Comments to the OECD Discussion Draft on Action 4 "Elements of the design and operation of the group ratio rule"

ICC welcomes the opportunity to comment on the new draft document on BEPS Action 4 pertaining to the "elements of the design and operation of the group ratio rule". ICC is in overall agreement with the detailed comments submitted by BIAC. Nevertheless, ICC would like to further highlight points that we believe to be particularly important.

General comments

ICC perceives the group-wide interest allocation rule as very complex. The facility for countries to specify particular limitations could result in a great deal of inconsistency. It is, moreover, a fundamental systematic change. It would replace the traditional international tax system based on the arm´s length principle with a formulary system, with an allocation of the tax base following the "economic activity" or other factors that are deemed to be appropriate. We believe that such a formulary system on a global scale is neither desirable nor easily feasible.

Since the start of the discussion on Action 4, business has emphasized that one important condition of a group-wide interest deduction rule is to implement the rule consistently throughout the world. Inconsistent implementation would lead to double taxation as well as an increase in the administrative burden for companies. We would therefore like to reiterate that participating countries should align their respective rules on group-wide interest allocation, should they wish to introduce such a new and disruptive system.

In addition, the draft document only focuses on the net third party interest /EBITDA ratio of a consolidated financial reporting group. However the Action BEPS 4 Report mentions the option to apply different group ratio rules (e.g. "equity escape" rule as applied in certain countries and, more recently, included in the Anti Tax Avoidance Directive[1]). We suggest that other group ratio rules should be optional for countries, in particular those providing a simpler and consistent calculation whilst reducing administrative burdens for companies.

Specific comments

Calculation of net third party interest expense

ICC firmly believes that the first approach is by far the most preferred of the three approaches described by the OECD in the draft document. It is a very simple and pragmatic solution to take the numbers from the group´s financial statements. Although there should be differences between these numbers and adjusted numbers, these differences would be negligible.

If approach 1 should be rejected by G20/OECD or the member states involved, we advise the following regarding approaches 2 and 3. The OECD states in the draft document that

[1] COUNCIL DIRECTIVE (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

both methods should come to the same result. Therefore, from a fiscal point of view, it would not matter, which method companies employ and ICC urges OECD to avoid establishing rules that would be too burdensome. In our view, it would be reasonable for businesses to be given the option of which approach they wish to apply. Otherwise, companies would be obliged to apply two different calculation methods. It would not be desirable – either for companies or for tax administrations – to have two complex calculation methods in place which have to be applied in parallel. The aim should be to have one calculation method that is being applied throughout the whole group on a worldwide basis. One solution to achieve this aim could be to declare the method introduced by the headquarter country as the leading method for all other countries where the group operates.

With respect to the adjustment of third party interest expenses, we have difficulty understanding why these would be necessary. The discussion draft suggests that non-deductible payments can be a BEPS risk. In our view this is not the case as those payments have already been neutralised by being treated as non-deductible. In this case, there is no clear justification for a second adjustment in respect of these payments by reducing the capacity to deduct interest. Furthermore, we would like to highlight the concern that diverging adjustment rules on a national level would result in a very complex and burdensome set of rules for companies.

It is, in principle, very helpful that the OECD suggests introducing an uplift for entities to the group´s net third party interest expense. This reflects that economic activity (being represented by the parameter of EBITDA) and interest are not always aligned, for reasons that very often are not within the control or influence of the respective entity or group. We also believe that the recommended uplift of 10% in the discussion draft is too low for many companies or entities and should be raised to at least 20%.

Definition of group-EBITDA

The number of options and adjustments included in the report (up to 22 Examples) leads to practical difficulty in determining the appropriate approach and potentially substantial compliance cost and legal uncertainty for taxpayers. For companies it is of utmost importance to have uniform rules throughout national jurisdictions that are easy to comply with. To this end, we would recommend that the EBITDA be taken from the group accounts. Stripping capitalized interest out of depreciation and amortization as suggested in the Final Report on Action 4 would be highly complex. At the same time, we would like to encourage you to make adjustments in order to reduce the volatility of EBITDA, which is not controllable by the respective entity or group (e.g. fair value adjustments).

The impact of losses on the operation of the group ratio rule

The ideas set out in the discussion draft are, as also stated in the draft, very complex and burdensome for both companies and tax administrations alike. We therefore urge the OECD to consider adopting a more pragmatic approach as outlined in the BIAC comment letter.

The International Chamber of Commerce (ICC)
Commission on Taxation

ICC is the world business organization, whose mission is to promote open trade and investment and help business meet the challenges and opportunities of an increasingly integrated world economy.

Founded in 1919, and with interests spanning every sector of private enterprise, ICC's global network comprises over 6 million companies, chambers of commerce and business associations in more than 130 countries. ICC members work through national committees in their countries to address business concerns and convey ICC views to their respective governments.

The fundamental mission of ICC is to promote open international trade and investment and help business meet the challenges and opportunities of globalization. ICC conveys international business views and priorities through active engagement with the United Nations, the World Trade Organization, the Organisation for Economic Co-Operation and Development (OECD), the G20 and other intergovernmental forums.

The ICC Commission on Taxation promotes transparent and non-discriminatory treatment of foreign investment and earnings that eliminates tax obstacles to cross-border trade and investment. The Commission is composed of more than 150 tax experts from companies and business associations in approximately 40 countries from different regions of the world and all economic sectors. It analyses developments in international fiscal policy and legislation and puts forward business views on government and intergovernmental projects affecting taxation. Observers include representatives of the International Fiscal Association (IFA), International Bar Association (IBA), Business and Industry Advisory Committee to the OECD (BIAC), Business Europe and the United Nations Committee of Experts on International Cooperation in Tax Matters.