



International Co-operation and
Tax Administration Division,
OECD/CTPA
2, rue André Pascal
75775 Paris
France

Submitted by email: interestdeductions@oecd.org

Confederation of Swedish Enterprise - Comments on the OECD Public Discussion Draft entitled “Elements of and design and operation of the group ratio rule” 11 July 2016

The Confederation of Swedish Enterprise is Sweden’s largest business federation representing 49 member organizations and some 60 000 member companies in Sweden, equivalent to more than 90 per cent of the private sector.

The Confederation of Swedish Enterprise is pleased to provide comments on the OECD Discussion Draft entitled “Elements of and design and operation of the group ratio rule” 11 July 2016 (hereinafter referred to as the Draft).

General Comments

The discussion draft is divided into three parts. The first part dealing with the calculation of net third party interest expense, the second definition of group-EBITDA and the third the impact of losses on the operation of the group ratio rule. Before we go into specific comments regarding these three parts, we would like to emphasize the need for a straightforward application of the group ratio rule in a consistent way across different countries. Some highly leveraged groups will be hit hard by the fixed ratio rule. The group ratio rule will be very important for such groups. In order to make the group ratio rule usable it must be easy to apply. The group ratio rule should not be more complex than absolutely necessary. Otherwise there is a risk that the group ratio rule will be too burdensome to comply with for some groups, leaving them unable to deduct most of their interest expense. Every element of the group ratio rule which increase the complexity of the rule should be carefully considered. If the element is not found to stop a clear BEPS-risk, it should not be included in the group ratio rule.

While the Confederation of Swedish Enterprise appreciates the efforts by the OECD to develop recommendations regarding the design and operation of the group ratio rule, we must also realize that it will take time before a well-functioning group ratio

rule is in place. And even when a group ratio rule is in place, it will most likely be complex and costly to comply with. With this in mind, the importance of the fixed ratio rule cannot be understated. The fixed ratio rule must be easy to apply and, especially for small open economies such as Sweden, the fixed ratio rule must be competitive. Otherwise investments will end up in other countries, with a more competitive fixed ratio rule. In this regard, we note that several large economies in Europe allow, or intend to allow, for interest deductions at the maximum prescribed EBITDA-rate (30%) as a response to the discussions of the Anti-Tax Avoidance Directive in the EU. These choices made by larger countries exert downward pressure on the statutory tax rates in other Member States, in particular in smaller economies in the periphery of Europe, to compensate for not being able to allow for more extensive allowable deductions than provided for in the larger economies.

In the following the Confederation of Swedish Enterprise leave specific comments on the different parts of the draft.

Calculation of a group's net third party interest expense

The Draft contains three approaches on how to calculate a group net third party interest expense. Approach 2 and 3 are however different ways to come to the same conclusion. The main question to be answered is whether adjustments should be made or not. Approach 1 means no adjustments to the interest income and expense figures in the consolidated income statement, while approach 2 means that expense that are economically equivalent to interest should be added to the figures from the consolidated statement. Expense that are not economically equivalent to interest shall in the same adjustment be removed from the figures in the consolidated statement. Approach 3 is not based on the consolidated income statement but will include the same adjustments as approach 2. In the Draft, approach 2 and 3 are recommended. According to the Draft approach 1 risks leading to substantial differences in presentation of interest income and expense in income statements. This would lead to that the net interest figure could be underestimated or overestimated. Concerns are also mentioned that approach 1 could lead to manipulation so that items are not accounted for as interest in the income statement.

The Confederation of Swedish Enterprise believes that approach 1 should be the recommended approach. Although there are some concerns with approach 1, as mentioned in the Draft, we believe these concerns to be greatly exaggerated. The figures in the income statement have been audited and manipulation should therefore not be easy. The Draft states that approach 2 and 3 will lead to a consistent figure for a group's net third party interest expense. Approach 1 would on the other hand lead to under- or overestimation of the interest figures. We are not convinced that this is correct and it is not clear how to measure what is an under- or overestimation. From economic theory, we know that it is notoriously difficult to disentangle the interest component from other cost components.

The consolidated income statement for a group is prepared in accordance with Generally Accepted Accounting Principles (GAAP) (e.g. US GAAP, IFRS or national GAAP). IFRS is applied in more than 100 countries for listed companies and US GAAP in the US for US companies. IFRS is mandatory for listed companies in the EU. IFRS and US GAAP are based on high quality financial reporting standards covering thousands of pages. While there are some differences between IFRS and US GAAP, it should also be pointed out that to a great extent the principles are similar or identical for financial reporting. The standards that govern financial reporting have thus reached far longer both in quality and in harmonization between different countries than tax legislation have. IFRS is e.g. applied in a consistent manner in different countries, while tax rules on the other hand can have greatly widespread interpretation and application depending on the country applying it.

