BUNDESVERBAND DEUTSCHER LEASING-UNTERNEHMEN 50 JAHRE

**Comment Letter from the Federal Association of German Leasing Companies**

**on the European Commission's proposal for a Council Directive**

**on laying down rules on a debt-equity bias reduction allowance and on limiting the deductibility of interest for corporate income tax purposes (COM(2022) 216 final)**

Berlin, 12 July 2022

## *1. Introduction*

As Bundesverband Deutscher Leasing-Unternehmen e. V. (BDL) we represent the interests of the German leasing industry. Leasing companies invest more than €70 billion annually in vehicles, machinery, IT equipment, real estate and other durable real assets for their mostly small and medium-sized customers. With regard to movable assets, more than a quarter of total domestic equipment spending in Germany is realized through leasing. More than one half of all externally financed investments are handled through leasing. Leasing thus makes a significant contribution to the aggregate supply of investment goods in Germany.

The present European Commission's proposal for a directive concerns fundamental tax framework conditions for financing. As leasing is serving as a link at the interface between the real economy and the financial economy, the proposal is of central importance for our industry in two respects: On the one hand, we are interested in ensuring fair tax treatment of leasing as a financing alternative itself, so that its economic advantages are not impaired by potentially detrimental tax effects. On the other hand, leasing companies themselves have considerable funding needs for the realization of their customer investments, which are covered by a risk-adequate mix of equity and debt capital. Hence, there is a vital interest in an appropriate taxation of *both* financing categories, equity *and* debt.

Having said this, we comment on the draft directive as follows:

## *2. Acknowledge and preserve the diversity of financing instruments*

The forms of financing and financing alternatives vary broadly today and their range reaches far beyond classic equity or debt financing. Even the classification of the different types as "financing" does not always succeed unambiguously, and this holds even more for the attribution to the categories "equity" or "debt". In addition to leasing, this also becomes apparent, for instance, in factoring, in the granting of subordinated loans and other mezzanine financing or in the programmes offered by development banks.

As BDL, we are utterly convinced that this diversity of financing instruments is favourable and leads to considerable benefits for the economy as a whole. It corresponds to the diversity of capital-seeking companies and their activities, facilitates their access to financing and puts it on a broader basis. It also increases the resilience of the financial system as a whole and lowers the cost of capital. Ultimately, everyone benefits from the broad availability of complementary financing alternatives, which enables a financing mix tailored to individual needs.

Against this background, we believe that the different forms of financing must not be played off against each other. We expressly oppose the distinction between "good" equity financing and "bad" debt financing as insinuated in the proposal. We also see no evidence of a structurally excessive debt ratio, at least not for Germany. Nor, in our view, is it possible to give a uniform answer to the question of a single appropriate target ratio of equity and debt financing to be aimed at for all companies in a Member State or the European Union. This is because it should be possible to adapt the composition of the financing mix individually to the needs and business activities of the companies under consideration – in particular with regard to their risk content.

Given this, it is first and foremost the diversity of financing instruments that deserves the Commission's particular appreciation and should be preserved and promoted in its full range.

### 3. *Preserve the integrity of national tax systems*

Of course, we acknowledge the principle of neutrality of taxation. Companies and capital providers should choose a financing structure according to the economic needs of their respective business activities, remaining largely uninfluenced by purely tax-motivated considerations. In reality, a certain tax influence on the capital structure can be empirically observed, but its magnitude is limited (see *Wissenschaftlicher Beirat beim Bundesministerium der Finanzen*, Finanzierungsneutrale Unternehmensbesteuerung in der Europäischen Union? Stellungnahme zum Richtlinienvorschlag der EU-Kommission vom Oktober 2016, internet version as of 16/11/2017, p. 4, with further references).

The way in which tax incentives affect the choice of financing structure is extremely complex and depends on numerous factors in the respective tax system. In Germany, for example, the different tax treatment of corporations versus partnerships and sole proprietorships, the trade tax and the flat-rate withholding tax on interest income all play a role. In other Member States, other factors are likely to be decisive. We therefore share the assessment of the *Wissenschaftlicher Beirat beim Bundesministerium der Finanzen* that financing neutrality of taxation should, if necessary, be ensured by *national* measures rather than by a harmonising intervention in the tax bases at European level (see *loc. cit.*, p. 6 f.).

We also agree with the criticism of the *Wissenschaftlicher Beirat beim Bundesministerium der Finanzen* that measures such as a deduction of notional interest on equity would imply a far-reaching intervention in the national income tax systems of the Member States, which would violate the existing distribution of powers between the European Union and the Member States in the area of direct taxation (see *loc. cit.*, p. 8).

