FESE views on the DEBRA proposal

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FESE welcomes the Commission's proposal on a debt-equity bias reduction allowance (DEBRA) and shares its general objective to address the tax-induced debt-equity bias across the single market. However, the proposal should not come alongside tax disincentives to debt investments.

The Commission's DEBRA proposal is a positive step to alleviate tax disincentives toward equity financing. An EU-wide approach would reduce tax competition and fragmentation, establishing a common approach. If adopted, DEBRA would allow companies to deduct an allowance on equity from their taxable base, where a taxpayer increases their equity from one tax period to the next. It should be noted that the allowance on equity is computed by multiplying (i) the allowance base with (ii) the relevant notional interest rate; therefore, its deduction would make equity investments more attractive.

We understand that the Commission proposal also introduces a reduction of debt interest deductibility at a maximum of 85% of exceeding borrowing costs (i.e. interest paid minus interest received). **However, initiatives aimed at eliminating the debt-equity bias should not impose new barriers to debt instruments.** Instead, new policies should result in investors paying lower taxes on their equity investments and incentivise the provision of equity capital as an alternative source of funding. In sum, **encouraging equity funding alternatives should not create additional restrictions for debt financing**.

A limitation to the deductibility of debt costs could have unpredictable negative impacts on companies' financing composition. Firms relying on strong debt financing could carry the burden of higher cost effects while adding the challenge of a possible reorganisation of their funding structure. Many national laws already entail specificities regarding the treatment and limitations of interest rate deduction preventing, among others, artificial transfers of the tax base from one country to another. In addition, it is important to note that **debt instruments continue to play a crucial role in the transition toward sustainable finance**. This is demonstrated by the constant market growth of so-called green, social, sustainability, and sustainability-linked bonds. Taxation should not be seen as a disincentive in the use of these types of instruments.

In conclusion, **while FESE welcomes the establishment of this allowance, we encourage policymakers to reconsider the introduction of an additional interest deductibility limitation rule.** This limit significantly restricts the free choice of financing options and does not recognise that the optimal level of debt-equity differs per economic sector and across economic cycles. There are legitimate non-tax reasons (e.g. capital costs) for companies to opt for debt financing. **We, therefore, recommend refraining from imposing new fiscal barriers to debt financing and rather concentrating on the equal treatment of equity.**