KPMG responds to European Commission public consultation on DEBRA Directive proposal

European Commission – Debt-equity bias – DEBRA – Allowance on equity – Interest deduction limitation – Anti-tax avoidance – EU implementation – Unanimity

On July 29, 2022, KPMG[1] member firms in the EU submitted a response to the European Commission's (EC's) public consultation on the proposed EU 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 Directive or DEBRA proposal).

KPMG acknowledges the EC's intention to support businesses and build resilience to unforeseen changes in the economic environment and to decrease the risk of insolvency and welcomes the concept of a common framework for rules to address the tax related debt-equity bias. However, KPMG's response highlights a number of areas where we believe additional clarifications could contribute to the functioning of the initiative and enhance legal certainty. In addition, we question the need for an additional interest limitation measure in addition to the interest limitation introduced by the EU Anti-Tax Avoidance Directive (Council Directive (EU) 2016/1164 - ATAD) and may make this initiative impracticable and less useful to taxpayers.

Background

On May 11, 2022, the EC issued the DEBRA proposal with the aim to create a level playing field for debt and equity, from a tax perspective, and to help companies build up a solid funding structure.

The proposal would apply to taxpayers that are subject to corporate income tax in an EU Member State and, subject to certain conditions, would provide for a deduction from the tax base of a taxpayer in respect of the increases in its equity in a given tax year. The Directive would further provide for specific anti-abuse measures to ensure that arrangements are not put in place to artificially benefit from the proposed new allowance on

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[1] The comment paper was produced on behalf of KPMG member firms located in the EU forming part of KPMG's Europe, the Middle East & Africa (EMA) region. Throughout the submission, "we", "KPMG", "us" and "our" refer to the network of independent member firms operating in the EU.

equity. In addition, the Directive would introduce a new limitation on interest deductibility, which would need to be applied alongside the interest limitation rules under ATAD.

For more information on the proposed Directive, please refer to Euro Tax Flash issue 475.

KPMG's contribution

In addition to the recommendation that the focus of this initiative should remain on addressing the debt-equity bias through rules that address the tax treatment of equity, the KPMG contribution attempts to highlight areas where we believe the Directive does not provide sufficient certainty on how the proposed rules are meant to apply in practice and where we see a risk that the administrative burden – for taxpayers and tax authorities alike – exceeds the benefits of the proposed measures.

In particular, these concerns relate to:

- the determination of the equity allowance base;
- the application of the carry forward and recapture mechanism as part of the proposed equity allowance regime;
- the application and proportionality of the proposed anti-abuse measures;
- the interaction between the proposed DEBRA interest limitation rule and existing rules under ATAD;
- the application of the proposed transitional period for equivalent regimes that are currently in force in several Member States;
- the treatment of specific scenarios, such as the application of the rules in group situations.

In addition, we note that the legislative text should be aligned as closely as possible with the Explanatory Memorandum and the preamble, to ensure a harmonized interpretation by tax authorities in EU Members States and to provide legal certainty to taxpayers assessing the impact of the equity allowance and the additional interest limitation rule (should this measure be introduced) on a group's financing structure. We also recommend that the proposed Directive should be consistent with existing EU tax policy and legislation such as ATAD and that the interaction with the EU Minimum Tax proposal is considered.

Next steps

The EC proposes that Member States should transpose the rules into domestic law by December 31, 2023 and that the provisions of the Directive should apply as of January 1, 2024. The legal basis for the EC's proposal is Article 115 of the Treaty on the Functioning of the EU (TFEU), which requires unanimity in the Council.

Member States and the EC will continue to discuss the proposed text in the dedicated Council working group once the European institutions resume business after the summer recess. When a compromise text that is likely to garner support from the majority of Member States is agreed upon, the revised proposal will be discussed in the Council to test whether political agreement can be reached. The text would be formally adopted once the European Parliament has issued its opinion and the Council has voted unanimously in favor.

ETC Comment

Based on the draft agenda for Council meetings during the second half of 2022, it is understood that the DEBRA proposal does not enjoy the same priority within the EC and ECOFIN Council as other initiatives e.g., the proposal for a Minimum Tax Directive. According to the draft agenda, the Czech Presidency aims to present a progress report on this initiative in the ECOFIN Council scheduled for December 6, 2022 (for more details, please refer to E-News issue 158).

As a result, the proposed timeline of the DEBRA Directive may require an extension to allow sufficient time between formal adoption and local implementation. In addition, the text of the DEBRA proposal may suffer substantial changes based on discussions in the Council working group, which may also reflect the responses received as part of the public consultation process. It remains to be seen whether discussions will result in a version of the initiative that Member States would support unanimously.

Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre, or, as appropriate, your local KPMG tax advisor.

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