CREFC Europe

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CREFCE response – Tax deductibility of corporate interest expense: consultation

Introduction

The Commercial Real Estate Finance Council (**CREFC**) Europe is a trade association promoting a diversified, sustainable and successful commercial real estate (**CRE**) debt market in Europe that can support the real economy without threatening financial stability. Our core membership include lenders and intermediaries who help connect capital seeking the risk and returns of CRE debt with real estate firms seeking finance.

We are grateful for the opportunity to respond to the questions raised by HM Treasury (**HMT**) in its consultation on how to address BEPS issues arising from corporate interest expense. We welcome the decision made by HMT to consult broadly on the manner in which the UK should respond to the OECD's Action 4 recommendations prior to deciding on how best to address BEPS risk and its stated willingness to consult further with stakeholders as it develops a legislative response to BEPS over this parliament.

In preparing our response, we have had the benefit of reviewing the submission to be made by the British Property Federation (the **BPF**), which represents the views of those businesses in the UK that own, manage and invest in property. As a general matter, we agree with the views expressed by BPF in their response and do not therefore repeat those views here. In addition, we generally support the suggestions and recommendations made by the BPF concerning the nature and scope of any new measures introduced to counter perceived BEPS risk.

However, there are certain issues raised in the consultation in respect of which we consider it appropriate to provide comments separately and we set these out below.

Background

The functioning of business in the wider economy relies on investment into CRE. It provides accommodation for businesses that is fit for purpose and appropriately priced, allowing them the flexibility to adapt and relocate with changing economic conditions and business needs. This is especially important for new and growing businesses within the SME sector.

As a capital intensive and long-term business often involving very large, valuable and illiquid assets, CRE is dependent on the ready availability of debt finance. This dependency is driven principally by the very different risk and return expectations (and hence cost) of different types of capital. A typical CRE funding is likely to involve a mix of senior debt (secured from third party finance providers) and equity. It may also involve mezzanine and/or junior debt (which could be obtained either from a third party provider or a related party); this type of funding is sometimes lent indirectly (the third party lends to a holding company of the asset owner, with the funds then on-lent intra-group to that owner, for reasons of structural subordination).

The UK CRE industry has historically sourced (third party) debt finance mostly from the banking sector. Over recent years, the UK CRE debt market has diversified, with the CRE industry being able to access finance not only from the banks, but also from a range of new lenders and new vehicles for non-originating capital providers (including institutional investors such as insurance companies and pension funds, as well as funds). Our membership includes a wide range of such third party lenders.

Restricting the tax deductibility of debt will increase its overall cost to real estate borrowers. As a result, such measures will reduce the amount of debt capital that the real estate industry is able to access, and thus deploy in investment. This will significantly impact the ability of the CRE industry to deliver socio-economic benefits to the real economy (in the form of providing flexible space for rent for business, jobs across the sector and an improved urban environment).

Further, an approach that links deductibility to EBITDA, as the OECD proposes, is structurally pro-cyclical, reducing the affordability of debt when trading conditions are harder. This poses a risk to financial stability.

General comments

1. Is a general interest restriction of universal application needed?

As a general comment, in responding to the specific questions raised in the consultation document, we do not think that the OECD's best practice recommendations in relation to Action 4 are the best course of action for addressing BEPS risks in relation to interest deductibility.

The UK tax code currently includes a number of measures that operate to limit the deductibility of interest in specified circumstances. These measures include transfer pricing (limiting deductions for interest to the "arms' length" amount); distribution rules (limiting deductions for debt with equity/quasi-equity features – including where interest exceeds a reasonable commercial return); targeted anti-avoidance rules (such as the "unallowable purpose" rule within the loan relationship provisions) and the worldwide debt cap (introduced to limit interest deductions for UK members of a group who borrow excessively compared to other group members). These have been developed, and amended, in response to perceived taxpayer abuse of the UK's interest deductibility rules. Some of these provisions are specifically intended to counter the type of taxpayer behaviour that the OECD is seeking to counter with its BEPS proposals. This potential for overlap with the OECD's recommended best practice is acknowledged in the commentary relating to question 18 in the consultation.