One example can perhaps illustrate why tax adjustments will give rise to different interpretation in different countries. In the Draft, it is stated that the following item should be excluded from net third party interest expense:

“non-interest income and expense, to the extent this is not economically equivalent to interest”.

This is a broad and vague definition and would probably be interpreted and applied differently in different countries for tax purposes. One could say that the same definition already applies to financial reporting. But the difference is that the application of such a definition is already far more developed in financial reporting standards such as US GAAP and IFRS and also national GAAP compared to where tax legislation is today. We therefore consider approach 1 superior to approach 2 and 3. Further, we are not convinced that approach 2 and 3 will actually lead to a more consistent application than approach 1. Taken into account the greatly increased complexity that approach 2 and 3 entails compared to approach 1, we cannot see a reason to recommend approach 2 or 3. Hence, we find approach 1 to be preferable.

As the Draft states, there will be some differences in the presentation of items in financial income statements depending on which financial reporting standard is applied. This should however not lead to a recommendation to apply approach 2 or 3, since the differences apply not only to the interest component but to all items.

If the OECD finds that approach 2 and 3 are the approaches to be recommended, the Confederation of Swedish Enterprise would like to highlight the need for limited and clearly defined adjustments. It is important that the group ratio rule is implemented in the same way in different countries. If jurisdictions implement the group ratio rule differently, it will mean increased complexity and uncertainty for taxpayers.

The Draft recognizes that groups may have issues aligning net interest expense and EBITDA. Therefore an entity may apply an uplift to its group's net third party interest up to 10 %. While the possibility for an uplift is welcomed by the Confederation of Swedish Enterprise, we believe that the limit to 10 % is too low. Groups can have great concerns with aligning debt with EBITDA within the group, and the margin of error might be much higher than 10 %. Therefore, if there should be a cap on the uplift, it should be higher than 10 %.

The Confederation of Swedish Enterprise agrees with the Draft's recommendation to allow groups to adjust their net third party interest to include the group's share of the net third party interest income or expense of an associate or joint venture entity. It should however be clearly recommended that it is up to the group to decide whether or not to include such adjustments. Whether a group chose to include its share of a JVE or associate entity in their net third party interest should not give rise to any BEPS-risk. Therefore the decision to make adjustments or not should be up to the group.

Definition of group-EBITDA

Much of what have been mentioned above about the definition of third party interest expense can also be applied to the definition of group-EBITDA. It is important to ensure a uniform implementation which leads to a consistent application and in the end lower compliance costs for taxpayers. A good example of a more straightforward approach is the recommendation to completely exclude capitalized interest from the adjustment for interest income and expense. This is a clear recommendation that could easily be implemented and applied consistently by all countries. The same can be said about fair value movements on income instruments and net interest on a group's defined pension liability. However, in the Draft it is mentioned a possibility for countries to require adjustments for the above-mentioned items. We believe that the final report should not include such flexibility.

As to non-recurring items, we share the view that they should be included in the group-EBITDA without adjustment. We are however concerned about the possibility stated in the Draft that countries may require specific categories of non-recurring income and expense to be removed from group-EBITDA. The Confederation of Swedish Enterprise see a risk of increased complexity if such requirements are permitted. If the OECD finds that this possibility must be kept in the final report, it should be clearly defined in the final report for what categories of non-recurring items adjustment requirements can be made.

The impact of losses on the operation of the group ratio rule

The Confederation of Swedish Enterprise shares the view that excluding entities with negative EBITDA from the calculation of group-EBITDA would impose a

significant additional burden on groups. There will also be difficulties for tax authorities to confirm that a group has such entities and ensure their losses have been removed. These negative effects will occur both in the event that the group has a positive or negative group-EBITDA. We are therefore of the view that the approach to exclude entities with negative EBITDA should not be applied in either scenario.

In a scenario where the group-EBITDA is positive, the Draft proposes a cap on a group's ratio so that an entity's interest capacity cannot exceed a set percentage of EBITDA. It is proposed that the limitation should not exceed 100 %. The Draft does also propose a limitation on an entity's interest capacity so that it cannot exceed the total net third party interest expense of the group as a whole. Both of these limitations should according to the Draft be applied to all entities making use of the group ratio rule and not only to those in groups which include entities with negative EBITDA. In this context, we would like to emphasize the importance of having appropriate rules allowing for full carry forward and possibly carry back rules for disallowed interest payments to ensure that companies are treated in a neutral way irrespective of earnings profiles over time and the number of entities in the group. The suggested ceilings in the Draft easily impose non-neutralities which are not desirable from an economic efficiency point of view.

On behalf of the Confederation of Swedish Enterprise

August 16, 2016



Krister Andersson
Head of the Tax Policy Department