# European Business Initiative on Taxation (EBIT)

**Comments on the OECD Discussion Draft on BEPS Action 4: Elements of the Design and operation of the Group Ratio Rule**

EBIT's Members at the time of writing this submission: AIRBUS, BP, CATERPILLAR, CONSTELLATION BRANDS, DEUTSCHE LUFTHANSA, DIAGEO, GSK, HUAWEI, INFORMA, JTI, PEPSICO, RELX, ROBECO, ROLLS-ROYCE, SAMSUNG, SCHRODERS, SHV, TUPPERWARE, UTC.

**EBIT comments on the OECD’s Public Discussion Draft on BEPS Action 4: Elements of the Design and Operation of the Group Ratio Rule**

Submitted by email to: interestdeductions@oecd.org

Brussels, 16 August 2016

Dear Achim,

EBIT is grateful for this opportunity to comment on the OECD’s Discussion Draft on BEPS Action 4: Elements of the Design and Operation of the Group Ratio Rule (the “Discussion Draft”) dated 11 July 2016.

There are a number of questions raised in the discussion draft concerning the detailed impact of the proposals. Many of these will depend on the key decisions reached on some of the principal issues. Therefore, we focus here on the issues we see of greatest potential significance to EBIT.

## Consistent approach to a group ratio rule

The Discussion Draft encourages countries to adopt a group ratio representing net third party interest expense to EBITDA and for there to be consistency between countries in their interpretations of the components. However, it also states the case for countries using domestic policy concerns to adjust the components and choosing another financial ratio to suit their domestic circumstances.

EBIT notes that a standard approach by territories would enable businesses to apply the ratio quickly and easily across all those territories in which they are subject to tax and have a potential interest restriction. The compliance burden of applying a group ratio rule is a critical factor which should be taken into account.

EBIT also notes the differences in the resulting treatment of interest, or items equivalent to interest, between territories due to domestic policy rules. A straightforward example might involve two territories applying an IFRS accruals basis of accounting for a component where for tax purposes one territory follows that accruals basis while the other follows a paid basis. Timing differences would arise in the second territory which would not arise in the first territory. Another example might involve specific derivatives that include an interest equivalent, say hedging debt movements, treated differently for tax purposes in the two countries (as well as potentially for accounting purposes). If there were indefinite carry-forward (and potentially some carry-back) of unrelieved amounts the impact of those differences over time may be significantly reduced. However, EBIT is concerned about countries applying relatively short time constraints which may result in substantial differences becoming permanent through factors other than BEPS. There is also the possibility that companies will be discouraged from entering into hedging arrangements that have generally been regarded from a policy perspective as a suitable response to limiting risk in the financial system.

Therefore, there may be a trade-off between criteria that allow a rule to be applied simply and that provide the appropriate amount of relief.

EBIT also recognises the range of different options which territories are likely to adopt (and are permissible under the Discussion Draft) which will add complexity and, at best, result in an internationally more coordinated but not one international standard approach.

EBIT would like to see the number of differences between approaches in territories kept to a minimum but, where differences are proposed, for the impact on businesses to be recognised and artificial constraints on relief minimised.

## Determination of amounts equivalent to interest

There are practical difficulties in determining items which are equivalent to interest. Businesses have previously identified some of these concerns in relation to the scope of BEPS Action 4 as a whole. They are exacerbated by the need to include consolidated amounts emanating from countries where interest restrictions may not be a problem per se. For example, identifying the interest element of some derivatives dealing with operational issues may be particularly complicated.

There will be further issues where accounting standards change. For example IFRS16 is expected to come into force in 2019, and will require operating leases to be accounted for as if they were loans in the hands of the lessee, and this will result in amounts of interest accruing in the accounts in respect of such leases.

EBIT thinks that a sensible compromise might be to require the inclusion of interest equivalents only in relation to underlying instruments which are in the nature of hedges against debt movements.

## Related party debt

The Action 4 proposals as a whole disallow interest expense in a borrower without preventing taxation of interest income in a lender. This may be manageable for groups where borrower and lender are in the same consolidated group, as we would assume it is expected that the group will be in a position to restructure such financing (though this is not necessarily the case in some circumstances).

However, if related party interest is excluded from the group ratio rule, it follows that it is likely to be disallowed in a situation where the lender and borrower are not in the same economic group. The parties are unlikely to be able to restructure the financing, because, by definition such restructuring would significantly alter the commercial arrangement. The most common situation where this might occur is in joint ventures, but there may be other situations in which this could occur. Such structures would therefore be taxed less favourably than wholly owned investments, despite the debt having wholly commercial purposes.

The most common situation in which this could occur is probably in joint ventures, but there may be other circumstances in which it might occur.

EBIT considers that more targeted rules which require adjustments in cases of perceived abuse of the group ratio rule would be more appropriate. It may be possible, for example, to restrict the limitation on connected party interest to situations where there are further indicators that the interest payment is motivated by tax considerations.

## Entities with negative EBIDTA

Adjusting the group ratio for entities with negative EBITDA also might give rise to potential mismatches between companies in the group involved in the same or similar activities and transactions.

EBIT thinks that the concern that negative EBITDA could result in aggregate interest capacity of all group entities far exceeding the actual net third party interest expense of the group, establishing a large excess which could distort the position in other years would be better dealt with via a suitable cap on the amount carried forward. As noted above, EBIT is concerned about restrictions which are not clearly targeted at BEPS, so the cap ought to reflect what is commercially reasonable (which might be more than the actual net third party interest expenses in any particular period). EBIT does not think that setting a cap otherwise on the group ratio as a whole is warranted.

EBIT trusts that the above comments are helpful and will be taken into account by the OECD in finalising its work in this important area. EBIT is committed to a constructive dialogue with the OECD and is always happy to discuss.

Yours sincerely,

**European Business Initiative on Taxation – August 2016**

For further information on EBIT, please contact its Secretariat via Bob van der Made, Telephone: + 31 6 130 96 296; Email: bob.van.der.made@nl.pwc.com).

**Disclaimer / Copyright**: This document contains the collective views of the EBIT business working group and is provided to you courtesy of EBIT. PwC acts as EBIT's secretariat but PwC is not a Member of EBIT. Nothing in this document can be construed as an opinion or point of view of any individual member of EBIT or of PwC. Any reproduction, in part or in total, of this document, in any form whatsoever, is subject to prior written authorisation of EBIT. Such authorisation can be obtained by EBIT's Secretariat via: bob.van.der.made@nl.pwc.com**.** EBIT Joint EU Transparency Register number: 26231733692-35. For more info on EBIT, please see: www.ebit-businesstax.com/