The existing UK rules, although complex, are generally well-understood by business. The nature of these rules means that they can be applied responsively by reference to the particular facts and circumstances of a taxpayer and the business sector in which it operates. Unlike the OECD's proposed fixed ratio rule, they do not impose an arbitrary limit on interest relief – the current UK rules accept that one size does not necessarily fit all.

In the Foreword to the consultation, David Gauke MP states that ministers "are reviewing the rules on interest deductibility that apply within the UK in light of the recommendations set out in the OECD report". Given that, as the government acknowledges, the introduction of new rules based on the OECD's recommendations would represent a major change to the UK corporate tax regime, we consider it essential that the consultation includes (indeed, starts with) an informed debate on the

extent to which the current UK rules relating to interest deduction are in need of such a radical overhaul to counter BEPS risk.

In particular, as the BPF notes in its Key Points (at point 7), the BEPS project was directed at countering tax avoidance by multinational enterprises (**MNEs**). However, both the OECD report and the UK's consultation seem to conflate BEPS with a perceived excessive use of debt within the corporate sector generally. These are two very different issues, needing different policy responses. The UK property industry has taken a very pro-active approach in explaining how financial stability risks associated with (cyclical) excessive debt should be addressed[1]. The Bank of England has applauded that approach[2].

This consultation should concentrate on BEPS risk alone. We would be delighted to involve the Treasury in the ongoing work to reduce financial stability risks associated with CRE.

2. Limited risk of BEPS in relation to third party debt

In its report on Action 4, the OECD highlights three areas of risk where interest expense could be used to create a BEPS risk. For third party debt, two of these risks are relevant:

- first, a borrower group placing higher debt levels in high tax countries. This risk is dependent on a taxpayer having a choice of jurisdiction for borrowing purposes – something that may only be the case for international groups; and
- second, borrowing by a group to fund the generation of tax exempt income. This risk links to the purpose for which a borrower uses debt, rather than the debt itself.

In each of these circumstances, the BEPS risk does not come from the third party debt per se, but rather from the use made of it by the borrower in question.

Third party debt lent in all other circumstances – i.e. the debt which funds business activities and investment in a straightforward way, particularly within a domestic context – carries little or no BEPS risk. This premise underlies the OECD BEPS recommendations. For example, the group ratio rule, on which (given its complexity) work is ongoing within the OECD, is proposed as a potential means of providing a form of safe harbour for third party debt.

We therefore consider that, within any legislative response to the OECD recommendations, the UK government should recognise as a general principle that the provision of debt on commercial terms by an unconnected finance-provider by itself has nothing to do with base erosion or profit shifting – and so interest on genuine third party debt should continue to be deductible in full (subject to usual applicable UK rules). We consider that this is key if companies are to continue to be able to raise the funds they need for their business activities without undue tax constraints.

As the BPF states in its comments, this means that if a fixed ratio rule is to be adopted, it must be accompanied by a sensible and workable group ratio rule. However, given the issues that arise in

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[1] In particular, we refer you to *A Vision for Real Estate in the UK* (May 2014). This report was produced by the Real Estate Finance Group, an independent UK CRE industry group, and can be accessed at: http://www.ipf.org.uk/industry-involvement/a-vision-for-real-estate-finance-in-the-uk.html.

[2] See the speech given by Alex Brazier, Executive Director, Financial Stability Strategy and Risk at the Bank of England in October 2015 entitled *Nurturing resilience to the financial cycle*, which can be accessed at: http://www.bankofengland.co.uk/publications/Pages/speeches/2015/850.aspx.

creating such a rule (certain of which the BPF touches on in its comments), we consider that the UK government should consider adopting a specific safe harbour for third party interest expense – if not generally, then as a minimum for non-recourse third party debt secured against a specific asset (the general model for CRE financing) where the BEPS risk is especially low.

