Debt-equity bias reduction allowance and limiting the deductibility of interest for corporate income tax purposes

2022/0154(CNS) - 16/01/2024 - Text adopted by Parliament, 1st reading/single reading

The European Parliament adopted by 324 votes to 132 with 155 abstentions, following a special legislative procedure (Parliament's consultation), a legislative resolution on the 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.

The proposed directive lays down rules on the deduction, for corporation tax purposes, of an allowance on increases in equity capital and on limiting the tax deductibility of additional borrowing costs.

Parliament approved the Commission's proposal with amendments to assist SMEs.

Allowances on equity

According to Members, an allowance on equity should be deductible, for:

- 10 consecutive tax periods, from the taxable base of an **SME or medium-sized group** for corporate income tax purposes up to 30% of the taxpayer's earnings before interest, tax, depreciation and amortisation ("EBITDA");

- 7 consecutive tax periods, from the taxable base of any **large undertaking** or large group for corporate income tax purposes up to 30% of the taxpayer's EBITDA.

Member States should ensure that taxpayers are able to carry forward, for a maximum of 3 tax periods, the part of the allowance on equity which exceeds the percentages of EBITDA laid down in a tax period.

If the deductible allowance on equity is higher than the taxpayer's net taxable income in a tax period, Member States should ensure that the taxpayer may carry forward the excess of allowance on equity as follows:

- for a maximum of 3 tax periods, where the taxpayer is a large undertaking or a large group;

- without time limitation, where the taxpayer is an SME or a medium-sized group.

The proposal stated that the base of the allowance on equity should be calculated as the difference between the level of net equity at the end of the tax period and the level of net equity at the end of the previous tax period, in other words, the year-on-year increase in net equity. According to Members, the allowance on equity should be equal to the base of the allowance multiplied by the 10-year risk-free interest rate for the relevant currency, increased by a **risk premium of 1% for SMEs**.

Limiting the deductibility of exceeding borrowing costs

To effectively address the tax-related debt-equity bias in a manner sustainable for the Union's public finances, Members considered that an allowance for equity financing should be accompanied by a rule limiting the deductibility of exceeding borrowing costs for groups that are not medium-sized groups and undertakings that are not SMEs. However, given the adverse economic conditions stemming from the COVID-19 crisis and from the Russian war of aggression against Ukraine, that limitation rule should only be introduced as of 2027.

Report and review

By 31 December 2028, the Commission should present a report to the European Parliament and to the Council on the implementation and impact of this Directive accompanied, if appropriate, by a legislative proposal to amend this Directive.

That report should pay special attention to SMEs, in particular assessing whether the special conditions available to SMEs have proven to be sufficient to increase the attractiveness of equity financing to them.

Transposition

Each Member State should, before it transposes this Directive into national law, make public an assessment of the estimated fiscal costs of the measures to be adopted and the resulting decrease in the effective tax rate for companies, and take proper measures to protect tax revenues if needed.

Member States should ensure that the measures they adopt to transpose this Article into national law comply with the guidance provided by the Code of Conduct Group (business taxation) on notional interest deduction regimes.