

4 February 2015

Via E-Mail
interestdeductions@oecd.org

Mr. Achim Pross
Head International Co-operation and Tax Administration Division
OECD Centre for Tax Policy and Administration
2, rue André Pascal
75775 Paris Cedex 16
France

Comments of SwissHoldings on the BEPS Action 4 Discussion Draft (Interest Payments) of 18 December 2014

Dear Mr. Pross

The business federation SwissHoldings represents the interests of 61 Swiss based multinational enterprises from the manufacturing and service sectors (excluding the financial sector). SwissHoldings is pleased to provide comments on the BEPS Action 4 Discussion Draft (Interest Payments) (hereafter referred to as “the Draft”).

I. General Comments

The choice between debt and equity is an important business decision, which is based on different considerations. In many circumstances, loans can be preferable to a contribution of equity for bona fide reasons. For instance, loans are more flexible than equity and generally carry a lower cost of capital than equity. Dividend distributions remain subject to significant limitations in terms of timing and amounts; loans cater better for potential fluctuations in the need for capital; less formalities are required for reductions or increases of loans compared to equity, resulting in less administrative costs for financing.

SwissHoldings believes that the starting point for Action 4 should be that interest and other costs, such as derivatives and insurance payments, are legitimate business costs and should therefore be deductible. Restrictions should be limited to abusive cases, i.e., to situations without a good commercial rationale. Contrary to the OECD SwissHoldings is convinced that intra-group loans are not per se aimed at base erosion and/or profit shifting. For instance, it is normal commercial practice to raise debt in the market through one legal entity that subsequently lends on to different legal entities in a group. The vast majority of businesses do not use interest payments for tax avoidance purposes. Arm’s length intra-group financing should therefore not be subject to stricter rules than external financing.

Efficient and flexible corporate financing is crucial to economic development and growth and should not be undermined. We urge the OECD to maintain tax deductibility for legitimate business costs, including financing costs, to focus on making existing legislation more fit-for-purpose, efficient and predictable and only to address situations where there is excessive debt in accordance with accepted business norms and the particular situation of a MNE.

II. Specific Comments

Regarding the concrete proposals contained in the Draft, SwissHoldings provides the following comments:

Group-wide rules for limiting interest deduction

The Draft proposes to limit the group's total interest deductibility by two factors:

- the actual net third party interest expense of the group and
- the allocation of the interest to corresponding economic activity.

SwissHoldings believes that such group-wide rules should not be pursued for a number of very important reasons:

1. One prerequisite of a group-wide interest deduction rule is to implement the rule consistently throughout the world. A group-wide rule is, in other words, inconsistent with other – already existing – national rules. No major OECD country has implemented a similar rule yet and it does not seem highly probable that a majority of G20/OECD countries will adopt a similar and thus compatible group-wide rule. Therefore, the adoption of such a rule by one country would (i) harm the competitiveness of companies falling under that jurisdiction compared to companies located elsewhere by creating administrative burdens and (ii) lead to double taxation.
2. Countries would have to agree to an approach defining which entities are covered by the rule, how net third party interest expense of a group should be calculated, and how an interest cap should be allocated between entities. The Draft notes that because the method for calculating an allocation-based interest cap would need to be agreed to by all countries, mismatches would likely arise where the agreed approach does not align with a country's domestic tax system.
3. Furthermore mixing data from consolidated accounts based on IFRS / US GAAP with local statutory account tax data is conceptually wrong because the accounting principles and measurement methods used by both systems are often fundamentally different. This means, that even though the rules might be implemented in a consistent manner throughout the G20/OECD countries, they would nevertheless be incompatible due to national tax law. These problems could lead to legislation by individual countries that would request the global data to be made comparable to the local data. In particular if several large economies would put forward similar requests, this would lead to a major, non-value adding effort for MNEs.
4. The group wide rule as currently proposed does not consider the different interest levels around the world. An allocation based on earnings or assets will therefore lead to a shift from high(er) interest rate countries (such as Australia, Brazil, China, India) to low interest rate countries (such as Euro-area, Japan, Switzerland, USA). I.e., the low interest rate countries will need to carry the tax impact of the higher interest rate countries.

