DG TAXUD
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SUBJECT:

Call for evidence: Anti-Tax Avoidance Directive (ATAD I)

The European Public Real Estate Association (EPRA) is the voice of Europe's listed real estate companies and with more than 290 members (companies, investors, and their suppliers), EPRA represents over 840 billion EUR of real estate assets (European companies only) and 95% of the market capitalisation of the FTSE EPRA Nareit Europe Index.

KEY HIGHLIGHTS AND RECOMMENDATIONS

EPRA underscores the importance of considering the unique characteristics and specificities of the EU real estate market by:

- Preserving the tailored approaches of Member States to accommodate the **unique characteristics of their Real Estate Investment Trust (REIT) regime** with regards to ATAD I;
- **Avoiding asymmetrical tax treatment** for legitimate third-party financing;
- Ensuring **consistent application** of the de minimis threshold and EBITDA cap across the EU;
- Enabling periodic reviews of the de minimis threshold and EBITDA cap to **reflect changes in interest rates and economic conditions**;
- Introducing additional targeted exclusions, similar to the infrastructure project exclusion under Article 4, to **support housing shortages and renovation needs.**

BACKGROUND

EPRA is pleased to provide feedback on the Anti-Tax Avoidance Directive (ATAD I), recognising the importance of evaluating the Directive in light of recent tax developments to avoid discrepancies, while also aligning with the new Commission mandate's focus on competitiveness.

ATAD I notably imposes a cap on the deductibility of interest expenses, featuring both a de minimis threshold and an EBITDA cap. This is intended to prevent aggressive tax planning strategies where companies might excessively leverage themselves to reduce their taxable income. While this objective is laudable, it creates unintended consequences when applied to **legitimate third-party financing**.

Indeed, as is commonly occurring in our sector, in cases of legitimate borrowing for large infrastructure or real estate developments, where loans are secured from independent third-party lenders (such as banks), the interest paid on such debt does not constitute a tax avoidance scheme. In these transactions, the lender is fully taxed on the interest income, ensuring that the tax obligations on the interest payments are fulfilled by the recipient.

On the other hand, borrowers face restrictions on the deductibility of these interest payments, leading to an **asymmetry in tax treatment**. The actual thresholds are generally too low to allow a full deduction of interest for large commercial properties, negatively impacting their attractiveness and reducing private capital flow across the EU.

In responding to this call for evidence, EPRA aims to inform the debate on:

- The specific implications of ATAD I on Real Estate Investment Trusts (REITs) regimes;
- The broader impact of ATAD I rules on the real estate industry as a whole.

REIT REGIME CONCEPT IN EUROPE

REITs are guardians of our cities' high-quality assets, covering all types of real estate assets, from offices to retail, and increasingly healthcare and retirement facilities. They help communities grow, thrive, and revitalise, while also providing an investment opportunity that makes it possible for everyday citizens as well as large institutional investors to benefit from valuable real estate, dividend-based income, and total returns. As societies in Europe are facing challenges to provide for their rapidly ageing populations, REITs play a crucial part in providing retirement security to millions of people, by offering long-term investors like pension funds and insurers stable and highly competitive assets to invest in. Furthermore, they are significant contributors to GDP and society as they represent hundreds of thousands of jobs on our continent. Currently established in 13 EU Member States, the introduction of REIT legislation by national governments has always been seen as an opportunity to attract new sources of capital into the local real estate market in a more open, transparent, liquid, and advantageous form of investment.

A Real Estate Investment Trust (REIT) is defined as *''a widely held company, trust or contractual or fiduciary arrangement that derives its income primarily from long-term investment in immovable property (real estate}, distributes most of that income annually and does not pay income tax on income related to immovable property that is so distributed.''* [1]

The fact that the REIT vehicle is not required to pay tax on that income is the result of tax rules that provide for a **single level of taxation in the hands of the investors in the REIT** (with corresponding withholding tax obligations imposed on the REIT with respect to its distributions to foreign investors).

Despite these common features, there may be differences between countries regarding how REITs are structured and how tax exemptions for income are provided. In some countries, REITs were developed using the tax rules generally applicable to trusts and companies; in others, a specific REIT tax regime has been adopted.

The specific tax mechanisms that ensure REITs are tax-exempt can vary from country to country and can include, for example, rules that allow the deduction of REIT dividends or distributions; tax exemption of only the part of the REIT's income distributed within a specific period; tax exemption of a REIT that meets certain conditions or rules that allocate income to investors rather than to the REIT itself. In addition, REITs are increasingly investing across borders, including in jurisdictions that do not recognise a REIT status, resulting in full tax liability there. The structural nuances and tax exemptions associated with REITs vary significantly across different jurisdictions.

This is why, when implementing ATAD I, Member States tailored their approach to accommodate the unique specifics of their REIT regime, **ensuring practical and workable outcomes**. These outcomes must be fully preserved, with thorough impact assessments conducted to avoid disrupting the delicate equilibrium that Member States have achieved in addressing their national specificities.

[1] OECD's definition of a REIT used for the purpose of the OECD Model Tax Convention.

