KPMG

EU debt-equity bias reduction allowance (DEBRA)

September, 2022

What is DEBRA?

- On May 11, 2022, the European Commission (EC) issued a proposal for a Directive providing for a debt-equity bias reduction allowance (DEBRA).
- Subject to certain conditions, the proposal 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.
- In addition, the Directive would introduce a new limitation on interest deductibility, which would need to be applied in advance of the interest limitation rules under the EU Anti-Tax Avoidance Directive (2016/1164).

What is the new interest deduction limitation?

- Exceeding borrowing costs (i.e. interest paid minus interest received) would be **85 percent** deductible.
- The deduction limitation would apply alongside the ATAD interest limitation rule.
- Effectively, taxpayers would be entitled to deduct only the lower of the two amounts in a tax year.

Who is affected?

- All undertakings subject to corporate income tax in an EU Member State.
- Exclusion for certain types of financial undertakings (e.g. credit institutions, investments firms, alternative investment funds, insurance undertaking, etc.), as defined under EU law.

How would the equity allowance operate?

Equity Allowance =

Increase in net equity x

Notional interest rate

- Net equity = sum of equity and reserves, less the value of holdings in associates and own shares
- Notional interest rate = 10-year risk-free interest rate for the relevant currency + risk premium (1 percent generally, increasing to 1.5 percent for SMEs)

Deduction mechanism

- Allowance is deductible for ten years, i.e. in the year it was incurred (TY) and in the next successive nine years (TY+9).
- Recapture mechanism for decreases in equity.
- Deductibility limited to a maximum of 30 percent of the taxpayer's EBITDA for each tax year.
  - Unlimited carry forward of the part of the allowance on equity that would not be deducted in a tax year due to insufficient taxable profits.
  - Five-year carry forward of unused allowance capacity.
- Anti-abuse measures aimed at limiting relief for artificial arrangements.

Why has this been proposed?

- Aimed at creating a level playing field for debt and equity from a tax perspective.
- Intended to assist companies build up a solid funding structure – companies with a strong capital base are perceived by the EC as being less vulnerable to shocks
- EC's proposal therefore aims to incentivize increasing equity (equity allowance) while disincentivizing the use of debt (interest limitation)

When would DEBRA be implemented and when would it become applicable?

2033

Transitional rules
Deferred application of the Directive for a period up to 10 years where equity allowance regimes are already in place

Jan 1, 2024
Member States to start applying the provisions of the Directive

2024

December 31, 2023
December 31, 2023
Domestic transposition

EP to provide non-binding opinion

Council to approve the Directive (unanimity required)

Directive to be published in the Official Journal

2023

July 2022
End of the public feedback period

May 11, 2022
Draft Directive published

2022

July 1 – Oct 7, 2021
Public consultation

June 14 – July 12, 2021
Roadmap consultation

May 18, 2021
Announced in the EC's Communication

2021

How can KPMG help?

The KPMG network of EU tax professionals can help you assess how the new rules may impact your business.

In particular, KPMG member firms can assist with the evaluation of your current financing structures in light of the proposed DEBRA equity allowance, interest limitation and anti-abuse measures.

If you would like to receive more information, feel free to contact one of the following advisors, or, as appropriate, your local KPMG contact.

Contacts

Raluca Enache
Director
KPMG's EU Tax Centre
E: Enache.Raluca@kpmg.com

Marco Dietrich
Manager
KPMG's EU Tax Centre
E: marcodietrich@kpmg.com

Ana Puscas
Manager
KPMG's EU Tax Centre
E: apuscas@kpmg.com

KPMG