Response to DEBRA Consultation

INREV

27 July 2022

INREV is the European Association for Investors in Non-Listed Real Estate Vehicles. We provide guidance, research and information related to the development and harmonisation of professional standards, reporting guidelines and corporate governance within the non-listed property funds industry across Europe, including the UK.

INREV currently has approximately 490 members. Our member base includes institutional investors from around the globe including pension funds, insurance companies and sovereign wealth funds, as well as investment banks, fund managers, fund of funds managers and advisors representing all facets of investing into non-listed real estate vehicles in the UK and the rest of Europe. Our fund manager members manage more than 500 non-listed real estate investment funds, as well as joint ventures, club deals and separate accounts for institutional investors.

General comment

INREV appreciates the European Commission's efforts to further neutralise the bias against equity financing and welcomes the carve out granted to financial undertakings and, in particular, through Article 2 (c) and (i) to Alternative Investment Fund Managers and Alternative Investment Funds either managed by an AIFM or supervised under the applicable national law.

Specific comments

Allowance on equity - Optionality

As the DEBRA proposal adds a new layer of complexity and compliance for companies, notably because of the potential application of the claw back rule described in article 4 (3) of the DEBRA proposal, INREV is of the opinion that the allowance on equity should be optional. Companies should be allowed to exercise this option at each increase in equity, and not once for all future equity increases.

Allowance on equity - interest rate

Article 4 (2) of the DEBRA proposal provides that *"[…] The allowance on equity shall be equal to the base of the allowance multiplied by the 10-year risk-free interest rate for the relevant currency and increased by a risk premium of 1% or, where the taxpayer is an SME, a risk premium of 1.5%."*

INREV is of the opinion that the suggested rates could, in practice, be low compared to the arm's length rates applied on debt fundings, and thus not likely to fully address the debt equity bias. INREV is thus of the opinion that the applicable rate should be defined according to the arm's length principle, in relation with the underlying assets held as supported by transfer pricing analysis or third parties financing analysis. Nevertheless, INREV is of the opinion that the suggested rates indicated in Article 4 (2) of the draft Directive proposal could be applied as a simplification measure, in the absence of such transfer pricing analysis and as the default rule.

Allowance on equity – base of the allowance – incorporation of new companies

Article 4 (2) of the DEBRA proposal provides that "*the base of the allowance on equity shall be calculated as the difference between the level of net equity at the end of the tax period and the level of net equity at the end of the previous tax period*". Examples provided in the Explanatory Memorandum to the

DEBRA proposal only refer to situations where an existing company increases its equity. INREV is of the opinion that the DEBRA proposal should also deal with the situation of a newly created company in order to confirm that it can benefit from the allowance on equity and in such case, the level of equity at the end of the previous tax period is equal to 0.

Allowance on equity – base of the allowance – liquidation of companies

Article 4 (2) of the DEBRA proposal provides that "*the base of the allowance on equity shall be calculated as the difference between the level of net equity at the end of the tax period and the level of net equity at the end of the previous tax period*". Article 4 (3) of the DEBRA proposal provides in addition that "*If, after having obtained an allowance on equity, the base of the allowance on equity is negative in a tax period, an amount equal to the negative allowance on equity shall become taxable*". INREV is of the opinion that the DEBRA proposal should clarify that the negative equity allowance applies only if the company survives. Thus, in case of liquidation, no negative allowance on equity is triggered at the time of the liquidation and transferred to the shareholders of the liquidated company no matter the period during which the liquidation occurs.

Allowance on equity – 10-year period – reorganisation of a group - neutrality

Article 4 (1) of the DEBRA proposal provides that the allowance on equity is granted for ten consecutive years. INREV is in the opinion that the wording 'reorganisation of a group' should be defined and the consequences of a reorganisation of a group should be clarified. In this respect, INREV is in the opinion that reorganisation of groups such as mergers, demergers, and transfers of seat, for example, should be neutral.

For that purpose, in case of a reorganisation characterised by the continuation of the legal personally of the "restructured company", the allowance on equity created at the level of the latter, before the reorganisation, should be transferred/continued at the level of the "continuing company". For example, in case of a merger (whether purely domestic or intra-EU), the allowance on equity obtained before the reorganisation by the absorbed company should be transferred by the latter to be continued by the absorbing company. The same should apply if a company migrates from one EU member state to another one: the available allowance should be continued at the level of the company in its new jurisdiction of residency.

In case of a liquidation, as there is no continuity of the legal personality of the liquidated company, the 10-year period should however be terminated and no allowance on equity should be transferred to the shareholder of the liquidated company.

Claw-back rules – statute of limitations

Based on article 4 (3) of the DEBRA proposal and its Explanatory Memorandum, if the allowance base of a taxpayer that has already benefitted from an allowance on equity under the rules of DEBRA, "*is negative in a given tax period (equity decrease), a proportionate amount will become taxable for 10 consecutive tax periods*". It is not clear whether the application of the claw-back rules is limited in the time.

INREV is in the opinion that after a certain reasonable period of time after a company has benefitted from the allowance on equity, an equity decrease should not trigger the claw-back rules anymore. Otherwise, there is no incentive for companies to use equity funding rather than debt funding because the allowance on equity is always at risk of being cancelled by a negative allowance on equity. This is particularly true if liquidations were to trigger a negative allowance on equity. Moreover, deductible interests are in principle not subject to such claw-back rules.

Anti-Abuse Rules – no autonomous interpretation

INREV is in the opinion that the anti-abuse rules under DEBRA are superfluous. A GAAR already exists under ATAD, thus if equity contributions were made only to benefit from a tax advantage, the granting of such benefit could already be challenged. INREV is in the opinion that an additional provision should not result in an autonomous interpretation of what an abuse is, just for DEBRA purposes, but should rather refer to existing anti-abuse legislation.

