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DG TAXUD
European Commission

In response to a public consultation on the draft 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, I forward our comments.

Yours sincerely,

Maciej Witucki
President of the Polish Confederation Lewiatan

Appendix:

Lewiatan Confederation's comments on the draft 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.

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Lewiatan Confederation's comments on the draft 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.

We support the EU Commission's long-term vision to provide a fair and sustainable business environment and EU Tax system as set out in its Communication on Business Taxation for the 21st Century. As part of this long-term vision, we support the objective to promote level playing field in tax treatments between equity and debt financing, removing taxation as a factor that can influence companies' funding decisions. Some EU Member States already provide for such rules in their national legislation and we support the EU Commission's harmonizing role to remove the debt-equity bias across the entire EU Single Market.

The key to making this reform successful is to strike the right balance between increased tax allowances on equity vs. limiting interest deductions. As we set out below, it is key here to take into account the effects of existing measures, such as the EU Anti-Tax Avoidance Directive (ATAD) which already limits interest deductions. Overly restricting interest deductions goes against the overarching policy objective and would disproportionately impact companies that have more difficulties accessing equity markets, such as SME's.

In our view, the following key considerations are critical to further improve the legislation in order to ensure that it meets its objective while remaining in accordance with EU constitutional principles, notably proportionality and equal treatment:

Overall comments

- Whilst we support the idea of allowing companies deductions in relation to equity financing, we do not support the idea of restricting interest deductions on debt further, when there are already interest limitation rules in place across EU countries following the implementation of the EU ATAD which already achieve this aim.
- The proposed legislation only allows a deduction for 85% of interest expenses exceeding interest income, and permanently disallows the balance of 15%. We believe this conflicts with the proportionality principle when paired with the ATAD rules in place to manage interest limitations following BEPS. Further, it is not clear how the 85% allowance has been determined and whether this is supported by underlying economic analysis. This appears overburdening where the debt is in place for genuine commercial reasons.
- Debt provides companies with greater flexibility to move cash within the group and quickly adjust working capital depending on business cycles and seasonal aspect of business activity,

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which are not consistent across the year. The decision to raise debt is thus often made based on genuine commercial reasons.

- Equity, in contrast, is difficult to quickly adjust for liquidity needs, and there are often legal, accounting, and other hurdles in order to return equity to shareholders. For example, in several countries it is only possible to legally distribute equity within distributable reserves limits and there is often a requirement to have recently audited statutory financial statements before a dividend can be distributed. This creates a materially greater burden than debt, for example through the creation of interim financial statements exclusively to that purpose. Therefore, equity may be a more unattractive option for pure treasury and cash flow purposes.
- The proposed directive requires tracing of equity and intragroup debt balances over several years, as well as annual losses and changes as a result of restructuring and reorganizations, which creates a considerable compliance burden to calculate the additions and subtractions to equity for every entity that is subject to these rules. We would welcome simplifications in this area and the removal of tracing requirements.
- Many companies use a mix of debt and equity responsibly, and keep debt levels within sufficiently low debt:equity ratios. We would therefore welcome more targeted measures to ensure that the proposal does not indiscriminately overburden those companies.

Specific comments on provisions within directive

Notwithstanding our overarching concerns above, we have noted some specific areas for consideration within the directive itself below.

- There is a benefit for increasing equity that is calculated on a very low rate of a risk free return plus a premium 1% (or 1.5% for SMEs). Depending on how interest rates move in future, this would not seem to be an adequate substitute for a 10 year loan rate and it is not clear if and how the premium would flex in future years. The rate of the NID should be periodically flexed based on ECB rates.
- The further restrictions on interest deductibility on debt do not appear to take into account whether debt is third party or intragroup. This does not seem proportionate, given that third party debt should already be on arm's length terms, and therefore deductibility should not be restricted for interest on third party debt.
- In many EU countries, for local GAAP purposes, expenses on finance leases are treated as 'interest' (in contrast to operating leases where expenses are treated as 'other operating

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expenses'). We would recommend that the rules on interest deductibility for debt exclude leases as this could be a barrier for taxpayers to enter into standard business/commercial arrangements.

- Where loans are obtained in situations where tax rate arbitrage intent is unlikely, for example where borrower vs lender jurisdiction corporate income tax rate differences are small, we would further recommend that there is a safe harbor included where the statutory corporate income tax rate of the lender/borrower countries are within 20% of each other.
- The allowance on equity is limited to 30% EBITDA, and there are also interest limitation rules in place following ATAD that are EBITDA-based. It would be helpful to confirm that these are two separate tests, and that the equity allowance does not need to be aggregated with interest expenses on debt for the purposes of applying these rules. To simplify compliance requirements for groups, we would strongly recommend that the basis for the 30% EBITDA test for the allowance on equity is very simple (e.g. 30% of EBITDA per local GAAP financial statements). Having different calculation methods for different countries (as is already the case today for ATAD rules that are in place) would be unduly complex and burdensome.

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