

PRESENTED BY:

The 2015 OECD International Tax Conference

June 10-11, 2015
Four Seasons Hotel
Washington D.C.



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V. Interest Deductibility and CFC Rules

The 2015 OECD International Tax Conference

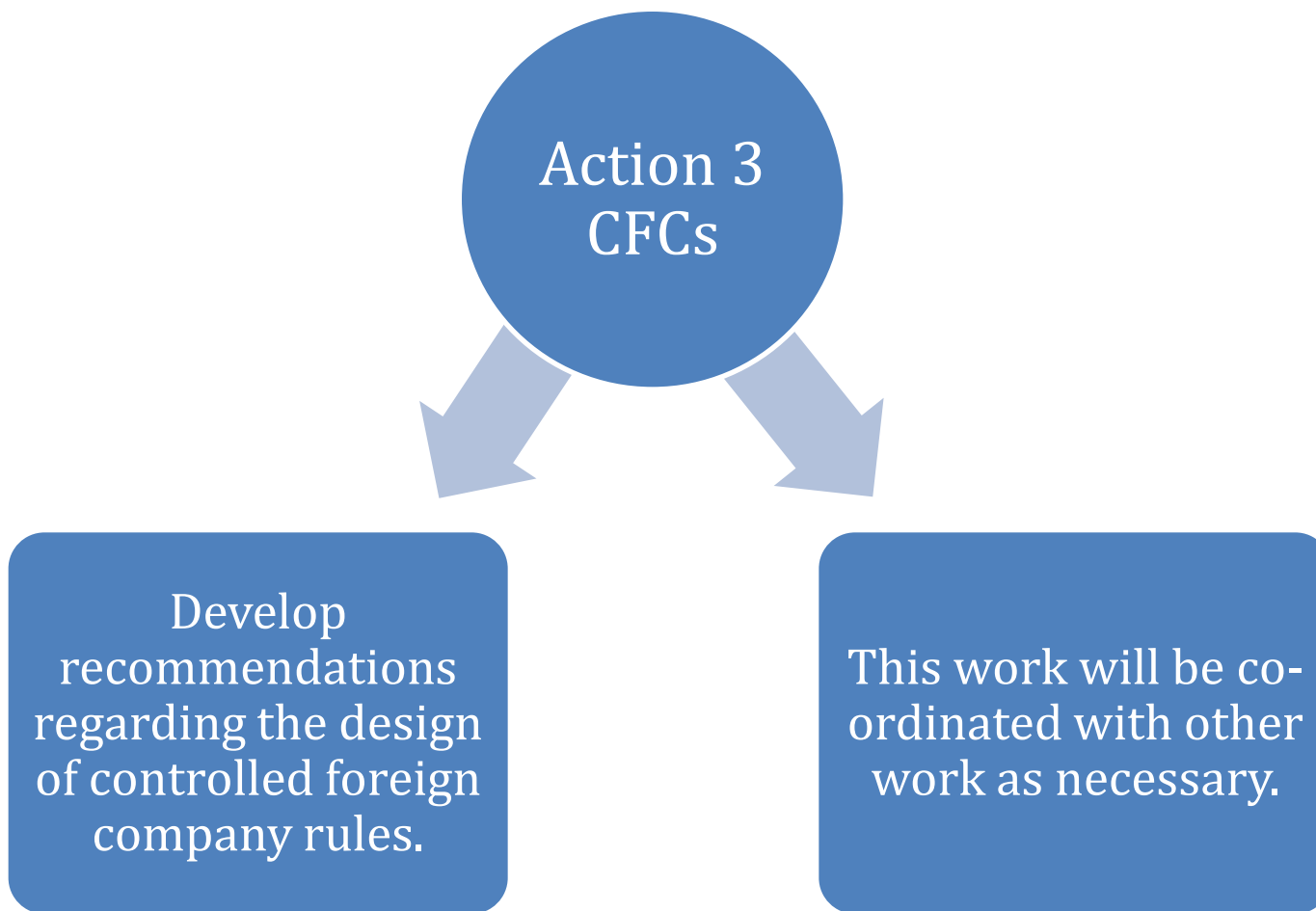
June 10-11, 2015
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Panelists

