The 100 Group

Taxation Committee

By email: BEPSinterestconsultation@hmtreasury.gsi.gov.uk

14 January 2016

Dear Mr Gauke

Consultation: tax deductibility of corporate interest expense

We welcome the opportunity to comment on HMT's consultation document on 'tax deductibility of corporate interest expense'.

Who we are

The 100 Group of Finance Directors represents the views of the finance directors of FTSE 100 and several large UK private companies. Our member companies represent around 90% of the market capitalisation of the UK FTSE 100 Index, and in 2015 paid, or generated, taxes equivalent to 14% of total UK Government receipts. Our aim is to contribute positively to the development of UK and international policy and practice on matters that affect our businesses, including taxation, financial reporting, corporate governance and capital market regulation. Whilst this letter expresses the views of The 100 Group of Finance Directors as a whole, those views are not necessarily those of our individual members or their respective employers.

Our views

We have responded to the detailed questions in the consultation in the attached pages, however below are our key points that we think could impact the Government's strategy to encourage greater investment in the UK, and to support productivity and growth:

- UK companies could be competitively disadvantaged internationally if there is a significant timing difference between a relatively early UK adoption of the rules and a relatively late (if at all) adoption by other countries;
- We believe that the WWDC principles should be sustained, and the adoption of OECD recommendations into the UK interest deductibility regime should be carried out with the objectives of simplicity (i.e. the removal of redundant or duplicative measures) and practical application.
- Taking into account the preservation of WWDC limitations, and the UK's broad range of more specifically targeted protections, we consider that the adoption of a 30% fixed ratio cap would be appropriate.
- Using accounting EBITDA rather than the more complex, and currently undefined, Tax EBITDA for the purpose of calculating the amount of deductible interest. This should lead to a more consistent definition and application from jurisdiction-to-jurisdiction and will also avoid potential distortions caused by differences between tax and accounting EBITDA.

We would be very happy to discuss our submission with you in more detail. Please do get in touch if you wish to discuss this further with me and the Committee.

Yours sincerely

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Chairman, Taxation Committee

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Response to Questions

1. What are your views on when a general interest restriction should be introduced in the UK?

The appropriate timing of introducing a general interest restriction largely depends on the extent and complexity of the rules introduced. If a minimal approach of modifying existing WWDC provisions is adopted then we see no obstacle to provisions coming into effect from 1 April 2017. If a more complex approach is adopted then UK companies will require more time to adjust to the new provisions.

Also, UK companies could be competitively disadvantaged internationally if there is a significant timing difference between a relatively early UK adoption and a relatively late (if at all) adoption by other countries. Therefore it seems appropriate to only introduce new legislation (i.e. a more complex approach) once the international environment has become clearer.

2. Should an interest restriction only apply to multinational groups or should it also be applied to domestic groups and stand-alone companies?

An interest restriction should apply to both domestic and multinational groups equally to avoid inappropriate competitive distortion/discrimination. In order to remove complexity and reduce compliance burden, any interest restriction should apply at a whole UK group level and not entity by entity.

We believe the mechanism operated by WWDC could be used as a basis for development.

3. Are there any others amounts which should be included or excluded in the definition of interest?

We believe a CFC financing income apportionment should be included in the definition of interest for calculating the net interest expense. This is on the basis that, had the loan been made direct from the UK (rather than via the CFC), any interest income received on the UK loan would have been included in the net interest calculation.

It would be problematic to include foreign exchange gains or losses in practice and does not appear to be linked to the policy objective of countering BEPS. Therefore, we do not believe that foreign exchange gains or losses should be included in the definition of interest, unless it reflects the economics (e.g. the cost to a business post swapping a debt into another currency).

We believe the classification criteria already established in designing the WWDC rules are appropriate and should continue to be followed.

4. How could the rules identify the foreign exchange gains and losses to be included?

See response to question 3 above.

5. If the rules operate at the UK sub-group level, how should any restriction be allocated to individual companies?

We believe groups should retain the right to allocate any disallowance(s) to whichever group company(/-ies) they choose, any attempt to force a mechanism is likely to increase the compliance burden for companies. Therefore, the mechanisms already established in the WWDC rules are appropriate and should continue to be followed.

6. Are there items which should be excluded from both the definition of interest and from "tax EBITDA", as referred to in the section on a fixed ratio rule?

We strongly recommend the use of accounting EBITDA rather than the more complex Tax EBITDA for the purpose of calculating the amount of deductible interest. This should lead to a more consistent definition and application from jurisdiction-to-jurisdiction and will also avoid potential distortions caused by differences between tax and accounting EBITDA.

Potential distortions to Tax EBITDA and therefore the level of interest expense restriction raises potential issues of a level playing field between "old" and "new" businesses, and between businesses which are employee intensive and those that are not. Distortions may arise through large pension obligations related to former employees, share option exercises, R&D allowances and other one-off underlying items made for accounting purposes. Given that debt and interest levels will tend not be proportionately distorted it does not seem appropriate that such items should give rise to a deferral of interest relief, at best, or no relief at all, at worst.