Specific targeted measures could then be introduced to address those situations identified by the OECD where BEPS is a real, identifiable risk (either replacing or building on existing UK tax provisions). We note that such an approach would be permitted within the OECD's best practice recommendations (see paragraph 173 of the OECD report).

3. International response

The OECD's work on BEPS is intended to result in a consistent international response to BEPS. However, through the optionality included within its recommendations as to best practice, the OECD acknowledges that there can still be differences in how different countries tackle BEPS.

We agree with the BPF that it is imperative that the UK takes into account the tax regimes of other OECD/G20 members and how they propose to respond to the OECD's recommendations on Action 4 when determining its own policy response. It would not be advisable for the UK to be a "first mover" or gold plate the OECD recommendations (given the significant impact this could have on the UK's competitiveness). The UK should also be mindful that approaches that are, on the face of it, OECD-compliant may operate very differently in practice in different jurisdictions, whether because of the details of the rules, or as a result of differences in the broader tax, legal and market environment.

We note that the EU, in addition to direct involvement in the OECD BEPS project, is itself now proposing to implement Action 4 through a new Directive on the revived plan for a common consolidated corporate tax base (**CCCTB**). While we acknowledge that international coordination can advance the consistency, fairness and effectiveness of taxation, we consider that this approach is neither in the interests of European business, nor in the interests of the UK.

The Consultation Questions – Key points

As stated above, we endorse the comments made by the BPF in its response to the consultation. In addition, we wish to highlight the following points:

Question 1: When should a general interest restriction be introduced in the UK?

We echo the points made by the BPF in response to question 1. We would also repeat the point made above that the consultation process should also involve (and should have perhaps started from) a discussion as to whether a general interest restriction (i.e. of universal application across UK taxpayers) is required, or whether instead the OECD recommendations should be applied in a more targeted way, building on the existing tax framework within the UK – this links to the comments made in our answers to questions 2, 9 -11, 17 and 18.

We also note that a key driver concerning the timing of introduction of any general interest restriction is the approach the UK government decides to take in relation to both grandfathering and transitional arrangements. The commentary to question 17 suggests that the government anticipates that grandfathering is likely to be limited. If so, we would recommend a transitional period of at least five years from the date on which final legislation is published. This links to the nature, and maturity profile

of most CRE loans. The OECD stresses in its report the need to give business a reasonable time to restructure existing financing arrangements and it is this that underlies our suggestion of a five year period.

Many CRE projects are long-term in nature, with related third-party financing arrangements reflecting the long-term nature of the projects. The majority of CRE loans have a maturity of between three and seven years, and some have longer terms. Investment decisions (including the decision made to lend and the decision to borrow) will have been taken on the basis of financial models. These models will contain assumptions as to tax deductibility of interest expense. If such assumptions prove to be untrue (because of the introduction of a fixed ratio rule), a borrower may find itself in breach of loan covenants given the impact on cash flows because of the additional tax that is then payable (which could not have been anticipated when the loan was entered into). This could trigger defaults, resulting in lenders taking appropriate enforcement measures.

Prepayment, whether in anticipation or as a result of the change in regime, may give rise to significant costs for borrowers – prepayment penalties (whether under the loan, or under a related derivative entered into to “fix” the interest cost over the term of the loan) are common. Lenders and borrowers will therefore need sufficient time to assess how best to restructure financing arrangements in a sensible and prudent manner, including identifying (and accessing) alternative funding sources (including equity markets), to avoid either incurring additional costs on prepayment or being forced to go to market at a time that market conditions are not conducive to capital raising. Indeed the ease of responding to a new interest deductibility restriction that affects a lot of existing third party debt across all sectors of the economy will depend on economic, financial and property market conditions at the relevant time. A longer transitional period will minimise the risk of major market disruption.

Question 2: Should an interest restriction only apply to MNEs?

