



Brussels, 11.5.2022  
SWD(2022) 144 final

**COMMISSION STAFF WORKING DOCUMENT**

**Subsidiarity Grid**

*Accompanying the document*

**Proposal for a COUNCIL DIRECTIVE**

**on laying down rules on a debt-equity bias reduction and on limiting the deductibility of interest for corporate income tax purposes**

{COM(2022) 216 final} - {SEC(2022) 204 final} - {SWD(2022) 145 final} -  
{SWD(2022) 146 final}

## Subsidiarity Grid

<b>1. Can the Union act? What is the legal basis and competence of the Unions' intended action?</b>
<b>1.1 Which article(s) of the Treaty are used to support the legislative proposal or policy initiative?</b>
<p>The legal basis for the intended action is Article 115 of the Treaty on the Functioning of the European Union (TFEU) on the approximation of laws of the Member States, which directly affect the establishment or functioning of the internal market. Although the provision does not mention direct taxation explicitly, this Article has consistently been used to date as the standard legal base for legislative initiatives with harmonisation objectives in direct taxation. The rule explicitly prescribes that the only legal instrument which can be used under this legal base is a Directive.</p>
<b>1.2 Is the Union competence represented by this Treaty article exclusive, shared or supporting in nature?</b>
<p>The Union competence represented by this Treaty article is shared between the Commission and Member States pursuant to Article 4 (2) (a) Internal Market of the TFEU.</p>
<p><i>Subsidiarity does not apply for policy areas where the Union has <b>exclusive</b> competence as defined in Article 3 TFEU<sup>1</sup>. It is the specific legal basis which determines whether the proposal falls under the subsidiarity control mechanism. Article 4 TFEU<sup>2</sup> sets out the areas where competence is shared between the Union and the Member States. Article 6 TFEU<sup>3</sup> sets out the areas for which the Unions has competence only to support the actions of the Member States.</i></p>
<b>2. Subsidiarity Principle: Why should the EU act?</b>
<b>2.1 Does the proposal fulfil the procedural requirements of Protocol No. 2<sup>4</sup>:</b> <ul style="list-style-type: none"><li>- Has there been a wide consultation before proposing the act?</li></ul> <p>Before proposing this act, stakeholder feedback has been requested and obtained through a wide range of activities. In particular:</p> <ul style="list-style-type: none"><li>(i) In the context of the Inception Impact Assessment, feedback from seven stakeholders was uploaded in Have-your-say from 14/06/2021 to 12/07/2021: one investment group, five business associations (one of which from UK), one Polish citizen.</li><li>(ii) A public consultation ran from 1/07/2021 until 7/10/2021. Overall, 67 responses</li></ul>

<sup>1</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:12008E003&from=EN>

<sup>2</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:12008E004&from=EN>

<sup>3</sup> <https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:12008E006:EN:HTML>

<sup>4</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:12016E/PRO/02&from=EN>

were received: 37 business associations mainly representing financial organisations of all sizes (including SMEs), 12 companies/business organisations (mostly tax accountant and financial organisations), 3 academic and research institutions , 8 NGOs or others (mostly Chambers of Commerce, stock exchanges) and 7 individual citizens. Most respondents came from either Belgium (14/67), Germany (14/67) or France (12/67). A total of 30 position papers have been uploaded.

- (iii) Bilateral meetings were organised with business associations.
  - (iv) A meeting with national tax authorities/agencies, business associations and civil society groups took place in the context of the Commission Experts Group “Platform for Tax Good Governance, Aggressive Tax Planning and Double Taxation”.
  - (v) A meeting took place with the European Economic and Social Committee (EESC).
- Is there a detailed statement with qualitative and, where possible, quantitative indicators allowing an appraisal of whether the action can best be achieved at Union level?

The explanatory memorandum of the act contains a statement that the proposal ensures the principle of subsidiarity.

**2.2 Does the explanatory memorandum (and any impact assessment) accompanying the Commission’s proposal contain an adequate justification regarding the conformity with the principle of subsidiarity?**

Statement on subsidiarity included in the explanatory memorandum:

This proposal complies with the principle of subsidiarity. The nature of the subject requires a common initiative across the internal market.

The rules of this Directive aim to tackle the debt-equity bias in the EU corporate sector from a tax perspective and provide a common framework to be implemented into Member States' national laws in a coordinated manner. Such aims cannot be achieved in a satisfactory manner through action undertaken by each Member State while acting on its own and without coordination with the others.