COMPETITIVENESS OF THE EU REAL ESTATE MARKET

Beyond the REIT sector and the tailored measures noted above, EPRA wishes to draw attention to the broader challenges the real estate industry is facing under the current regulatory framework.

Third-party financing and interest deductions

Ensuring fair taxation and treatment is essential to maintaining stability within the EU real estate market. However, caps on interest deductions under ATAD I can significantly limit the amount of interest that can be deducted, leading to **asymmetrical tax treatment.**

The concept of asymmetrical treatment in the context of ATAD I refers to the differing tax treatment of interest income and interest expenses between lenders (such as banks) and borrowers. This asymmetry arises because the Directive restricts the ability of borrowers to deduct interest expenses, while lenders are fully taxed on the interest income they receive.

Lenders, such as banks or other financial institutions, provide loans to borrowers and receive interest payments in return. For these lenders, interest income is a form of taxable income. Therefore, they pay tax on the entire amount of interest they receive without any limitation. This means that the government collects tax revenue on the interest income in full.

Borrowers, on the other hand, face a restriction on the amount of interest they can deduct. The de minimis threshold or 30% EBITDA cap means that even if they pay more interest than these caps allow, they cannot deduct the excess, leading to a higher taxable income and, consequently, a higher tax burden.

This asymmetry is problematic, as it penalises genuine economic activity – where borrowing is a legitimate and necessary part of funding large-scale developments. Large infrastructure and real estate projects often require significant amounts of debt, due to their capital-intensive nature. The inability to deduct the full amount of interest paid on these loans leads to over-taxation of the borrower, despite there being no avoidance of taxation on the interest income at the lender's end.

Thus, while ATAD I effectively addresses tax avoidance in aggressive tax planning schemes, it unintentionally **affects legitimate third-party financing.**

Ensuring tax regulatory certainty

The way Member States have implemented the Directive, along with subsequent modifications, has raised concerns within the industry. Constant adjustments and regulatory uncertainty regarding EBITDA rules and the de minimis threshold can discourage long-term investors and risk **undermining the competitiveness of the EU and individual countries**, especially at a time when capital investment is urgently needed.

In addition, smaller entities within the real estate industry find the EBITDA rules overly complex and prefer to rely on the de minimis threshold. However, when implementing the Directive, some countries have set significantly lower thresholds, putting these entities at a disadvantage.

Therefore, EPRA believes there is value in **enhancing the current framework** to ensure that the de minimis threshold of €3 million and the 30% EBITDA is not lowered.

Interest rates and economic conditions

For much of the past decade, the EU experienced relatively stable interest rates, with little fluctuation as inflation remained consistently low. However, recent developments have marked a significant shift. Rising inflation, driven by various factors, has increased interest rates to combat inflationary pressures. This shift is currently not reflected in ATAD I. The Directive's failure to acknowledge these changes risks placing additional pressure on industries like real estate, which are particularly sensitive to borrowing costs and inflation dynamics.

To address these challenges, policymakers should include a provision in the Directive that allows for the timely re-evaluation of the existing thresholds for tax deductibility of interest during periods of **high interest rates and challenging economic conditions**. This would ensure better alignment with shifting economic realities and help safeguard the real estate sector's competitiveness while maintaining the necessary flow of capital investment.

Broadening interest deduction exclusion limits

In addition to the exclusion under Article 4, paragraph 4 regarding infrastructure projects, EPRA sees merit in having the Directive address the pressing challenges Europe faces concerning renovation needs and housing shortages.

Therefore, without prejudice to other exclusions adopted by Member States that must be fully preserved, we believe that extending the exclusion from the limitations on interest deductions for **borrowing costs incurred to address housing shortages and renovation needs** across the EU would play a pivotal role in tackling these urgent challenges.

DIALOGUE WITH THE ENTIRE REAL ESTATE ECOSYSTEM

When considering potential legislative changes and their impact on the EU real estate market, EPRA strongly encourages policymakers to engage with our association. Indeed, given the crucial role of real estate investments in generating returns that help fulfil the obligations of pension funds and insurance companies, any adjustments to existing legislation should be approached with caution and careful consideration.

EPRA is also part of a broad real estate coalition encompassing investors and managers, companies, developers, and professionals, whether listed or non-listed, bank and non-bank lenders, and the service providers that support the industry, on a national, European, and international level.

Collaborating with us will ensure that any policy changes are informed by the insights and expertise of the **entire real estate ecosystem.**

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We remain entirely at your disposal to discuss these issues in greater detail. Should you need any other information, we are at your disposal: publicaffairs@epra.com

About EPRA

The European Public Real Estate Association (EPRA) is the voice of Europe's listed real estate companies, investors, and their suppliers. EPRA achieves this through providing better information to investors and stakeholders, active involvement in the public and political debate, promotion of best practices, and the cohesion and strengthening of the industry. With more than 290 members (companies, investors, and their suppliers), EPRA represents over 840 billion EUR of real estate assets (European companies only) and 95% of the market capitalisation of the FTSE EPRA Nareit Europe Index. Find out more about our activities on www.epra.com.

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