EFAMA

European Fund and Asset Management Association

DEBRA (DEBT EQUITY BIAS REDUCTION ALLOWANCE)

EFAMA COMMENTS ON THE EUROPEAN COMMISSION'S PUBLIC CONSULTATION

7 October 2021

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EFAMA’s COMMENTS ON THE EUROPEAN COMMISSION’s PUBLIC CONSULTATION ON DEBT EQUITY BIAS REDUCTION ALLOWANCE

This initiative is being launched by the Commission to present a legislative proposal to address the tax-induced debt-equity bias, also to support the action plan for the Capital Market Union and to encourage companies to finance their investment through equity contributions rather than through debt financing.

While EFAMA fully supports the Commission’s initiatives to relaunch the CMU, we regard the question of whether there is an excessive preference to debt in European corporate tax systems as a wider macroeconomic question - and one that is beyond the scope of this response.

Hence, rather than respond to EC’s questionnaire directly, EFAMA considers it is more helpful to share the views of the industry and influence the upcoming initiatives by focusing on **specific tax policy consequences.**

We appreciate this is an early stage in the debate and that **a wide range of policy options are being considered**. In EC’s roadmap, we can read the objectives pursued by this initiative could be achieved by different types of approaches by **disallowing the deductibility of interest payments**; or by **creating an allowance for equity by enabling the tax-deductibility of notional interest for equity**.

In the impact assessment undertaken in 2016 for the CC(C)TB proposal – please refer to SWD(2016) 341 final – when addressing the debt bias the Commission already recognized the adverse impact of the non-deductibility of interest payments: *“Applying the full non-deductibility of interest paid to the financial sector would represent a disproportionate financial cost for the sector, unless by symmetry the interest received would be exempted.”*

While **we have not at this stage identified any unintended consequences of extending deduction to equity**, we assume that Member States would be prompted to reconsider their current policy of exemption all dividends. By contrast, **any blanket restriction on debt deduction definitely would have immediately identifiable consequences on our industry and end investors**.

To set the context, **we assume** that it is already anticipated that **there would have to be some form of safe harbour rules for conventional banking activity** (which by its nature involves near-matching flows of interest in and interest out). To tax interest receipts in full but only give a partial deduction for interest payments would leave the corporate taxation of banks fundamentally unconnected to their actual profitability.

To protect our industry from any adverse impact of these measures, **EFAMA understands the asset management sector would also need a similar safe harbour**. Please refer to the following **examples of investment vehicles that are fully dependent on the full deduction of interest and that would need to be protected from the unintended consequences (e.g. disruption of the existing market) of the policy options that are being considered to address the debt bias**.

Securitisation vehicles

Securitisation is an accepted and encouraged route by which European countries gain access to liquid non-bank finance. Even if the policy aim has evolved to a greater preference for equity finance, there would be a need to disrupt the existing market.

Investment funds

These operate in a similar way to securitisation vehicles generating interest flows from portfolios of from all forms of debt. As with securitisation vehicles, it is essential that the investment fund provides investors with a tax neutral outcome. Any tax inefficiencies that arise as a result of restrictions on interest deductions within the fund structure will act as a significant barrier to investment.[1]

Final remarks

EFAMA stands ready to protect the industry from any adverse effects of this initiative on investment activity within the EU, and to assist the Commission in the design of the necessary safe harbour rules for the financial sector, in particular for investment vehicles that are fully dependent on the full deduction of interest.

[1] While the UK is no longer part of the EU, we assume a level playing field would be preferred. If the UK is to adopt the same debt restriction principles as the EU, a policy adaptation would be needed for the UK domiciled Authorised Investment Funds (i.e. the UK's retail regulated mutual funds). Where such funds are more than 60% invested in debt, they operate by taxing the interest income of the fund but then achieving the tax neutrality that is an essential feature of all mutual funds by deducting the distribution to investors as a deemed interest payment.

About EFAMA:

EFAMA is the voice of the European investment management industry, which manages over EUR 27 trillion of assets on behalf of its clients in Europe and around the world. We advocate for a regulatory environment that supports our industry's crucial role in steering capital towards investments for a sustainable future and providing long-term value for investors.

Besides fostering a Capital Markets Union, consumer empowerment and sustainable finance in Europe, we also support open and well-functioning global capital markets and engage with international standard setters and relevant third-country authorities.

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EFAMA is a primary source of industry statistical data and issues regular publications, including Market Insights and the authoritative EFAMA Fact Book.

More information is available at www.efama.org.

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