Action 4 is directed at countering international tax avoidance – the shifting of profits cross-border to benefit from differentials in tax rate/regime. So conceptually – as the OECD acknowledges in its report (at paragraphs 30 and 49, for example) – it would be reasonable for the UK to choose to adopt the BEPS recommendations solely in relation to the kind of multinational group activities that were the focus of the BEPS initiative – and which the OECD acknowledge pose the principal BEPS risk. The UK would then rely on the existing UK tax rules (supplemented, if necessary, by additional targeted measures) to address any risk of avoidance within a domestic context. The OECD acknowledges in its report on Action 4 that, for domestic groups, targeted provisions are acceptable.

This is particularly relevant to the potential application of the BEPS measures to the existence of third party debt within domestic groups. In and of itself, borrowing on commercial terms from an unconnected finance-provider has nothing to do with base erosion or profit shifting, and should not be touched by rules intended to curb such behaviours.

In particular, the specific BEPS risk identified by the OECD in relation to third party debt is the placing of higher debt levels in high tax countries. This risk only exists if a taxpayer has a real choice of jurisdiction for borrowing – a choice that is in practice only available to international groups.

Any adoption of the BEPS recommendations by the UK should safeguard the deductibility of interest on commercial third party debt, save where there is an identifiable BEPS risk. Anti-BEPS measures should be proportionate, and that means aiming them at the mischief which they seek to address.

If the government nevertheless opts to introduce a rule of universal application, we agree with the BPF that there must be adequate safe harbours built into the rules, to ensure that the large majority of businesses that pose little or no BEPS risk are not faced with a disproportionate compliance burden or, indeed, inappropriate tax consequences. We note that the commentary on question 9 in the consultation refers to the fact that a de minimis of £1m could exclude 90% of UK companies. It would be simpler, and better policy, to design the legislation so as not to apply to the large majority of businesses that pose little or no BEPS risk, but simple and straightforward safe harbours and exclusions would be the next best thing.

We would encourage the government to give further consideration to whether it would be permissible under EU law to limit any BEPS measures to MNEs. If not, then we echo the comments made by the BPF that the UK government should ensure that companies are able to obtain a full deduction for all third party interest expense where there is a low BEPS risk – through, as a minimum, a safe harbour for third party debt secured against an immovable asset (whether directly or routed through a group entity, to accommodate structural subordination structures)[3], together with an effectively designed group ratio. Any such safe harbour should apply to all forms of third party lender (i.e. not only banks or other financial institutions): diversity of credit supply is to be encouraged, not least because of the resilience it can bring to the financial system.

Questions 3 – 6: **Specific definitional and other Issues relating to the fixed ratio rule**.

No additional comments.

Question 7: What is the appropriate percentage for a fixed ratio rule?

We concur with the comments made by the BPF: we consider that if the UK does decide to adopt a fixed ratio rule at all, it should adopt as high a fixed ratio as possible. In particular, we note that the consultation indicates that the UK government is likely to retain many of its existing rules relating to interest deductibility (though see below our response to question 18). As a result, setting a ratio at the higher end of the corridor would be justified within OECD best practice.

In setting the level of any fixed ratio, it will be important to take account of the fact that interest rates are currently at a historic low (the same point also applies to the de minimis – see below). Many groups will be borrowing at higher historic rates (even where loans are provided on a variable rate basis, many UK corporate borrowers choose to hedge their interest rate exposure through derivatives (such as swaps, caps or collars) when taking out a loan to "fix" their financing costs, and will sometimes recycle those swaps when refinancing). So, subject to the existence of grandfathering arrangements, if the ratio is set by reference to current low rates, groups may be penalised where they have a high interest

[3] Such structures are illustrated in the appendices to the BPF response. As banks are encouraged to reduce riskier lending, they are becoming more common. Essentially, a senior lender will often want any mezzanine loan provider to be structurally subordinated, so the mezzanine debt is loaned to a holding company in the borrower group rather than to the asset-owning entity (to which the senior debt is lent). The security arrangements in such cases will depend on the commercial agreement between senior and mezzanine lenders and set out in an intercreditor agreement.

cost, not because of excessive borrowing but because of when in the economic cycle they took out the borrowing.

