Tackling interest abuse by multinational corporations

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The OECD is discussing interest deductions by multinational companies tomorrow. I was principle author of the BEPS Monitoring Group's submission on the issue.

The subject is reported on that Group's web site as follows:

We have now published our submission in response to the consultation on BEPS Action Point 4 Interest Deductions.

We warmly welcome the proposals in this report, which could greatly reduce the opportunities for tax avoidance by multinationals using internal financial structures to reduce their taxes artificially by inflated deductions of interest from taxable profits. We support its main proposal, that countries should introduce a limit on such interest deductions based on the consolidated net interest expense of the whole multinational corporate group to third parties, apportioned to each group member according to its earnings before tax, interest, depreciation and amortisation (EBITDA). However, we also make some comments and suggestions.

Firstly, more attention should be paid to the problem of divergence between the standards for financial accounting and those for taxation. Since consolidated financial statements will at least initially be used, we suggest that companies should be required to identify and adjust for any material differences caused by inconsistent financial accounting rules and differing accounting and tax treatments of significant items, at both the group and entity levels. Any allocation of net interest expense based on group accounting must be based on data drawn from the consolidation process where (i) all intra-group transactions have already been eliminated from consideration and (ii) the accounts of subsidiary entities have, if necessary, been restated from the local accounting standards to those of the group financial statements. In the longer term, we strongly urge the OECD to work on the development of an international standard for tax accounting for such purposes, which could build on the work already done in the EU's Common Consolidated Corporate Tax Base.

Secondly, it should be recognised that the adoption of any allocation rule entails a *move away from the separate entity principle, but in this case only in relation to charging for costs. As we noted in our response to the report under AP10 on Low Value Added Services, which also proposed an apportionment method, many tax authorities, especially in developing countries, may be reluctant to accept an apportionment method for joint costs, as they can be used to reduce taxable profits in source countries. We nevertheless support an apportionment approach in general, since it is in line with business reality, and results in rules which are much easier to administer. In the case of interest, we support a cost apportionment since (i) allocation based on earnings reflects economic activity and hence to some extent benefit; and (ii) evidence shows that this method would restrict interest deductions to a level which will normally be well below that resulting from the interest cap or thin capitalisation rules that countries currently apply.*

However, as we have argued in several submissions, we would generally favour a move to more comprehensive profit apportionment solutions. Hence, we strongly encourage the systematisation and expanded use of the profit split method, which fairly and easily apportions both costs and revenues. This would be the most effective way to achieve the aims of the BEPS project as laid down by the G20 leaders, to ensure that multinationals are taxed 'where economic activities take place and value is created'.