Countries with a lot of outbound investments (such as Germany, Japan, Luxembourg, Netherlands Switzerland, UK) will likely have less group-internal interest income from their subsidiaries since groups will choose more external funding in order to maintain the level of tax deductible interest or fund the subsidiaries with equity in order to avoid a double taxation (not deductible interest expenses for the borrower but taxable interest income for the lender).

5. The group-wide approach will influence how MNEs organize their global funding (debt vs. equity; long-term debt vs. short-term debt; choice of currency; etc.) with unforeseen consequences on the capital markets, which could be far reaching. It will most probably push MNEs to increase share buy-back programs (capital reduction) and increase their overall debt level. This might reduce the overall credit ratings of MNEs, making them more fragile and increasing their costs of borrowing, with unforeseen consequences on the financial markets. This might create effects comparable to those which regulators such as the Financial Stability Board have been trying to get to grips with regarding the financial sector following the 2008 financial crisis.
 6. Limiting the ability of MNEs to provide intra-group loans to operating companies, will artificially shift part of the lending business to banks and debt markets. This would allow banks to make more profits and industrial MNEs to make fewer profits. Therefore, the group-wide approach unduly favors the banking industry. At the same time, credit risks for banks would increase and not decrease as
-

intended by regulators, such as, e.g., the Financial Stability Board. It should be noted that the still ongoing financial crisis was created by overgearing and inappropriate risk taking on leveraged financing activities. Furthermore, banks would be encouraged to provide new loans to operating industrial companies out of their subsidiaries located in low tax jurisdictions. Therefore the group-wide approach would likely lead to reduced tax revenues also in OECD countries.

In order to ensure flexibility of financing, arm's length intra-group financing should not be subject to stricter rules than external financing. It is normal commercial practice to raise debt in the market through one legal entity that subsequently lends on to different legal entities in a group. We do not understand what the logic shall be that industrial groups should be dependent on external bank loans if they can grant intra-group loans at arm's length conditions. Also in the future any group lending carried out in accordance with the arm's length principle should still be possible. Furthermore, the arm's length principle, which is relatively easy to apply, should always be the starting point to develop new or simplified rules. Also, the arm's length principle supports local ratios, because local ratios can be set in a way that they have some alignment with the arm's length principle, while this is not the case with the group-wide approach.

7. The group-wide interest deduction model might also not be in the interest of developing countries. MNEs which make new investment projects in developing countries take risks (volatile environment) and must usually wait for a long time before receiving cash returns on investment (dividends) coming out of the country. MNEs are therefore interested in investing into such new markets with a reasonable balance between equity and debt financing. The group-wide interest deduction model does not allow to choose the most appropriate balance between equity and debt. This increases the risks of MNE investments in developing countries and may lead to a reduction of investments in such countries.
 8. Furthermore the group-wide interest deduction model neglects some additional important criteria, which banks take into account when assessing the amount of interest (tax deductible) which are charged to an industrial borrower:
 - Companies with same accounting profile (profitability, balance sheet profile) may run very different types of businesses which require completely different debt conditions;
 - Companies may also be in different phases of development (start-up, fast-growth, maturity) and will therefore be subject to very different borrowing conditions, which the proposed group-wide approach does not take into account at all. Indeed, one of the many flaws of the proposal is that it does not take into account projected future cash-flows (based on a concrete business plan) of the entity which is borrowing funds to assess the appropriate level of tax deductible interests, while such projected future cash-flow method is the basic tool used by the banking industry.
 9. Family owned companies are often predominately or fully equity financed because they regularly have a different dividend policy compared to publicly listed companies. They are not forced by expectations of the public / analysts to distribute a certain dividend amount. Family owned groups which are strongly equity financed and finance their group entities with inter-company financing would be discriminated without sound reasons against highly leveraged groups with debt push down. The discrimination would consist in a distortion of the competition on a local level. Direct competitors would not be entitled to the same tax deduction depending on how their top holding company is financed.