Tax debt-equity bias arises from the different treatment of debt and equity financing costs for tax purposes and is a problem common to businesses across all EU Member States. Despite this, only six Member States have taken tax measures to approximate the tax treatment of debt and equity. What is more, although there is soft law guidance for this type of tax incentives, the relevant national measures of the six Member States vary significantly in terms of design elements and anti-tax avoidance rules.

The complete lack of measures that mitigate tax debt bias in 21 Member States along with the existence of significantly different measures in 6 Member States may create distortions to the functioning of the internal market and affect the location of investment in a significant manner. In addition, it may give rise to loopholes across the single market and create a risk of aggressive tax planning.

Furthermore, an EU initiative would add value, as compared to what a multitude of actions taken at national level can attain. A single rule for the EU will allow reducing compliance and administrative costs: on the one hand, taxpayers will need to comply with a single rule for all their operations in the single market; on the other, Member States' tax administrations will need to consider only one rule for all taxpayers' operations, instead of a fragmented system of rules. An EU-wide rule is also expected to boost competition in the single market by ensuring that all businesses, regardless of where they are located, have similar incentives towards sustainable financing.

An EU-wide initiative in the form of a binding legislative proposal is therefore necessary to address a problem that is common across the EU in a coordinated and effective manner. An EU initiative would prevent potential loopholes between diverging national initiatives and would ensure that location of business and investment are not adversely impacted.

**2.3 Based on the answers to the questions below, can the objectives of the proposed action be achieved sufficiently by the Member States acting alone (necessity for EU action)?**

Member States acting alone would not be able to sufficiently achieve the objectives of addressing the tax debt bias across the EU corporate sector. The problem is not confined to a single Member State or a group of Member States, but affects all of them. In addition, the combination of some Member States operating divergent national rules with a complete lack of rules in other Member States can create distortions and undermine competition in the single market.

(a) Are there significant/appreciable transnational/cross-border aspects to the problems being tackled? Have these been quantified?

There are significant cross-border aspects to the problem, which affect the functioning of the internal market. It is in this context that the Code of Conduct Group (Business Taxation) has scrutinised the relevant national measures.

The problem is common to all EU Member States, but only a few of them have taken tax measures to tackle it. These measures pertain to the tax treatment of equity financing and as such can affect the location of business in the single market. A patchwork of different national rules per jurisdiction combined with no rules at all in some jurisdictions across the single market can distort decisions on the location of business, while also creating a compliance burden for businesses operating cross-border.

These aspects have not been quantified.

(b) Would national action or the absence of the EU level action conflict with core objectives of the Treaty<sup>5</sup> or significantly damage the interests of other Member States?

<sup>5</sup> [https://europa.eu/european-union/about-eu/eu-in-brief\\_en](https://europa.eu/european-union/about-eu/eu-in-brief_en)

<p>The absence of EU level action in tackling tax debt bias by balancing the tax treatment of equity and debt financing could undermine / continue undermining the functioning of the internal market.</p> <p>Member States have taken divergent or no actions to tackle the problem and the mismatches amongst them lead to loopholes, allowing abuse and risking to affect the location of business in a non-optimal manner.</p> <p>Moreover, multinational groups incur significant administrative burdens when complying with a proliferation of similar, yet different, national measures targeting the same issue.</p>
<p>(c) To what extent do Member States have the ability or possibility to enact appropriate measures?</p>
<p>Member States have the possibility to enact measures to tackle tax debt bias in their jurisdictions. Nevertheless, if a Member State enacts such measures without coordinating with other Member States, it may create room for harmful tax practices, by attracting the location of business for purely tax motives. The problem intensifies if several Member States take measures that are not coordinated.</p>
<p>(d) How does the problem and its causes (e.g. negative externalities, spill-over effects) vary across the national, regional and local levels of the EU?</p>
<p>The problem of the debt-equity bias varies across countries due to differences in corporate income tax and interest rates, which drive the debt-equity bias. Calculations of the debt-equity bias indicate that it is more pronounced in some Member States while it is absent in the Member States that operate a domestic equity allowance mechanism. Debt-equity ratios of non-financial corporations, which are in part determined by the debt-equity bias, differ considerably across the EU, ranging from 0.36 to almost 1.04.</p> <p>DEBRA seeks to create a level playing field across the EU by ensuring that all EU businesses are treated equally in terms of taxation concerning their financing choices and regardless of how they choose to finance themselves, i.e. through equity or debt instruments. As a result, the location of business within the single market should not be a relevant factor affecting the tax treatment of financing costs.</p>
<p>(e) Is the problem widespread across the EU or limited to a few Member States?</p>
<p>The problem that this initiative targets, different treatment of debt and equity financing instruments for tax purposes, is widespread in the EU, with only six Member States having taken measures to address it. The existence of few national measures in this regard can create distortions in the single market and open loopholes that can be exploited for tax planning purposes.</p>
<p>(f) Are Member States overstretched in achieving the objectives of the planned measure?</p>

Member States will not be overstretched to achieve the objectives of the planned measure. The initiative will require very limited additional human resources from national tax authorities to comply with the planned action. In addition, the measure is designed to have very limited impact on Member States' budgets, while helping the re-capitalisation of EU business.

