Additional Comments received on Public Discussion draft

BEPS ACTION 4: INTEREST DEDUCTIONS AND OTHER FINANCIAL PAYMENTS

19 February 2015

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Summary/Action

This note contains additional comments received with respect to the public discussion draft on BEPS Action 4 (Interest Deductions and Other Financial Payments).
An invitation for comments was published on the OECD Website on 18 December 2014, with a deadline of 6 February 2015.

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17th February 2015

Dear Sir/Madam

BEPS Action 4 Discussion draft: Interest Deductions and other Financial Payments

We welcome the opportunity to comment on the proposals in the Public Discussion Draft – BEPS Action 4: Interest Deductions and other Financial Payments (the Discussion Draft), and support the OECD's consultative approach on the developments of these proposals.

The International Banking Federation (IBFed) represents the combined views of a group of national banking associations.[1] The IBFed provides advice and advocacy for the banking industry and contributes to the development of public policy on banking and other financial services. IBFed works with governments and other stakeholders to improve public awareness and understanding of the industry's contribution to the economy to ensure the public continue to benefit from a stable, competitive and accessible banking system.

Submission

This letter does not go into detailed discussion of bank regulatory capital and the rules relating to the types and amount of capital banks are required to hold. However, both the

[1] The International Banking Federation was formed in March 2004 to represent the combined views of a group of national banking associations (American Bankers Association, Australian Bankers' Association, Canadian Bankers Association, European Banking Federation, Japanese Bankers Association, Banking Association of South Africa, China Banking Association, Febraban, Indian Banks Association, Korea Federation of Banks, and Association of Russian Banks). The countries represented by the Federation collectively represent more than 18,000 banks with 275,000 branches, including around 700 of the world's top 1000 banks which alone manage worldwide assets of over $31 trillion.

Australian Bankers' Association and the British Bankers' Association[2] have submitted individual letters that provide in depth discussion on bank capital and the regulation of such. We acknowledge that such discussion provides background information that helps to put the issues raised under Action 4 in perspective, and therefore, generally agree with the concepts of both letters.

Banks and insurance companies present particular issues that do not arise in other sectors (as has been identified in the Discussion Draft). In this regard, we agree that consideration of net interest rather than gross interest expense should be the focus of Action 4, and welcome the recognition of the importance and effect of the regulation of banks. A general rule of allocating a Group's net third party interest expense amongst its members would produce highly distortive and arbitrary results for banking and insurance companies. The regulatory and operating environment for banks obviates the need for such a rule. To determine if there is a need to develop specific rules for banks, we recommend that any remaining areas of BEPS risk be identified. Such measures could then be targeted to support, rather than contradict, the regulatory regime. We welcome the opportunity to assist the OECD in any ongoing work to assess the need for such targeted rules and assist in developing them.

Context

Certain of the primary concerns that BEPS Action Item 4 is to address are set out in paragraph 3 of the Discussion Draft:

- a parent company claiming relief for interest expense while the return on equity holdings is taxed on a preferential basis; and
- certain entities in a group bearing a disproportionate share of the group's total third party interest cost.

The banking industry is highly regulated, with a major focus on requiring that banks have sufficient level of capital to absorb loss. Hence, the regulatory environment of the banking industry already constrains the behaviour of banking groups in a way which obviates many of the risks identified under the BEPS process (including those identified above). The means by which banking regulation acts as an effective constraint are set out in greater details in the ABA and BBA submissions and summarised below:

a. Banks require minimum levels of regulatory capital and [most of the] funding cost for this form of capital is non-deductible. The regulatory capital of a bank typically consists of ordinary equity, retained earnings/reserves and funds raised through various hybrid instruments (i.e. Tier 1 and Tier 2 instruments). While the international trend is to make the cost of servicing certain Tier 1 hybrid instruments

[2] Both associations are members of the IBFed

deductible, currently, in most countries, only the cost of servicing (some) Tier 2 instruments will be deductible (i.e. those regulatory capital instruments which give rise to hybrid taxation treatment have been addressed by Action Plan 2.); and

b. Whilst banks raise third party debt, there are already controls on the total level of debt in each entity, and regulators will seek to ensure that debt is not disproportionally reallocated to particular entities.

Underlying BEPS risks are heavily constrained through banking regulations and other mechanisms in the domestic tax legislation. However, we are happy to work with the OECD in assessing the need for developing well targeted rules to eradicate any identified abuses.

Further Information

We look forward to discussing this with you in more detail.

Yours faithfully

Sally Scutt
Managing Director, IBFed and
Deputy CEO British Bankers' Association

Michael Barbour
Chair of Tax Working Group, IBFed

Encl:

Copies of the ABA and BBA submissions on BEPS Action 4: Interest Deductions and other Financial Payments.