- **Achim Pross**, Head of International Cooperation and Tax Administration Division, OECD
- **Doug Poms**, Acting Deputy International Tax Counsel, U.S. Treasury
- **Olga Hartwell**, Vice President & Senior Tax Counsel, GE
- **Saul Rosen**, Senior Tax Counsel, Citigroup
- **Manal Corwin**, National Leader, International Tax, KPMG LLP

BEPS Action 3 - CFCs



BEPS Action 3 - CFCs

Structure of the 2015 Report

Building blocks for effective CFC rules

- **Definition of a CFC, including control**
- **Low-tax exemption and threshold requirements**
- **Definition of income**
- **Rules for computing income**
- **Rules for attributing income**
- **Rules to prevent or eliminate double taxation**

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Policy considerations

General agreement that different CFC rules prioritise different policy objectives

- **CFC rules are part of a jurisdiction's overall tax system, so the policy objectives of the tax system affect the policy objectives of CFC rules**
- **CFC rules that are part of worldwide systems may focus more on long-term deferral and foreign-to-foreign stripping**
- **CFC rules that are part of territorial systems may focus more on shifting out of the parent jurisdiction**

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Indicia/factors

Different CFC rules also look at different factors

- **Most jurisdictions have the same overall concern: income has been shifted into the CFC and separated from underlying value creation**
- **But different jurisdictions look at different indicia/factors: legal classification, relatedness of parties, source of income, substance**
- **Recommendations must be flexible and not overly prescriptive**

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Definition of income

Discussion and public comments have focused on definition of income

- **Non-exhaustive list of approaches and combinations of approaches:**
 - **Categorical analyses – divide income based on legal classification, relatedness of parties, and source of the income**
 - **Substance analyses – look at various proxies, including people, premises, assets and risk**
 - **Excess profits analysis – treats income above a normal return as CFC income**

BEPS Action 4 - Interest

The problem

“no or low taxation associated with practices that artificially segregate taxable income from the activities that generate it”