Also a publicly traded group may be discriminated if it is predominately equity financed and partially finances a subsidiary with an intra-group loan, e.g., because of flexibility and fluctuation aspects.
 10. SwissHoldings considers a group-wide interest deduction model as a fundamental systematic change. It would modify the traditional international tax system based on the arm's length principle to a formulary system, with an allocation of the tax base following the "economic activity" or factors that are deemed to be a benchmark for it. We believe that such a group-wide approach on a global scale would lead to a significant increase of double taxation and cause many other unintended problems.
 11. For Swiss based MNEs, which often have above international average direct investments into third nations, the group-wide approach would result in a serious disadvantage for Switzerland as a long-standing OECD member country. The group-wide approach does not take differences of national economies (geographical size and structure) into account at all.
-

12. In case of a group-wide interest cap rule there is no room for individual targeted rules in the countries such as debt push down, “artificial” debt, transfer pricing regulations, the use of debt to fund tax exempt or tax deferred income. Any such additional regulations are not needed and will immediately lead to non-tax deductibility of external net-interest expenses, which will heavily impact the funding costs for companies and therefore hinder economic development and growth. The same is applicable for withholding taxes on interest, which would also hinder groups to implement an appropriate capital structure in all group entities and trigger additional tax costs related to the funding of group entities.

Fixed ratio test

SwissHoldings is convinced that a fixed ratio test can be best practice, provided that it is well designed. A proper design can have, among others, the advantages of (i) being simple, (ii) giving more design flexibility to national legislators and (iii) flattening business cycles:

1. Compared to group-wide rules a fixed ratio rule is mechanistic and as such tends to be simple to apply for both companies and tax administrations. In combination with a monetary threshold for small and medium sized entities, most legal entities subject to a jurisdiction would not even fall under the rules, which obviously would add simplicity.
2. Some countries have multiple tests, which include, e.g., a group-wide debt-to-equity test. Contrary to the group-wide test presented in the Draft, this is merely an escape rule in order to demonstrate that the financing of one entity is not exceeding the group ratio and therefore the interest not deductible under the fixed ratio regime should still be deductible. However, it is important to note that some of those multiple tests are extremely challenging for companies. If the OECD should want to apply such multiple tests, they should be simple to apply in order to be fit for the purpose.
3. Regarding the design flexibility, with a fixed ratio rule there is no need for a worldwide identical implementation in various jurisdictions. For example, it is not necessary to have exactly the same definition of interest in different jurisdictions.
4. SwissHoldings advocates for the introduction of complementary rules that flatten business cycles. The major cause for the above praised simplicity is at the same time the major concern with fixed ratio rules: Its mechanistic nature. Being mechanistic, it can in weak business cycles lead to limiting the deductibility of interest even though a business has in no way used interest for tax planning purposes. In weak business cycles, thus, for reasons that are not projectable for businesses, EBITDA can be extremely volatile. Therefore, non-deductible interest should be allowed to be carried forward in an unlimited manner and not for five years only. Such unlimited carry-forward is in line with current law in many countries (e.g. Denmark, Finland, Germany, Italy, United States). The same should apply to EBITDA capacity that has not been used to deduct interest.
5. Finally, SwissHoldings holds the view that the percentage which limits the deductibility of interest should not be lower than 50% (50% is, e.g., stipulated by US domestic law, the so-called 163j Test). The Draft states that the existing rules of between 25 and 50% are too high percentages in order to prevent base erosion and profit shifting. In our view the overall aim of a well designed rule should not be to harm businesses that are not engaged in using interest as a means of profit shifting and at the same time prevent the – from a point of view of tax administrations – excessive use of interest deduction. Different industries have differing profit margins as well as differing debt ratios. Therefore, the fixed ratio should not be orientated towards the average of all businesses. Rather, one solution could be to define the country ratio based on the specific industry a company is active in, and hence applying different limits for different business environments.

We kindly ask you to take our comments and proposals into due consideration.

Yours sincerely

SwissHoldings

Federation of Industrial and Service Groups in Switzerland

[signature]

[signature]

Christian Stiefel
Chair Executive Committee

Dr. Martin Zogg
Member Executive Committee

Cc: - SwissHoldings Board
- Nicole Primmer, Senior Policy Manager BIAC
- Will Morris, Chair BIAC Tax Committee Bureau
- Krister Andersson, Chair BUSINESSEUROPE Tax Policy Group