In view of the significant structural differences in the Member States' economies and the interdependencies between national tax systems and the respective non-tax legal systems, the principle of exclusive competence of Member States for income taxation should be fully maintained.

### 4. *Reconsider the criticised directive proposal fundamentally*

For the above reasons, we principally reject a pretended "one-size-fits-all" regime as would be imposed by a harmonised European directive. As outlined below, the proposal also raises significant content-related concerns and should therefore be fundamentally reconsidered.

### *4.1 Regulation contradicts results of public consultation*

First of all, it should be noted that the proposed regulatory approach of combining an allowance on incremental equity with a limitation to interest deduction was not subject to the public consultation carried out by the European Commission. In fact, it is diametrically opposed to the results of this consultation: Respondents preferred precisely those options that involved maintaining the existing interest deductibility unreduced. In contrast, respondents overwhelmingly rejected variants that provided for a restriction of interest deductibility. The fact that the present proposal now provides for a limitation of interest deduction to 85% cannot be reconciled with this clear result.

### *4.2 Inadequate stipulation of scope*

The scope of the proposed regulation comprises companies that are subject to corporate income tax in the European Union. In Germany, partnerships and sole proprietorships would therefore be excluded. Depending on their individual financial circumstances, they can be either significantly favoured or significantly disadvantaged by this fact, with no recognisable rationale for this unequal treatment.

Financial undertakings are excluded from the scope of application for understandable reasons. However, the catalogue of exempt financial undertakings in Article 2 is incomplete because it does not cover, for example, certain leasing companies depending on their regulatory status. The latter face similar conditions with regard to their financing situation as, for example, credit institutions, so that the same standards would have to apply regarding the applicability of the proposed regulation. This is all the more true as, from an economic point of view, the effective equity base of leasing companies would be systematically underestimated by the equity definition of the proposed directive. This would lead to a structural disadvantage for leasing companies, because the negative effects of a limitation of interest deduction on debt would not be compensated by adequate advantages from equity allowance.

### *4.3 Undue complexity of the equity allowance rule*

While the participants in the consultation had favoured equity relief based on total equity, the Commission is now proposing an incremental regime, whereby only additional equity is recognised and benefited for a limited period of 10 years. Equity reductions have to be deducted accordingly. At the same time, the deductibility of the allowance on equity is limited to a maximum of 30% of the taxpayer’s EBITDA.

The mechanism of incremental calculation with limitations in terms of duration and amounts, combined with the provision of different carry-forward periods for exceeding parts of the allowance and for unused allowance capacities, leads to an overly complicated and highly administration-intensive regulation. Moreover, the Commission apparently deems a lengthy catalogue of anti-abuse measures to be necessary, which also adds to complexity.

### *4.4 Counterproductive limitation to interest deduction*

The most critical point of the proposed regulation is the general limitation on interest deduction to 85%. It violates elementary principles of income taxation such as the net principle and the ability-to-pay principle. As a result, companies could be required to pay tax even though they do not make any profit. The consequence would be an erosion of the company's substance and a weakening of the equity base – the exact opposite of what the Commission is aiming for. We share the analysis from the then Impact Assessment on CCCTB: *"[T]he non-deductibility of interest leads to a negative effect on GDP, driven by depressed investment."* (*Commission Staff Working Document, Impact Assessment*, SWD(2016) 341 final, p. 50). Even if the non-deductibility concerns only parts of the interest expense, the fundamental tendency of this measure to be detrimental to investment still prevails.

## 5. Conclusion

In summary, we believe that the directive proposal in this form does not contribute to an improvement of the tax framework conditions for financing in Europe and should therefore be reconsidered fundamentally. The potential benefits of equity relief are clearly predominated by the unnecessarily complicated calculation of the allowance amounts and, first and foremost, by the general limitation of debt interest deductions. In our view, maintaining unrestricted tax deductibility of debt financing costs is of utmost importance to avoid substance taxation that would deplete equity in the event of a loss. If measures to relieve the burden on equity financing appear necessary, they should be regulated at the level of the member states in accordance with the existing distribution of powers in order to allow for individual national circumstances.

**Contact:**

**Bundesverband Deutscher Leasing-Unternehmen e. V.**

Dr. Martin Vosseler
Geschäftsführer/Managing Director
Markgrafenstraße 19
D-10969 Berlin
Phone: +49 30 20 63 37 0
Mail: vosseler@leasingverband.de
German Lobbyregister: R01688

**Federal Association of German Leasing Companies**
Representation Brussels
Anja Patricia Gruhn
Ständige Vertreterin/Permanent Representative
Avenue des Arts 19 A-D
B-1000 Brussels
Phone: +32 2 20 39 29 0
Mail: anja.gruhn@leasingverband.de
EU Transparency Register: 84917875724-73