(g) How do the views/preferred courses of action of national, regional and local authorities differ across the EU?

Currently only six Member States have taken action to address the problem of tax debt bias at national level. To the contrary, 21 Member States have taken no relevant measures. One Member State has considered introducing a relevant measure but concluded that measures at individual Member State level entail risks of abuse and only an EU-wide approach can be effective.

Amongst the six Member States that have relevant measures, the policy reasons behind their introduction vary, as do key design elements. In particular, such measures have been introduced to attract investment, or to address specific needs of undercapitalisation of local companies, including mainly family businesses. A common element of the different domestic rules is the weight attached to the anti-abuse framework.

Those Member States that do not have in place such measures may be applying a very low statutory corporate income tax (CIT) rate, which in principle allows to alleviate the debt-equity bias.

Nevertheless, Member States agree in principle on the cross-border nature of the problem and the potentially harmful effects that domestic measures may cause to the internal market if they create a fragmented framework in the EU. This is the reason why relevant measures at national level fall within the scope of the Code of Conduct Group (Business Taxation).

**2.4 Based on the answer to the questions below, can the objectives of the proposed action be better achieved at Union level by reason of scale or effects of that action (EU added value)?**

The EU action will keep compliance costs to a minimum, as businesses will need to adhere to a single set of rules, rather than different national measures, to tackle tax debt bias. A common policy approach will provide taxpayers with tax certainty, close loopholes used for tax avoidance and reduce compliance costs for cross-border business.

(a) Are there clear benefits from EU level action?

An EU initiative would add value, as compared to what a multitude of national implementation methods can attain. A single rule for the EU will reduce compliance and administrative costs, for both taxpayers and tax administrations. An EU-wide rule is also expected to boost competition in the single market by ensuring that all businesses, regardless of where they are located, have similar incentives towards sustainable financing.

(b) Are there economies of scale? Can the objectives be met more efficiently at EU level (larger benefits per unit cost)? Will the functioning of the internal market be improved?

An EU action would keep compliance costs to a minimum, as businesses will need to adhere to a single set of national measures, to address the tax debt bias. For a group active across the EU, there will be gains in terms of economies of scale, as all of its entities, no matter in which Member State they are resident for tax purposes, will follow a single set of requirements. In the same vein, given that this measure aims at strengthening capitalisation and hence the resilience of companies, it is useful that it applies equally to all companies of a cross-border group.

The current measure is closely linked with the actions towards completing the capital markets union. The mitigation of the debt-equity bias incentivises the use of equity. This complementary effect can only be fully realised if the measure is applied across the entire internal market.

In the EU, a market of highly integrated economies, there is a need for common strategic approaches and coordinated action, to improve the functioning of the internal market and maximise the positive impact of mitigating tax debt bias. This can only be achieved if legislation is prescribed centrally and transposed in a uniform fashion. In fact, similar measures being in place across the EU as regards tax treatment of debt and equity, location of business may be determined in an optimal way and competition can be enhanced, since all EU businesses will be enjoying the same treatment.

(c) What are the benefits in replacing different national policies and rules with a more homogenous policy approach?

Different national policies lead to mismatches across the single market that cross-border business can exploit to gain unintended tax benefits. One single policy could eliminate this risk. In addition, one single policy can support competition in the single market by ensuring that all EU business, regardless of location, enjoy similar treatment in tax terms.

In addition, a common policy approach will provide taxpayers with tax certainty, reduce compliance costs and close loopholes used for tax avoidance.

(d) Do the benefits of EU-level action outweigh the loss of competence of the Member States and the local and regional authorities (beyond the costs and benefits of acting at national, regional and local levels)?

The competence of Member States in tax matters is maintained as this proposal is complementary and contributes to the effectiveness of existing national and EU measures. While the EU action sets a uniform and coordinated approach to the deductibility of equity and debt financing costs, Member States remain free to design their own tax systems, as well as to determine the level of their corporate income tax rates.

(e) Will there be improved legal clarity for those having to implement the legislation?