The ratio should also take account of the expected future trajectory of interest rates. With rates anticipated to normalise – albeit gradually – over the medium term, the ratio should take account of future increases to minimise the need for adjustment as conditions change. The OECD itself acknowledges the risk of the ratio being out of step with changing conditions – but states that countries are not expected to make changes, save where there is a "significant change" in interest rates. Given that it is anticipated that rate changes will be gradual and incremental, there is unlikely to be a "single" significant change even though, over time, the cumulative effect may be significant. The UK government needs to be clear as to the assumptions made in setting the ratio, and the circumstances in which it would look at adjusting the ratio: this is needed to provide business with certainty, and comfort that the rules will be work equitably.

Question 8: Should the rules include a group ratio rule?

For the reasons set out by the BPF, we consider that, should the UK adopt a fixed ratio rule as proposed by the OECD, it is essential that it also adopts a sensible and workable group ratio rule. A fixed ratio rule is arbitrary and will take no account of the particular circumstances of a particular business or sector. A group rule would go some way to recognising that one size does not fit all.

Absent a safe harbour for third party debt, the CRE industry would be disproportionately affected by measures conceived as a means of combating MNE profit-shifting because of its relatively high structural reliance on debt.

We agree with the BPF that, in the context of real estate, groups should have a choice of whether to apply an earnings/interest test or instead look to a balance sheet based ratio. We also note the importance of using an appropriate definition of "group" that reflects commercial reality.

We would also recommend that, when shaping a group ratio rule, the UK government choose to adopt an uplift of third party interest expense as allowed by the OECD. This will help mitigate some (but not all) of the concerns about whether the group ratio rule would allow alignment of earnings and interest expense.

We share the BPF's concerns about the difficulties implicit in creating a sensible group ratio rule, some of which are outlined in the OECD report. We therefore favour an additional separate safe harbour for third party debt in the form proposed by the BPF. "Excluded" third party debt could still be taken into account when applying the BEPS measures to "other debt", but, as a result of this safe harbour, would not itself be subject to restriction under the BEPS rules.

Questions 9 - 11: What form of de minimis threshold should apply?

As stated above, we consider that any new rules should be targeted so that they apply to those situations where there is a real, identifiable risk of BEPS. Ideally, any interest restriction based on the OECD recommendations should be drafted to apply only to those companies/groups where BEPS is a valid concern. The rules should therefore be drafted to exclude from the operation of the rules those companies where the risk of BEPS is perceived as sufficiently low to justify reliance on existing

measures within the UK tax code (including the arms' length test). This is recognised as a valid approach by the OECD (as per paragraph 54 of the OECD report).

If it is not possible to limit the application of any new measure to MNEs (for example, because of EU law reasons), and absent an exemption for (commercial) third party debt, a de minimis safe harbour is the main route for such low risk entities to be taken out of the new rules. In common with the BPF, we consider that the level and nature of a de minimis should focus on the characteristics of the companies/groups that are seen as low risk – as a matter of principle, the focus should be on excluding the "right" businesses (rather than focusing on what percentage of companies will be excluded if a particular threshold is set). For this reason, we consider it would be helpful also to provide for a general exclusion for SMEs. Such an exclusion be consistent with national, EU and global efforts to support the SME sector, in particular by safeguarding its access to capital (including credit).

We consider a de minimis is required even if the measures include a sensible group ratio rule. This is because, although a workable group ratio could potentially groups to continue to be able to deduct (a significant part of) third party interest expense, those groups would still be within the regime. This means that the relevant group would be subject to an ongoing compliance burden to determine its group ratio each accounting period (even where the effect of that calculation means the rules have no effect on third party interest deductibility) and would still have to apply the fixed ratio in relation to any related party debt[4]. Any de minimis should be responsive to changes in interest rates and other economic factors. The points made above in relation to the level of the fixed ratio and interest rate changes apply equally to any de minimis threshold.

