UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

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VIA EMAIL
Pascal Saint-Amans
Director
Centre for Tax Policy and Administration
Organisation for Economic Cooperation and Development
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France
(interestdeductions@oecd.org)

Re: USCIB Comment Letter on the OECD Discussion Draft on BEPS Action 4 – On Elements of the Design and Operation of the Group Ratio Rule

Dear Mr. Saint-Amans,

USCIB[1] appreciates the opportunity to comment on the discussion draft on elements of the design and operation of the group ratio rule.

General Comments

USCIB supports the comments submitted by BIAC. We write separately in order to emphasize a few points.

It is difficult to overestimate the difficulty of complying with a worldwide group ratio if countries adopt different standards that will require a worldwide group to compute net interest expense and group EBITDA differently for each country in which the group operates and in which the group ratio rule is applicable. In order to minimize those difficulties, the OECD should recommend that countries not require adjustments to financial statements unless those changes are seen as essential to the proper functioning of the group ratio rule.

Countries have agreed that the starting points for the calculation of net interest expense and group EBITDA are based on the group's consolidated financial statements whether those financials are based on IFRS, US GAAP, Japanese GAAP or other accounting standard permitted

[1] USCIB promotes open markets, competitiveness and innovation, sustainable development and corporate responsibility, supported by international engagement and prudent regulation. Its members include top U.S.-based global companies and professional services firms from every sector of our economy, with operations in every region of the world. With a unique global network encompassing leading international business organizations, USCIB provides business views to policy makers and regulatory authorities worldwide, and works to facilitate international trade and investment.

by the relevant country. Thus, countries are willing to accept some variation in how these numbers are calculated and not insist that all entities use the same starting point. Similarly, the OECD should recommend that, in addition to following the financial accounting standard of the parent company, any adjustments also follow the adjustments required by the jurisdiction in which the group parent is located. This would permit a group to compute these numbers once and use those numbers for the global adjustments.

Calculation of a group's net third party interest expense

The discussion draft provides three approaches to determining net third party interest expense. The first approach is to accept the number from the group's financial statements. We support the BIAC recommendation which would permit taxpayers to use this number.

Approaches 2 and 3

The discussion draft states that the second and third method of computing net interest expense should reach the same result but by different avenues, the discussion draft prefers either of these methods over the first method and there does not appear to be any specific factors which are sufficiently significant for one to be recommended over the other. (Para. 18 and 19.)

The second method starts with the interest income and expense in the consolidated financials and adjusts those numbers to include or exclude items in accordance with whether they fall within the definition of interest and payments economically equivalent to interest. (Para. 12.)

The third method starts by requiring an entity to identify all of the group's items of income and expense that are economically equivalent of interest and then determine whether those items are included in the consolidated financial statements as interest income and expense.

Assuming countries require adjustments to the consolidated financial statement to reflect items that are economically equivalent of interest, then countries should permit groups to use either approach 2 or approach 3 since both approaches should reach the same answer and neither is preferred. If countries only permit the use of one of these methods and the countries make different choices with respect to whether they prefer approach 2 or approach 3, then companies may be required to do these adjustments both ways at some cost and for no apparent benefit to the tax administrations. Tax administrations should also not require excessive documentation for each item required to be identified in the "bottoms-up" approach 3.

Adjustments to net third party interest expense

To recognize practical issues that may prevent a group aligning net interest expense and EBITDA: USCIB supports the recommendation of an uplift to a group's net third party interest expense of up to 10% and believes that the 10% uplift may be insufficient given the practical difficulties (outlined in the BIAC comment letter) of aligning interest expense and EBITDA.

Adjustments for certain non-deductible payments: The discussion draft states that because the group's net third party interest expense is based on consolidated financial statements, net interest expense may include items that are not deductible for tax purposes. Including such payments in net third party interest expense will increase the interest capacity of the entities in the group. Countries may, therefore want to reduce net third party interest expense by nondeductible payments. The OECD recommends, however, that these adjustments "should be limited to specific identifiable categories of payments which, in the assessment of the country, pose a material BEPS risk." (Para. 26.)

These payments are economically equivalent of interest, so in a sense taxpayers are already being penalized by the denial of a deduction for what is a legitimate "interest" expense. They should not be further penalized by being denied interest capacity. Further, it is hard to see the material BEPS risk inherent in the payments if the deduction is already being denied. It should make little or no economic sense for a taxpayer to incur a non-deductible expense that is equivalent to interest in order to "create" cap that would permit the deduction of other interest expense.

Adjustment for interest paid to related parties: The Action 4 Final Report recommends targeted rules to address the possibility that groups could use certain types of payments to avoid the effect of the fixed ratio rule and the group rule. One possible approach to a targeted rule "would be for a country to exclude net interest expense paid to related parties from the definition of net third party interest expense." (Para. 27.) The definition of related parties (para. 28) is very broad and is already part of the Action 4 Final Report.

USCIB understands the concern of the OECD and countries regarding possible taxpayer planning to avoid the impact of the interest deductibility rules. Nevertheless, we believe that the proposal to exclude net interest expense paid to related parties is not appropriately targeted. A company may be a related party even though the ownership interest in that entity is less than 25%. Thus, interest expense paid to such a related entity will result in unrelated parties having the bulk of the economic return from the payment of interest. Without more (e.g., a structured arrangement) it seems very unlikely that the net interest expense would not reflect a real economic payment. If this option is to be retained, the OECD should further limit its scope to focus more narrowly on addressing legitimate BEPS concerns. Further, even though the discussion draft describes this as one possible option, other options are not presented so it may be more likely that this option will be adopted by countries seeking to address planning. The OECD should describe other more targeted options that would more narrowly address any BEPS concerns.

Adjustment to take into account group's share of the net third party interest expense of an associate or joint venture: Group EBITDA includes the group's share of earnings from any associates or joint ventures under equity accounting principles. The consolidated income statement does not identify the share of the net interest expense related to the associate or

JV. This creates a potential mismatch – income is included, but interest expense funding the investment is not.

The discussion draft provides that countries may give taxpayers an option to include the group's share of net third party interest income or expense of an associate or joint venture as part of the group calculation. The discussion draft recommends an option because it may be difficult to obtain this information and it may not be material.

USCIB supports this recommendation.

Definition of group-EBITDA

Capitalized Interest

The Action 4 Final Report approach to capitalized interest expense would require entities to include capitalized interest in the adjustment for interest income and expense in the year when the interest is incurred and make ongoing adjustments to strip capitalized interest out of depreciation and amortization. This approach is complex, so countries should consider instead requiring an entity to follow the financial accounting treatment of capitalized interest in computing group-EBITDA. (Paras. 35 – 38.)

USCIB supports this recommendation.

Sincerely,

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