CONFEDERATION FISCALE EUROPEENNE

Opinion Statement FC 5/2015

on interest deductions and other financial payments

(BEPS Action 4)

Prepared by CFE Fiscal Committee

Submitted to the OECD

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Introduction

This Opinion Statement by the CFE Fiscal Committee relates to the OECD discussion draft "BEPS Action 4: Interest deductions and other financial payments"[1], released for public consultation on 18 December 2014.
We will be pleased to answer any questions you may have concerning our comments. For further information, please contact Mr. Piergiorgio Valente, Chairman of the CFE Fiscal Committee or Rudolf Reibel, Fiscal and Professional Affairs Officer of the CFE, at brusselsoffice@cfe-eutax.org.

General remarks

As a preliminary remark on this action point we would like to express our concern about the impact this action point may have as it may influence the way companies make investments and how they finance them. This action point might result in hindering future investments and have a negative impact on the future economic development.

While we understand that multinational enterprises might be tempted to exploit differences in the tax systems of countries all over the world, the instauration of a limit on the deduction of interest payments may not be the best solution to counter these problems that arise in first place from the different treatment most countries apply to the remuneration of equity and the remuneration of debt.

Where dividends as remuneration of equity are, in general, a non-deductible item, interest that remunerates debt financing will in general be tax-deductible. Most countries apply already certain rules to limit the deduction of interest. Installing a more general rule will only be beneficial if it is applied worldwide (in all countries) in the same way. As we look at the proposals of this action point, although it is preliminary what the conclusion of action 4 will be, the proposed rules leave a lot of room for local implementation that might differ between countries. Therefor it can be expected that countries will, as before, adapt their policies in order to remain (as) attractive (as possible) for foreign investors. MNEs will probably adapt their policies to exploit differences in the laws of the different countries.

Other solutions that could be envisaged would be to install a tax system where the effects of financial income/costs are neutral for the calculation of corporate income tax, or where the corporate tax treatment of the remuneration of equity or debt is not or not substantially different.

Finally, we would like to stress that financing with equity or with debt is also treated very differently from a legal point of view. These differences will also have an impact on the decisions companies make when choosing how to finance their investments.

Policy considerations (Chapter II)

A first remark concerns the last sentence of § 10. '*Overall, however, in general groups should still be able to obtain tax relief for an amount equivalent to their actual third party interest cost'.*

[1] http://www.oecd.org/ctp/aggressive/discussion-draft-action-4-interest-deductions.pdf.

Although this statement is made as a general rule we have the feeling that the instauration of rules to limit the deduction of interests will, at least in some cases, lead to situations where not all third party interest cost will be tax deductible.

Double taxation

We are also concerned about the (risk of) double taxation that will occur when rules to limit interest deductibility, as described in the consultation document, will be installed.

Although the avoidance of double taxation is considered to be a principle when designing these rules (§ 11 – 4th bullet) the proposed solution for the avoidance of double taxation by allowing the carry forward of disallowed interest expense into future periods does not avoid double taxation as such. It only softens or reduces the double taxation by allowing a possible future deduction. The suggestion to limit the carry forward in time made in chapter XII (§ 198) is unacceptable from a tax payer point of view. From practice in several countries were interest limitation rules were introduced it is apparent that a lot of companies that struggle with the limitation of the interest deduction and who are in a stress position during a certain time are never able to use the carry forward interest in future assessment years and as such the double taxation becomes permanent.

Existing approaches (Chapter III)

Another matter of concern is § 21. '*It was also agreed that arm's length test and withholding taxes should not form part of this consultation process.*'

We believe that the existing arm's length principle should be taken into account in the design of rules that would limit interest deductions, rather than replacing it by an overall limitation of interest deduction.

The same goes for withholding taxes. They are part of the actual tax landscape and cannot be ignored when establishing new rules. Although we agree that in certain cases (like in the EU with the Interest & Royalties Directive) the withholding tax will be reduced to zero, this is only to avoid, as much as possible, double taxation. Double taxations arises because in most countries the withholding tax paid in the source state is only partially reduced by a tax credit. The tax credit will only be given to the amount of tax on net income whereas the withholding tax is applied on gross income (Cfr § 23).

In our opinion it is not appropriate to keep transfer pricing and withholding taxes, which by themselves already cause a lot of concern for the taxpayer, out of the discussion. The consultation paper should at least give an indication how the interest limitation rule will interact with the transfer pricing rules and what the impact will be on withholding taxes.

What is interest and what are payments economically equivalent to interest (Chapter IV)

As CFE stated in its Opinion Statement on BEPS action 2[2] (hybrid mismatch arrangements), we remain of the view that the ideal solution would be common, internationally agreed concepts of debt and equity. The solution proposed in § 35 that consists of a non-exhaustive list of interest payments and payments economically equivalent to interest is not a good solution and will give rise to different interpretations/applications of the rule in different countries.

As such, foreign exchange gains and losses, guarantee fees and arrangement fees should not be considered as interest or economically equivalent to interest for these purposes.

What should a rule apply to (Chapter VI)

CFE agrees that, if any rule should be installed, that rule should apply to the entity net interest expense after offsetting interest income. Application of a rule to the entity's gross interest expense is not acceptable.

Small entity exception (Chapter VII)

CFE also agrees that the rules should foresee a small entity exception. We favour the small entity exception as a size threshold rather than a monetary threshold, which will probably be different in every country. Countries are not likely to review the monetary threshold periodically and update it to reflect change in the economic environment. In practice, we see that monetary thresholds stay in place over a very long time without any review (except lowering of thresholds, where this generates more tax income). We believe that a size threshold is a more objective criterion and is easier to be set in all countries at the same level. Size thresholds already exist and are also used for instance in accounting law at EU level. We regret that the proposal does not propose a threshold as part of a best practice recommendation and that the statement favours a monetary threshold over a size threshold.

Finally, we believe that in the first ten years, any rule should only be applied to multinational enterprises that have operate on a truly global scale.

Whether interest deductions should be limited with reference to the position of an entity's group (Chapter VIII)

As stated in the draft discussion paper, the impact on accounting and compliance issues from a group wide test will be considerable.

The statement of § 59 that the group-wide test would allow a group to centralise its third party borrowings in the country and entity which is the most efficient is rather allegorical as groups already

[2] CFE Opinion Statement FC 9/2014 of May 2014: http://www.cfe-eutax.org/node/3676.

do this and we have the impression that limiting intra-group debt and intra-group interest deductions is the main concern for action 4.

We have also serious doubts about the ‘mechanical allocation’ of interest deductions to group companies and how this will affect the revenue of the different countries involved.

Whether interest deduction should be limited with reference to a fixed ratio (Chapter IX)

Although a fixed ratio rule is relatively simple to apply we do not agree that current systems that apply fixed ratio rules set these ratios too high.

A ratio rule should also consider the groups ability to borrow rather than the actual borrowing.

Whether a combined approach could be applied (Chapter X)

Both approaches have their advantages and disadvantages. We remark that the proposed rule can lead to double taxation if the rules are applied. As said earlier, the avoidance of double taxation by allowing carry forward of non-deductible interest expenses is not a good option. Any rule that leads to double taxation should be disregarded.