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Invest Europe response to the European Commission consultation on its proposal on Debt-Equity Bias Reduction Allowance (DEBRA)

Invest Europe, the association representing venture capital, private equity, infrastructure fund managers as well as their investors, has a very evident and vested interest in a long-term increase in incentives to invest in European businesses. As such, we will in principle welcome all genuine efforts made to increase any investment and commend the European Commission for picking up the gauntlet and making efforts to address the issue.

Balancing the treatment of debt and equity financing in a more equitable way is a daunting task and whilst addressing a perceived “bias” seems logical, it is worth noting that there are many valid legal, regulatory, and commercial reasons for use of debt such that, even if there was complete parity in the tax treatment of the two forms of finance, debt would still be preferable in many circumstances.

Excessively addressing a perceived bias at the cost of legitimate business decisions to use debt instruments and/or a mix of debt and equity instruments will not achieve an overarching goal of increased investments in Europe.

Even so, a proposal from the European Commission is timely to open a wider discussion on the subject. With a European economy resettling after a COVID-19 crisis, with existing considerable challenges to deliver on a digital and green transition and with added new challenges, directly or indirectly affiliated to the war in Ukraine, the European economy could benefit from short-term boosts with permanent and long-term effects. An allowance for reductions based on equity could be an instrument to deliver that.

At the same time, we recognise that at the current juncture an allowance that grants deductions in the corporate tax base – however dwarfed this would be compared to overall tax revenues – could lead to misinterpretations of corporate contribution to the overall economy and destabilising countermeasures taken. As such, we understand and agree that a DEBRA should not be amassed to a size where it would lead to substantial losses in overall revenues for the Member States.

Similarly, we understand and agree to the rationale behind the higher notional deduction percentage rate to SMEs and in parallel agree that a pan-European DEBRA should not be put in place in a detrimental way vis-à-vis national DEBRA schemes set up. We therefore fully support the grandfathering clauses offered to the six Member States with such allowance schemes already in place, albeit this grandfathering would need to come to an end with the shortest reasonable timeframe to avoid longer-term dilution of a pan-European level playing field.

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Whilst we welcome proposals to make equity financed investments more attractive and understand and agree to some of the reasons for the proposal taking its current form, we do find that the specific model for a DEBRA chosen here leaves significant improvements to be desired.

Firstly, on a general note, the notion that corporate choice of financing model is akin to a binary simplistic waging pros and cons is not coherent with reality in European businesses. The choice between equity and debt or indeed a mix of these at varying degrees is much more complex and rarely – if ever – significantly driven by tax considerations.

The somewhat simplified view of binary choices and corporate financing is expressly and unwelcomed seen in the anti-abuse provisions in the current proposal, where, with the burden of proof reversed, the directive commits the corporate to prove that reductions in equity are a specific and exclusive result of losses incurred.

Whilst we evidently understand and agree that a DEBRA cannot be put in place without a proportionate set of anti-abuse rules, we find that the suggested set of rules goes beyond what is proportionately needed and that particularly the rule on excluding any intragroup financing disproportionately limits the very financing of innovative and high-risk start-ups, that arguably are also those companies suffering most in an overly debt-financing dependent business environment.

More specifically, we find that the proposed additional interest limitation rules, particularly when – as proposed – it is set to be additional to the interest limitation rules in ATAD1, are counterproductive to the aims that the proposed directive otherwise claims to strive to achieve.

The combined effect of the ATAD1 and this proposal's interest limitation rules would in our view leave EU corporations worse off than without this proposal, detriment to the attractiveness of Europe to investors.

Equally, it adds complexity and disadvantage to businesses who very legitimately are exempt from ATAD1 or, even where they are not, it creates further unnecessary restrictions.

Whilst the very concept of a DEBRA is very laudable and – recognising the complexity in getting the balance right – the efforts made by the European Commission are commendable, we find on balance that firstly, further finetuning is needed, particularly of the articles on the interest limitation rules, how they apply and interact with international guidelines or existing regulation, like ATAD1. Secondly, it should be explored further whether the current suggested interest rate limitations aren't set to be skewed in a pro-cyclical way, ahead of years where equity investments will be direly needed.

About Invest Europe

Invest Europe is the association representing Europe's private equity, venture capital and infrastructure sectors, as well as their investors.

Our members take a long-term approach to investing in privately held companies, from start-ups to established firms. They inject not only capital but dynamism, innovation and expertise. This commitment helps deliver strong and sustainable growth, resulting in healthy returns for Europe's leading pension funds and insurers, to the benefit of the millions of European citizens who depend on them.

Invest Europe aims to make a constructive contribution to policy affecting private capital investment in Europe. We provide information to the public on our members' role in the economy. Our research provides the most authoritative source of data on trends and developments in our industry.

Invest Europe is the guardian of the industry's professional standards, demanding accountability, good governance and transparency from our members.