The 100 Group

Taxation Committee

Mr Achim Pross
Head, International Cooperation and Tax Administration Division
OECD/CTPA

By email: interestdeductions@oecd.org

6 February 2015

Dear Mr Pross

OECD Discussion Draft on BEPS Action 4: Interest Deductions and Other Financial Payments

We welcome the opportunity to comment on the OECD's discussion draft on Action 4: Interest Deductions and Other Financial Payments.

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 2014 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

The 100 Group has been, and remains, supportive of the OECD BEPS project and in general we support the majority of the emerging initiatives and recommendations. However, we wish to communicate our concerns about the proposals on interest deductions in the discussion draft. In general, we are concerned that the proposals as currently drafted will discourage investment and disproportionately impact capital intensive industries. We also believe they could lead to significant double taxation and seem disproportionate to BEPS issues arising from interest deductions.

Our concerns focus on the following general areas:

a) The impact of the proposals on incentives and economies
b) Proportionality and double taxation
c) Practical compliance

<u>The impact of the proposals on incentives and economies</u>

We are particularly concerned that a global interest limitation rule will have significant unintended consequences for member countries. We are concerned that the proposed recommendations would distort commercial realities and discourage investment. We also believe that the proposals would have a disproportionate impact on capital intensive industries.

Investment is extremely important to economies globally, especially developing economies. In our view, the proposed recommendation will potentially discourage investment, particularly affecting the economics of long-term infrastructure projects. The proposals will also limit the scope for individual governments to encourage investment and set taxes that are appropriate to their particular tax system.

Capital intensive industries will be disproportionately impacted by the proposed recommendations compared to other industries. An approach that would disallow a percentage of interest expense of an entity presents a tax bias towards lower-geared business models, which will disproportionately impact certain capital intensive sectors which are naturally more highly geared due to their commercial profile.

We do not believe that groups could simply rearrange their intra-group financing in practice in order to meet the requirements of a group-wide rule. Reasons for this could include, for example, the impact of minority shareholdings, banking restrictions, local regulatory restrictions on borrowings, corporate law constraints related to capital levels, foreign exchange and transactional costs. Structural limitations on tax capacity to relieve interest expense may also exist as a result of effective double taxation and withholding taxes.

In our view, proposals which limit interest deductions according to a share of net consolidated group external interest expense will penalise and distort normal commercial arrangements and competition. For example, say a multinational group acquires a third party group in a specific country. If the acquired company's pre-existing third party debt means that the relevant interest ratio is higher than that of the acquiring group, then interest allocation proposals would seem to result in partial disallowance of the interest expenses in the acquired company – even though there are no abnormal or abusive arrangements and no change to arrangements of the acquired group. In addition there are secondary impacts of interest restriction that need to be adequately risk assessed before implanting any new legislation. Adjusting a key attribute of a major asset class will create ripples. Governments need to identify and risk assess these secondary impacts that could prove to be significant and damaging to economies.

<u>Proportionality and double taxation.</u>

We believe that anti-abuse rules should be proportionate to the BEPS risk which they are targeting. Individual countries should be able to set their own tax rates and approaches, provided that this does not constitute 'harmful tax practice'. While excessive leverage can erode the tax base, we believe that in addressing this the OECD should ensure that it does not introduce rules that prevent the deductibility of interest in genuine commercial group structures where no BEPS risk exists.

We are concerned that the discussion draft does not clearly define the nature and extent of the BEPS issue arising from interest. Interest income is generally taxable (or otherwise dealt with by Action 2 – hybrid mismatches), and any unilateral restriction on deductions for interest will cause double taxation. Therefore, we recommend that in addition to considering the concerns outlined above, that the OECD specifically examines the exact nature and extent of BEPS which arises from interest deductibility. We believe that discussion and examination of the risks would enable a determination of whether the recommendations proposed are proportionate to the BEPS risk they are targeting.

We believe that the introduction of the proposed group-wide rules will lead to double taxation because the levels of debt and interest in a group entity will not generally be related to the level of earnings or net assets. We don't agree that a group-wide test will lead to a group being able to deduct all of its external net interest costs. There are likely to be large levels of disallowances, and yet corresponding interest income remains taxable.

Practical compliance

Global interest allocation proposals will present significant practical compliance problems. These practical difficulties and related costs will impact both taxpayers and tax authorities.

We believe that global interest allocation proposals risk undermining tax systems and audit processes by introducing requirements which compliant tax payers may struggle to meet and tax authorities may struggle to audit.

Some practical issues that would need to be overcome in order to operate an interest allocation approach include: mismatches in entity groupings between existing processes and the requirements of the proposal; accounting GAAP differences; differences between accounting profit and profit for taxation purposes in different jurisdictions; and the approach to investment income, currencies and loss making companies.

Recommendations

In setting out our concerns about the proposed recommendations, we aim to be constructive and to assist the OECD in shaping the future of the Actions. We suggest that you consider the high level concerns we have set out above in shaping the next steps. We include some discussions of suggestions of potential approaches that could help to address some of these concerns below.

As a result of the concerns outlined above, we strongly recommend that the final outcome of Action 4 should take the form of best practice recommendations, in line with the original objective. Those recommendations should focus on problems of double non-taxation or harmful competition, but without creating burdensome rules for genuine commercial finance transactions.

Having set out above our concerns about proposals for a group-wide rule. We strongly recommend that any such rule in a final best-practice approach should be focussed on anti-abuse and not a general allocation rule.

It seems likely that provisions that are well targeted at BEPS risks would need to consider a number of tests, possibly also including some form of purpose test. A global interest allocation would not address BEPS risks in a targeted fashion.

We are concerned that the discussion draft concludes that the arm's length test should not form part of the consultation process. We would strongly recommend that an arm's length test is permitted as an option within a range of best practice approaches, possibly in conjunction with other tests. The arm's length test demonstrates that companies could engage in such a transaction externally, which in turn demonstrates that such a transaction is not excessive when it takes place between companies in the same group. The arm's length test enables consideration of the actual circumstances of transactions – something that the group wide test and fixed ratios do not do. For example, an arm's length approach will take into account specific circumstances of different industries as well as credit ratings of individual companies and groups.

The approach to an arm's length test could potentially be used in conjunction with fixed ratio limits as a 'backstop' in a relatively simple way.

Overall, we feel that the nature of our concerns are so fundamental and should form the starting point of continued deliberations. As such we have not responded to specific questions on this occasion.

Work should focus on developing generic, targeted best practice measures that focus on BEPS mismatches in a practical and proportionate way.

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

Yours sincerely

PP

Andrew Bonfield
Chairman, Taxation Committee
Andrewbonfield100groupfd@kpmg.co.uk

www.the100group.co.uk