Association Française des Trésoriers d'Entreprise

Paris, 27th July 2022

Response to the EU Debt equity bias reduction allowance - public consultation

The AFTE, representing 900+ non-financial companies with very diverse profiles, welcomes the amendments to the initial regulation proposed by the European Commission, notably the implementation of a harmonized notional interest deduction regime for the EU companies.

Nevertheless, the AFTE anticipates that, for the reasons, below the proposed directive may not result in increased equity funding by EU companies instead of debt.

First, the AFTE notes that the scope of the regulation is very broad and applies indifferently to most EU companies. Yet their profiles are very different with large companies primarily relying on the financial markets to finance their activities and small / medium / family-owned businesses (SMEs) for which debt is often the only reasonable option to finance their growth. As a result, the AFTE expects that the two measures provided by the Directive would be unfairly applied across EU companies depending on their profiles.

For many large companies, the proposed directive would only result in increased cost of debt. Indeed, the deductibility of interest would be limited to 85% for all taxpayers while the notional interest measure would generally not be applicable given the limitation related to "*the tax value of its participation in the capital of associated enterprises and the value of its own shares*" as well as the necessity to distribute dividends, which is a market requirement for shareholders and investors.

For SMEs, their size prevents them from accessing financing markets or private equity funding and as a result would still heavily rely on debt funding only to face increased cost[1]. The AFTE also notes that the implementation of such regime would be particularly burdensome for SME, whose resources are limited, notably the determination of excess interest and the notional interest as the case maybe.

Then, the AFTE considers that the notional interest rate insufficiently encourages EU companies to finance their development through equity instead of debt. This measure could be improved by applying a similar debt-equity tax treatment, notably considering:

- The application of a notional interest rate that would be more attractive for instance by incrementing the 10-year interest by a fair-market equity risk premium significantly higher than 1 or 1.5%.
- The assurance for companies to deduct notional interest during the full allowance period to provide certainty to EU companies, unless in case of tax avoidance purpose.

Finally, the AFTE warns about possible counterproductive collateral effects. Indeed, in a globalised capital market, the denial of the interest deduction or increased fiscal pressure as a matter of principle would be highly detrimental to the economic growth of EU businesses. The profitability of EU companies would decrease compared to its non-EU counterparts and would not be able to generate net income and accumulate retained earnings. This is even more important in the current economic context.

[1] In France, recent studies show that 95% of the companies being small companies, their room to increase their equity by additional contribution from their shareholders is very small or inexistent. The only way for those companies to improve their balance sheets is to generate net income and accumulate retained earnings.

46 rue d'Amsterdam • 75009 PARIS • Tél : 01 42 81 53 98 • afte@afte.com • www.afte.com • Association régie par la loi du 1er juillet 1901
Journal officiel du 17 novembre 1976 • TVA FR48 314 974 338 • SIRET 314 974 338 000 76 • code APE 9499Z

The AFTE considers that the lower profitability that would result from the directive would also negatively impact the EU's economic attractiveness compared to other territories. Investors currently operating in the EU could be encouraged to relocate part of their funding activities in non-EU countries.

Therefore, the AFTE bear the European Commission attention that this directive would be harmful to the competitiveness of its businesses without efficiently encouraging them to opt for equity instead of debt financing. If it still considers that the gap between debt and equity tax treatment must be narrowed, the implementation of a truly equivalent regime between debt interest and notional interest would be recommended.