The EU action will ensure that the measures are enacted according to the *acquis* and follow a common line across the Union. As such the EU Action can provide taxpayers with legal certainty that the new legal framework is compatible with the EU fundamental freedoms, including the freedom of establishment.

### 3. Proportionality: How the EU should act

#### 3.1 Does the explanatory memorandum (and any impact assessment) accompanying the Commission's proposal contain an adequate justification regarding the proportionality of the proposal and a statement allowing appraisal of the compliance of the proposal with the principle of proportionality?

Statement on proportionality to be included in the explanatory memorandum:

The envisaged measures do not go beyond ensuring the minimum necessary level of protection for the internal market. The Directive does not therefore prescribe full harmonization but only a specific tax measure to address a common EU-wide problem.

In particular, the Directive lays down a rule to provide, across the EU and for all EU taxpayers, for the deductibility of an allowance on equity financing costs complemented by a proportionate rule to limit the deductibility of interest on debt financing instruments. The Directive also ensures the sustainability of the measures for Member States' budgets by virtue of a general rule that limits the deductibility of financing costs from taxpayers' taxable base to a proportionate amount. By setting a common EU-wide framework, the Directive allows legal certainty across the single market and the reduction of compliance costs for taxpayers.

Thus, the Directive ensures only the essential degree of coordination within the Union for the purpose of materializing its aims. In this light, the proposal does not go beyond what is necessary to achieve its objectives and is therefore compliant with the principle of proportionality.

#### 3.2 Based on the answers to the questions below and information available from any impact assessment, the explanatory memorandum or other sources, is the proposed action an appropriate way to achieve the intended objectives?

The DEBRA proposal aims for a proportionate solution, as Member States remain free to determine their own tax systems, including tax residence rules and the level of their corporate income tax rates. The new rules will merely ensure that all Member States recognise the deductibility of financing costs in a balanced manner for both equity and debt and do so within specific limits in order to keep a neutral impact on their budgets.

- (a) Is the initiative limited to those aspects that Member States cannot achieve satisfactorily on their own, and where the Union can do better?

This initiative is limited to providing Member States with tools to address an issue that they



<p>cannot satisfactorily address on their own. Non-coordinated policies on the tax treatment of debt and equity financing costs create loopholes across the single market and hence tax abuse opportunities. They also entail risks to increase disproportionately budget costs for certain Member States over others. An aligned approach eliminates loopholes and mismatches and ensures proportionate distribution of costs across the EU.</p>
<p>(b) Is the form of Union action (choice of instrument) justified, as simple as possible, and coherent with the satisfactory achievement of, and ensuring compliance with the objectives pursued (e.g. choice between regulation, (framework) directive, recommendation, or alternative regulatory methods such as co-legislation, etc.)?</p>
<p>In order to ensure a consistent application of the rules within the EU and compatibility with EU law, the principal method for implementing the measures in the EU will be by way of binding law. A Directive can provide a common framework for implementing measures to tackle tax debt bias into Member States' national laws in a coordinated manner and adjusted for EU law requirements. Most importantly, this is the only legal instrument mentioned in the legal base of Article 115 TFEU, which is the base used for direct taxation.</p>
<p>(c) Does the Union action leave as much scope for national decision as possible while achieving satisfactorily the objectives set? (e.g. is it possible to limit the European action to minimum standards or use a less stringent policy instrument of approach?)</p>
<p>Yes, the proposal is limited to establishing a similar tax treatment of equity and debt financing costs, i.e. their proportionate deductibility. The EU action will be through a proposal for a directive, the adoption of which requires unanimity in the Council. In addition, the proposed rules do not impair Member States' tax sovereignty as Member States will remain free to determine the details of their corporate tax systems, including the rate.</p>
<p>(d) Does the initiative create financial or administrative cost for the Union, national governments, regional or local authorities, economic operators or citizens? Are these costs commensurate with the objective to be achieved?</p>
<p>The initiative will create some additional administrative costs for national tax authorities. These costs will be linked to implementing the initiative and complying with measures provided by the initiative, in particular to tackle any potential abuse. The initiative has the potential to create some limited short-term fiscal costs. In the long term, though, the additional growth potential is expected to overcompensate for these costs, by boosting competitiveness of the EU single market and ultimately potentially even contributing to Member States' tax revenues.</p> <p>There will also be some additional administrative costs for taxpayers. However, the taxpayers who operate cross-border will benefit from the minimizing the compliance costs that arise from fragmented legislation.</p>
<p>(e) While respecting the Union law, have special circumstances applying in individual Member States been taken into account?</p>

Not applicable.