Finally, we consider that, in certain situations, it would be appropriate for the de minimis threshold to apply to an individual member of a group, rather than the group overall. Within the CRE sector, individual assets are often held by separate companies – effective SPVs (single purpose vehicles). Generally, such an SPV will raise funds directly from third party lenders. The lending decision is primarily based on the cash flows from, and value of, the asset held by the SPV. Such lending is typically on a non-recourse basis to other group members and so does not take account of the group balance sheet (i.e. there is no cross-collaterisation). We therefore consider that it would be reasonable (and equitable) for the de minimis to apply to any SPV in this type of scenario as if the SPV were a single entity (reflecting the commercial reality of the financing) – so the SPV will effectively be "de-grouped" for these purposes only.

We would also ask that the UK government provide for a specific exemption for securitisation companies that fall within the scope of the Taxation of Securitisation Companies Regulations 2006. Such companies are within the charge to corporation tax. Save where specifically excluded, the provisions of the Corporation Tax Acts therefore apply to a securitisation company. The effect of the Regulations is to specify a particular measure of profit to be used when assessing the amount of tax payable, instead of the "standard" measure of taxable profit as computed under general corporation

[4] In this context, we note that when the UK introduced the worldwide debt cap rules, the compliance burden that might otherwise fall on low risk taxpayers resulted in the introduction of a gateway – a much simpler calculation based on an accounts test (see section 262 Taxation (International and Other Provisions) Act 2010). The result of which could mean a company was excluded from the application of the debt cap rules for that accounting period. The worldwide debt cap rules also include a specific SME exclusion (see section 344 Taxation (International and Other Provisions) Act 2010).

tax principles. We consider that a specific exemption for securitisation companies from any new anti-BEPS measures is required to avoid any uncertainty as to the interaction between the UK's securitisation regime and any general interest restriction rule.

In this context, certain securitisations involving CRE are structured as single borrower "secured loan" transactions. In these transactions, a special purpose issuer (often on-balance sheet) raises funds on the capital markets, on-lending them to one or more asset-holding single purpose vehicles in the same corporate group. (These differ from conduit structures, where a bank transfers a portfolio of existing CRE loans, made in the normal course of its banking business, to an issuer.) The financing will be on a non-recourse basis, with security given over the underlying real estate.

Investors in the securitisation are ultimately looking to the rental income arising from the underlying property assets to service their debt, and not the corporate credit of the relevant group. Although the issuer would qualify as a securitisation company, and thus fall within the securitisation regime, the underlying borrower entities would not so qualify (because the assets they hold are not financial assets). As any new rule is developed, we would ask the UK government to consider making specific provision to address the position of any such securitisation borrowers (as the viability of the securitisation – and its credit rating – is predicated on the underlying borrowers' ability to finance the notes). This is particularly important in terms of transitional arrangements given that single borrower CRE securitisations tend to be long term in nature (often with debt maturity dates of at least 20 years), the underlying real estate is often let out on market standard long-term occupational leases providing a relatively fixed income stream (hence the ability of the borrower to raise such long term finance) and the credit assessment of the securitisation structure will be based on models that assume interest is deductible in full.

Question 12: Addressing volatility of earnings.

The CRE sector is both inherently cyclical and built around relatively stable long-term cash flows (given the structure of occupational leases within the UK market). As a result, as the BPF states in its submission, linking interest deductibility to EBITDA could prove to be dangerously pro-cyclical as far as the CRE industry is concerned: a CRE business facing tenant failures (and thus lower earnings) may additionally face an increase in costs as deductibility for interest is reduced. This would plainly serve no purpose as regards combating BEPS, whilst posing a real threat to business and potentially even financial stability.

Therefore we would also support including measures aimed to combat volatility. A mechanism based on existing UK tax rules – enabling carry forward (on an unlimited basis) and carry back (on a limited basis given the need to finalise tax returns within a reasonable period – would be a sensible minimum. Although not perfect as a means of managing volatility, such measures have the advantage of familiarity and would also be simpler to operate in practice than (for example) the ability to average EBITDA over a specified period. We would suggest that any carry back measure be for a longer than the current 12 month period that is currently allowed for trading losses and non-trading deficits: for example, a minimum of three years. We consider that such measures would be required whatever the level of the fixed ratio.