If, in contrary to our proposal Tax EBITDA is used for the purpose of calculating the amount of deductible interest we believe the precise meaning of 'Tax EBITDA' needs to be clearly stated, given that it is an entirely new concept. Paragraph 6.4 of the consultation document defines 'Tax EBITDA' simply as "a group's taxable earnings before interest, depreciation and amortisation....in the UK, depreciation would refer to capital allowances". We believe the most straightforward way to calculate tax EDITBA is to start with PCTCT (before any general restriction of interest under these proposals) and remove any expensed foreign tax relief, any amounts of interest and foreign exchange, and any amounts included as deductible amortisation and capital allowances. This should be followed by a list of a list of specified adjustments to avoid potential distortions caused by differences between tax and accounting EBITDA. These are all numbers which should be readily available as part of the preparation of tax computations and aims to make the calculation more straightforward than tax adjusting a number that is not a GAAP measure and consequently not identified in statutory accounts

We are also likely to have a new accounting standard under which property leases will be treated as finance leases. The impact of this would also need to be carefully factored in given that finance lease interest is intended to be included in the definition of interest

7. What do you consider would be an appropriate percentage for a fixed ratio rule within the proposed corridor of 10% to 30% bearing in mind the recommended linkages to some of the optional rules described below?

Taking into account the government objectives of providing a supportive environment for business, the preservation of WWDC limitations, and the UK's broad range of more specifically targeted protections, we consider that the adoption of a 30% fixed ratio cap would be appropriate.

Currently, in the UK, interest rates are at an all-time low and therefore we recommend that any fixed ratio is monitored. This should be reviewed whenever there is a significant change in the interest rate environment, or at the very least it could be included in Action 11 (Monitoring) so it is reviewed every five years.

8. What are your views on including in any new rules an option for businesses to use a group ratio rule in addition to a fixed ratio rule?

A group ratio rule in addition to the fixed ratio rule is important to ensure that certain industries or groups with unique capital structures or requirements are not unduly discouraged from investing into the UK, for example, infrastructure projects which typically require higher levels of debt over a longer period of time.

We do not believe that including a group ratio rule should be viewed as allowing scope for the fixed ratio limit to be set at a lower level. A group ratio is likely to be more complex for a multinational group to assess, and therefore taxpayers should only be required to make that assessment in a limited number of cases, i.e. for those industries where there is a structurally higher level of debt to EBITDA. For other businesses the simpler compliance approach of testing net interest expense against the 30% fixed ratio should be sufficient.

9. What form of de minimis threshold would be most effective at minimising the compliance burden without introducing discrimination or undermining the effectiveness of any rules?

We believe that a de minimis approach using an absolute figure, with any appropriate antifragmentation protection, is most appropriate.

10. What level should the de minimis threshold be set at, balancing fairness, BEPS risks and compliance burdens?

We see this as a matter which the Treasury is likely to be best placed to determine using statistical data available. We believe that the objective should be to provide some administrative relief and support for small businesses. If it is possible to tailor de minimis or other reliefs for genuine start-up circumstances then that also seems to us to be appropriate as a policy matter. We do not believe that it is appropriate to design relief so that it extends to medium sized businesses - which by their nature should be more firmly established - as that may generate less justifiable competitive distortions.

11. Should SMEs as defined by the EU criteria be exempted from the rules, in addition or as an alternative to a de minimis threshold?

We have no comments.

12) What is the best way of ensuring that the rules remain effective and proportionate even when earnings are volatile?

It would seem inequitable for a group to have several years where no interest deduction was permitted (due to negative EBITDA) to then only take deductions for a percentage of EBITDA in the first year it then makes profits.

We believe that carry-forward/ carry-back provisions in respect of disallowed interest provide suitable protection against earnings volatility.

We note the hesitation in the Consultation Document, and OECD Action 4 document, concerning the possibility of tax-motivated trades in excess capacity companies. We consider that that is unlikely to be a material problem for limited capacity carry-forwards as suggested (and, if necessary, avoidance can be targeted by legislation) but some form of capacity carry-forward is important if issues associated with volatility are to be properly addressed.

13. In what situations would businesses choose to use the PBP exclusion? How would this differ if no group ratio rule was implemented?

We support the inclusion of the PBP exclusion and believe this should be appropriately targeted. We also encourage that consideration is given to all industries that may be effected or otherwise competitively disadvantaged (e.g. Builders, and Utilities).

Any specific issues regarding the PBP exclusion are best dealt with by those businesses directly impacted.

14. Do you have any suggestions regarding the design of a PBP exclusion, taking account of the OECD recommendations?

See response to question 13 above.

15. Do you have any views on the specific risks that might sensibly be dealt with through targeted rules?

We believe that the existing targeted rules within the UK legislation provide sufficient protection to the UK tax base against excessive and tax-driven interest deductions.

16. Do you have any suggestions as to how to address BEPS issues involving interest raised by the banking and insurance sectors?

We understand that HMRC and the OECD recognise that EBITDA is not an appropriate measure for banking and insurance entities and suggest that the UK response to this initiative BEPS 4 should exclude banks and insurance.

17. What are the types of arrangement for which transitional rules would be particularly necessary to prevent any rules having unfair or unintended consequences, and what scope would these rules need to be effective?

We support transitional rules to prevent any unfair outcomes or unintended consequences. We envisage that for most companies it should be possible to avoid such outcomes and consequences by having sufficiently broad carry forward I carry back provisions as described in our response to question 12.

18. To what extent do you believe that the new general interest restriction rule should replace existing rules?

In order to encourage greater investment in the UK, and to support productivity and growth we believe that the WWDC principles should be sustained. The adoption of OECD recommendations into the UK interest deductibility regime should be carried out with the objectives of simplicity (i.e. the removal of redundant or duplicative measures) and practical application.