Anti-Abuse Rules – clarification needed

Article 5 (1), a. of the DEBRA proposal provides that appropriate measures should be taken to ensure that the base of the allowance on equity does not include the amount of any increase which is the result of granting loans between associated enterprises.

The example provided under point 5 of the Explanatory Memorandum of the DEBRA proposal indicates that the above-mentioned anti-abuse measure would *“[…] exclude from the base of the allowance equity increases that originate from (i) intra-group loans, (ii) intra-group transfers of participations or existing business activities and (iii) cash contributions under certain conditions. Thus, for example, as regards intra-group loans, the measure should prevent that an equity injection granted to company A located in Member State A is used to grant a loan to a related company B located in Member State B. This is because in such case, company B would also use this money to inject equity in another related company C, located in Member State C. This would lead to multiplying the allowance on equity with only one genuine equity increase at group level.”*

Considering the objective of this measure that is to avoid multiplying the allowance on equity, it would be important to understand how this rule would apply where an investor that injects equity is an investment fund that provides funding (in the form of equity and loans) to a holding entity held by the fund and that amount is subsequently lent by the holding entity to one or several subsidiaries or injected as equity in those subsidiaries.

Allowance on equity - Participation exemption rule

INREV is in the opinion that the allowance on equity (i.e. the notional deduction) under the DEBRA proposal should not fall in the scope of the anti-hybrid rule set forth by Article 4(1), point (a) of Directive 2011/96/EU (the Parent Subsidiary Directive) introduced by Council Directive 2014/86/EU of 8 July 2014 amending the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States. As a result, it should be clarified that the exemption on dividend received is not denied because the paying entity has benefited from a notional deduction. Similarly, a notional deduction under the DEBRA proposal should not trigger a hybrid payment subject to anti-hybrid mismatches rules under ATAD 2.

Interest deduction limitation - Principle

Real estate investments tend to be sensitive to any changes to deductibility of interest as debt is used extensively for commercial reasons. For the low-risk lower yielding "core" properties favoured by pension fund investors, even minor changes to the deductibility of interest can have significant effect on the returns to investors, and correspondingly, on the pricing of assets.

INREV is in the opinion that the additional tax measures on interest deductibility under DEBRA are superfluous because various rules having an impact on interest deduction rights (i.e. ATAD 1 and ATAD 2) have already been implemented and the new "DEBRA limitation" will just lead to increased complexity of tax rules, not only for EU enterprises but notably also for EU tax administrations.

INREV understands that the new additional limitation to interest deduction should apply independently of the allowance on equity, and thus should impact all companies in the scope of the DEBRA proposal whether they benefit from an allowance on equity or not. Since the definition of financial undertakings under ATAD is not the same as the one under the Proposal (the Proposal excludes more entities than ATAD does), some undertakings (e.g. Securitisation special purpose entities within the meaning of EU Regulation No 2017/2402) will only be subject to the interest limitation rules of ATAD and not to the ones of the DEBRA proposal. INREV is in the opinion that this adds even more unnecessary and unjustified complexity.

Interest deduction limitation – exceeding borrowing costs and exclusions

According to article 6 (1) of the DEBRA proposal, "*Member States shall ensure that a taxpayer is able to deduct from its taxable base for corporate income tax purposes exceeding borrowing costs as defined in Article 1, point (2)*" of ATAD. Under such definition "*'exceeding borrowing costs' means the amount by which the deductible borrowing costs of a taxpayer exceed taxable interest revenues and other economically equivalent taxable revenues that the taxpayer receives according to national law*".

However, the DEBRA proposal does not provide for a safe harbour rule, a grandfathering clause and an exclusion for loans used to fund long-term public infrastructure projects like the ones provided by the interest deduction limitation rules under ATAD. As a result, the difference between the total amount deductible according to the DEBRA proposal and the one deductible according to ATAD could be of significant importance because some exceeding borrowing costs that are fully deductible under ATAD will be subject to the DEBRA limitation of 85%. As there is no justification for such discrepancy, INREV is of the opinion that a safe harbour rule, a grandfathering clause and an exclusion for loans used to fund long-term public infrastructure projects should be included in the DEBRA proposal.

Exchange of information

Article 6 of the DEBRA proposal provides for a list of information to be communicated by the tax authorities of member states to the Commission "*within 3 months from the end of every tax period*". INREV believes that, in practice, this may be complicated for member states in which annual accounts and income tax returns have longer filing and /or publication deadlines, e.g., 6 months, as from the end of a financial year. It would be important to clarify which period the information to be communicated

within 3 months should refer to or extend this 3-month period as from the end of the tax period if the information to be communicated refers to the end of that same tax period.

Definitions

INREV is in the opinion that for the sake of clarity and to ensure legal certainty, the meaning of certain expressions should be defined or the way they should be interpreted clarified:

- 'Significant influence': The DEBRA proposal does not define this term. It should be clarified that it must be interpreted in accordance with the case law of the EU Court of Justice[1].
- 'Acts together': The DEBRA proposal does not define this term. The recitals of the DEBRA proposal should clarify that it must be interpreted by reference to the definition provided in BEPS Action 2[2].

We are grateful in advance for your attention and remain at your disposal for any additional information or any assistance you may wish to receive.

[1] ECJ EU 13 April 2000, C-251/98, ECLI:EU:C:2000:205, section 22 and 26 and ECJ EU 23 October 2007, C-112/05, ECLI:EU:C:2007:623, section 13.
[2] BEPS Action 2 Final Report, recommendation 11.2 and 11.3. See also BEPS Action 2 Final Report, page 117-118.