Given that any such measures would in effect have their own internal limits (due to capacity), we do not consider that there is a basis for including additional restrictions such as caps or time limits. To

the extent that the government considers that there could be a risk of "capacity" selling, we consider that this would be best addressed by adopting tailored anti-avoidance legislation replicating those that currently apply to interest deductions on a change in ownership.

A related issue concerns the tax position of the lender to a loan where there has been disallowance under the BEPS provisions (it should be remembered in this context that the lending landscape is no longer as dominated by banks as it used to be, so a variety of investor types could be affected). Currently, where interest is disallowed as a result of a transfer pricing adjustment, the lender can seek a corresponding adjustment (under UK domestic law or through the competent authority procedure). Similarly, if interest deductions are restricted under the distribution rules, the resultant UK tax law recharacterisation applies to the recipient as well as the payer, providing equity of treatment.

Particularly if the BEPS provisions apply to third party debt, but also more generally, we recommend that consideration be given to addressing the potential double taxation that will arise from a BEPS restriction. If the parties choose, then a lender within the charge to UK tax should be able to treat part of its interest as non-taxable – and any excess available for carry forward would be reduced. Given that the OECD measures are intended to be replicated internationally, it may be feasible to agree a similar approach for non-UK lenders within treaty jurisdictions (or at least within the EU). It seems hard to justify taxing a lender (and specifically a third party lender) on interest that is (and will continue to be) disallowed under the BEPS rules: there needs to be symmetry within tax for it to be perceived as fair. Given the arbitrary nature of the fixed income rule, and the lack of any "purpose" or commerciality test within its operation, a failure to offer a third party lender (in particular) an opportunity for relief would be inequitable.

Questions 13-14: the Public Benefit Project exclusion.

No additional comments.

Question 15: The use of targeted rules to address specific risks.

No additional comments.

Question 16: Addressing BEPS risk within the banking and insurance sectors.

No comments.

Question 17: Transitional rules.

Please see our comments on question 1 and also our comments on securitisation companies in our response to questions 9-11. We therefore agree with the comments made by the BPF that there should be grandfathering for third party loans entered into prior to (at the earliest) the new measures being published in final form, and that such grandfathering should be indefinite. The OECD acknowledges that in certain cases indefinite grandfathering is allowed.

If such a course were adopted, then it would be appropriate to bring the rules into effect earlier than suggested in our response to question 1 – for example, the two year period suggested by the BPF.

A separate issue, not touched on specifically in the consultation, links to the interaction between the new measures and any carry forward interest expense relating to (a) accounting periods before the

new measures take effect and (b) grandfathered debt following the introduction of any new measures. Where a company has carried forward interest expense at the time the new measures take effect, we consider that where such expense was deductible in full at the time it was incurred, it should remain deductible under the "old" rules in full (whether as part of a trading loss or non-trading deficit) and not be subject to any new restrictions. Otherwise, there is a clear risk of retrospective taxation.

Question 18: To what extent should any new general interest restriction rule replace existing rules?

As stated in our general comments, we consider that the consultation should involve (and ideally would have begun with) an informed debate on the extent to which the existing UK approach to interest deductibility needs such a major overhaul to address BEPS concerns. If the UK decides to introduce a universal general interest restriction based on the OECD recommendations, this will mark such a major change to the UK corporate tax system that the resulting opportunity to repeal and/or simplify existing areas of the UK tax code dealing with interest deductibility should be taken. Existing UK rules should only be kept if there is a clear policy need for their remaining on the statute book.

Once the UK has determined its policy approach to the OECD recommendations, we would ask that there is a follow-on consultation exercise involving a review of existing legislation – including the extent to which transfer pricing legislation should continue to apply to financing costs in light of the new measures to be introduced by the UK and other countries. This is particularly relevant if third party debt is not excluded from the operation of the OECD measures; however, if there is an appropriate safe harbour for third party debt, we acknowledge that many of the existing provisions may still be needed.

We remain at your disposal should you have any questions or require further details.

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