CBI and 100 Group RESPONSE TO THE OECD DISCUSSION DRAFT ON BEPS ACTION 2: NEUTRALISE THE EFFECTS OF HYBRID MISMATCH ARRANGEMENTS

1. The CBI and 100 Group are pleased to comment on the OECD's discussion draft on Action 2: neutralise the effects of hybrid mismatch arrangements, published on 19 March 2014.
2. As the UK's leading business organisation, the CBI speaks for some 190,000 businesses that together employ around a third of the private sector workforce, covering the full spectrum of business interests both by sector and by size.
3. The 100 Group represents the views of the finance directors of FTSE 100 and several large UK private companies. Our member companies represent almost 90% of the market capitalisation of the FTSE 100 group collectively employing over 7% of the UK workforce.

General comments

4. We support the comments issued through BIAC's response to the OECD discussion draft on BEPS action 2 dated 30 April 2014, however we wanted to take the opportunity to outline a number of supplementary comments that concern our joint memberships.
5. We commend the work of the OECD in producing a detailed and comprehensive discussion document, which clearly outlines the complex issues involved in hybrid mismatch arrangements. However, our key concern is that any measures to address this issue should be clearly targeted, proportionate to the perceived abuse and should not impose undue compliance burdens.
6. We therefore consider that the scope of the measures should be restricted to "profit shifting arrangements" between related parties, and should only apply to third parties where they facilitate or are a party to structured arrangements. In effect, this would limit the scope of the rules to an anti-abuse rather than a wide anti-avoidance rule.
7. We also note the considerable overlap between Action 2 and the workstreams on CFC rules and interest deductibility, which are not due to report until 2015. We believe it is important that the work on these areas should be fully co-ordinated, so the actions taken forward in 2014 should be revisited once the 2015 work is concluded.
8. As part of this process, agreeing common definitions of the key terms should not be neglected. These definitions need to apply across a wide range of tax jurisdictions with very different tax regimes giving rise to possible issues for both taxpayers and tax administrations.
9. It is important to keep in mind the remarkable complexity of these proposed rules. The proposals themselves are complex and the interactions covered are also complex. This is particularly apparent in the Imported Mismatch rules. To ensure the allocation of taxing rights is correct will require an enquiry by a tax authority as to the treatment of an item of income under two other different tax regimes. We believe that the Import Mismatch rules should be omitted from this Action Plan until it is clear how the rules will work in practice.
10. More generally, the piecemeal adoption of hybrid mismatch rules by different countries could lead to taxpayers facing complex and rapidly-changing compliance burdens. We recommend that a clear process be established to ensure that consistent rules are adopted, in a co-ordinated fashion.

Hybrid instruments and transfers

11. It is important to note that BEPS action 2 is not intended to address sovereign tax policy choices. Where a government has decided to grant a tax incentive, it is legitimate for businesses to make use of

it. For example, the Brazilian interest in net equity (IONE) is very similar in substance to regimes that grant a tax deduction for invested equity, so should clearly be outside the scope of any hybrids rules. Similarly the Belgium notional interest deduction (NID) regime that treats part of a company's equity like debt is distinct from a taxpayer structuring an instrument to achieve the same result.

12. The approach should be to set out clear criteria for including instruments within the rules. Although subjective this might include a "main purpose" or "main benefit" test of the profit shifting arrangements. For example, a gateway test could be used to apply the rules where the purpose of the arrangement is to secure a tax advantage in either of the jurisdictions.
13. It would be appropriate to include a specific anti-abuse rule, so that any attempt to structure an instrument to fall outside the scope of the hybrid rules would fail.
14. We are strongly of the view that a "bottom-up" approach is to be preferred. The key problem with a "top down" approach is that a lot of routine transactions could inadvertently fall within the scope of the rules. For example, many corporates (not just in the financial sector) use a group cash pooling system. If a subsidiary has a routine banking arrangement with the same bank, this could be regarded as an "arrangement" and so detailed enquiries would have to be made to ensure that there was no element of a hybrid mismatch.
15. A bottom up approach is essential to enable the measures to be targeted at abusive behaviour. This is because, absent global harmonisation of tax systems, there will always be mismatches arising in commercial situations.
16. For the avoidance of doubt, instruments which are widely held and traded should not be within the scope of any rules, since the risk of these being part of a structured arrangement is low.

Regulatory capital

17. In certain industries, particularly financially regulated ones such as banks and insurance companies, there are already considerable regulatory restrictions relating to the issuance of capital instruments. The addition of complex tax rules in this area will add to compliance burdens and could distort commercial decisions.
18. In particular, regulators are increasingly encouraging financial institutions to raise capital at the level of a top-tier holding company, and then use intercompany funding to move the capital into operating companies.
19. We therefore consider that instruments issued primarily to meet regulatory capital requirements should not be subject to hybrid mismatch rules. We are aware that the ABI have outlined why regulatory hybrid capital should be carved out and support this position.

Joint Ventures

20. Joint ventures take many forms, ranging from contractual joint ventures to legal entity partnerships and jointly owned incorporated entities. In many cases, one partner in a joint venture will have no information about the tax position of a joint venture partner.
21. The definition of a related party should refer to a significant element of control, by reference to economic interest or voting power. We would suggest that 40% would be an appropriate threshold, rather than the 10% put forward in the Discussion Draft.