.

² COM(2016) 685 final.



On 11 May 2022, the Commission issued its announced 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.

As its title states, the Commission proposal addresses the debt-equity bias through a rule based on increases in equity (making financing through equity more attractive), while it limits the deductibility of interest (making financing through debt less attractive), in order to mitigate the impact of promoting equity financing on Member States' budgets. It must be noted that a limitation to the deductibility of interest was already included in 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 (ATAD), albeit for other reasons (to discourage base erosion and profit shifting arrangements using excessive interest payments).

II. Work in other institutions

At its plenary meeting on October 26-27, the European Economic and Social Committee approved its opinion on the Directive proposal³. While the Committee supports the objectives pursued by the Commission, it raises some doubts on the actual structure and content of the proposal. It considers the limitation of interest deductibility to be harmful for micro- and small and medium-sized enterprises and calls on the Commission to substantially revise its proposal. The European Parliament's opinion on the proposal is still pending.

III. Work in the Council

The proposal was presented under the French presidency at the Working Party on Tax Questions (High Level) on 2 June 2022, where Member States had a first exchange of views on the proposal. While a number of delegations expressed support for the aims of the proposed legislation, a significant number of Member States questioned the priority of the file in light of the many proposals in the field of direct taxation currently pending (CCCTB, IRD), discussed (Unshell, Pillar 2) or under preparation (Pillar 1, BEFIT).

The French presidency also invited the Commission to provide a more detailed technical presentation of the proposal at the Working Party on Tax Questions (Direct Taxation) on 10 June 2022. Member States, in particular those with notional interest deduction regimes in place, had questions on possible issues that could arise in their national frameworks. A number of delegations also made references to the interaction with the interest limitation rule under the ATAD (see above), the guidance on notional interest deduction regimes provided by the Code of Conduct Group (Business Taxation) and the future relationship with the international taxation framework resulting from the implementation of the "Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy

³ Opinion of the European Economic and Social Committee, ECO/595-EESC-2022.



OECD/G20 Inclusive Framework on BEPS”. Some delegations also raised general concerns on (and the Commission responded to the majority of these points in the Council Working Party meetings):

- the budgetary impact of the proposal;
- the consequences of the proposal in terms of administrative burden;
- the complexity of the mechanism;
- and the question of subsidiarity.

On 5 September 2022, the Czech presidency launched the article-by-article examination of the proposal, which continued on 7 October and 15 November. The Commission provided a detailed presentation of each article of the proposal, with delegations following up with further questions. Throughout the discussions various delegations brought up the general concerns above. Furthermore, a number of more technical issues were raised, such as:

- the expected difficulties with the implementation of the carry-forward mechanism;
- the implementation of the anti-fraud measures;
- the compatibility of the mechanism with national taxation frameworks, for example with regard to group taxation systems or entity-level taxation;
- the difference in some Member States between equity for accounting purposes and equity for tax purposes;
- the absence of an exemption from the interest limitation rule in favour of SMEs, who naturally benefit from the notional interest deduction only to a limited extent.

The Commission provided replies to most topics and had a number of bilateral meetings with Member States on some remaining issues, such as group taxation systems, the difference between accounting vs. tax definitions or the entitlement of permanent establishments to the equity allowance. The Commission provided Member States with further clarifications on these issues during the 15 November WPTQ meeting.

IV. Next steps

In light of the background of the proposal (see section I) and the views expressed by delegations in the course of the WPTQ meetings (see section III), in particular on the interaction with other EU measures in the field of corporate income taxation, it is the view of the Presidency that the best way forward would be to suspend the examination of the DEBRA proposal and, if appropriate, to reassess it only after other proposals in the area of corporate income taxation announced by the Commission have been put forward. Such an approach could also facilitate the discussions as it is expected that both the effects of the ATAD and the situation around the implementation of the second pillar of the OECD/G20 statement will have become clearer.



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The Presidency would therefore include the following paragraph in the December Ecofin report to the European Council on tax issues:

“In light of the many interlinkages with other corporate tax files, both those currently under discussion in the Council and those announced by the Commission in the near future in its Communication on business taxation for the 21st century, the examination of the DEBRA proposal will be suspended and, if appropriate, it would be reassessed within a broader context only after other proposals in the area of corporate income taxation announced by the Commission have been put forward.”

Delegations are invited to indicate whether they agree with the suggested way forward.



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