

TAX

PROPOSAL FOR A DIRECTIVE PROVIDING FOR A DEBT-EQUITY BIAS REDUCTION ALLOWANCE (DEBRA)

VdA EXPERTISE



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The European Commission recently issued a proposal for a Directive seeking to create a level playing field for debt and equity financing.

The Proposed Directive known as DEBRA – Debt Equity Bias Reduction Allowance comes on the heels of the Commission's May 18, 2021, Communication to the European Parliament and the Council putting forward that Member States need to minimize tax distortions currently existing between debt and equity financing to facilitate access to capital for European Union companies and to promote the integration of national capital markets into a single market.

Under current tax rules, companies can deduct interest arising from debt financing, but not the costs related to equity financing.

These distortions plainly influence the decisions that companies take on how to finance their growth, often choosing to take on debt rather than increase their equity.

Against this background, the European Commission is proposing that increases in equity between different tax periods should be deductible from taxpayers' taxable income, as is the case with interest arising from debt financing.

The intention behind this proposal is to create **(i)** a deduction on companies' equity for IRC [Corporate Income Tax] purposes for a period of 10 consecutive years, as well as **(ii)** new limits on the deductibility of net financing costs.

i. Deduction on equity

The difference between the level of net equity at the end of the fiscal year and the level of net equity at the end of the previous fiscal year will be the basis to calculate this deduction.

The difference must be multiplied by the 10-year risk-free interest rate for the relevant currency plus a risk charge of 1% or, in the case of SMEs, 1.5%.

This deduction will be limited to 30% of EBITDA. Should it overshoot this limit, the unused portion may be carried forward over the next five years. Moreover, reporting may be deadline-free if the deduction outstrips the taxable income for the relevant period.

Under the Proposed Directive, Member States may take appropriate measures to ensure that the basis for deduction does not include amounts resulting from **(i)** the granting of loans, **(ii)** transfers of shareholdings or transfers of business as a going concern between related parties, and **(iii)** cash contributions by residents for tax purposes in a jurisdiction that does not exchange information.

ii. New limits to the deductibility of net financing expenses

The Proposed Directive also foresees a new limit to the (annual) deductibility of net financing costs, capped at the lower of:

- 85% of total net financing expenses for the period; or
- the higher of EUR 1,000,000 or 30% of the EBITDA.

The difference between the two amounts can be carried forward or back in accordance with Article 4 of 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).

Note that the carry-back option is not a statutory option in Portugal.

The new provisions of the Proposed Directive must be adopted in the laws of the Member States by 31 December 2023 and will enter into force the following day (1 January 2024).

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