BEPS Action Plan, chapter 3

location of third party interest in high tax countries

quantity of related party interest, in excess of group's actual interest cost

use of interest expense to fund tax exempt income

BEPS Action 4 - Interest

The Action Item

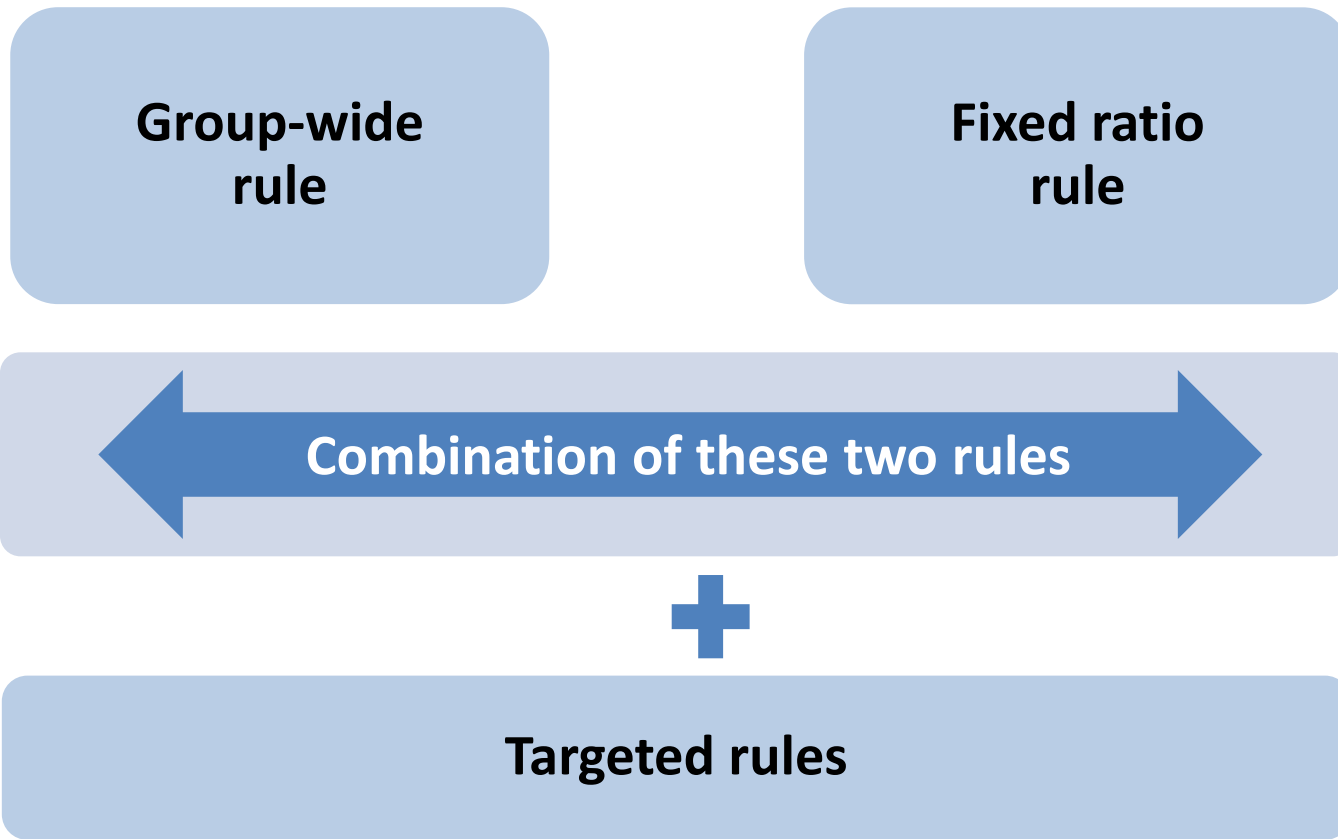
Develop recommendations regarding **best practices** in the design of rules to prevent base erosion through the use of interest expense ...

... for example, through the use of **related party** and **third party debt** ...

... to achieve **excessive interest deductions** or to finance the production of **exempt or deferred income** ...

... and other financial payments that are **economically equivalent to interest.**

BEPS Action 4 - Interest Public Consultation



BEPS Action 4 - Interest

Developing a best practice – status of discussion

Fixed ratio rule

+

Group ratio rule

+

Optional *de minimis* monetary threshold to remove low risk entities

+

Optional carry forward of disallowed interest/unused capacity

+

Targeted rules to support general rules and address specific risks

BEPS Action 4 - Interest

Developing a best practice – status of discussion

Fixed ratio rule

EBITDA

x

Benchmark fixed ratio

- Objective measure
- Based on taxable income
- Supported in public consultation

- No single ratio, but a range
- Principles to help countries setting a ratio

BEPS Action 4 - Interest

Developing a best practice – status of discussion

Group ratio rule

- **Allows an entity to exceed the benchmark fixed ratio**
 - **Based on relevant group financial ratio**
 - **Based on consolidated financial reporting group**
 - **Countries may opt not to apply, based on policy considerations**

BEPS Action 4 - Interest

Developing a best practice – status of discussion

Optional *de minimis* monetary threshold to remove low risk entities

Optional carry forward of disallowed interest/unused capacity

- Provide flexibility to exclude entities with low net interest expense
- Carry forwards smooth the impact of earnings volatility

BEPS Action 4 - Interest

Developing a best practice – status of discussion

Targeted rules to support general rules and address specific risks

- **Protect fixed ratio rule and group ratio rule from planning to avoid/reduce their effect**
 - **Tackle specific BEPS risks not addressed by these rules**
 - **Need for special rules which take into account features of banking and insurance sectors**