Dutch Banking Association

OECD
Committee on Fiscal Affairs
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Submitted by email: interestdeductions@oecd.org

Date 6 September 2016
Reference BR2549

Subject: Discussion Draft on approaches to address BEPS involving Interest in the banking and insurance sectors

Dear madam, sir,

The Dutch Banking Association ("NVB") [1] welcomes the invitation from the Committee on Fiscal Affairs to comment on the Discussion Draft on approaches to address BEPS involving Interest in the banking and insurance sectors as published on 28 July 2016. We are happy to provide our comments on the Discussion Draft and trust our input will help to get an even better understanding of the specific situation of regulated banking groups which makes excessive leverage a remote risk.

Banking groups are highly regulated (Questions 1, 3, 5, 17)
The Discussion Draft on various occasions clearly and rightly notices that banking groups are highly regulated which means that the risk of excessive leverage in a bank or insurance group is low. We agree that there is less, or even better no, need to introduce tax rules aimed at dealing with a risk that does not exist or is already addressed. The Discussion Draft recognizes that regulators require banks to hold minimum amounts of equity which by definitions limits the opportunities for them to engage in BEPS activities. The required minimum level of equity has different definitions for different purposes and banks must meet them all. The Regulatory capital requirements know only one direction and that is towards higher capital both on a consolidated as well as a stand-alone basis. As there is little risk on excessive leverage in a regulated banking group, we are of the opinion regulated banking groups can remain out of the scope of Action 4.

If the BEPS working group nevertheless still feels the need for interest limitation rules for banking groups as well, we strongly request to take our comments into account.

Interest expenses to fund non-taxable income (Questions 6, 8, 9, 10)
Although the Discussion Draft recognizes that the risk on excessive leverage is remote for regulated banking groups, it still has concerns on allocation of deductible interest expenses to fund non-taxable income. The Discussion Draft correctly points out regulatory and commercial constraints for the use of equity but nevertheless fears that banks may excessively allocate their funding to assets

[1] The Nederlandse Vereniging van Banken ("NVB") is the representative voice of the Dutch banking community with over 90 member firms, large and small, domestic and international, carrying out business in the Dutch market and overseas. The NVB strives towards a strong, healthy and internationally competitive banking industry in the Netherlands, whilst working towards wider single market aims in Europe.

generating non-taxable income, e.g. equity participations. We feel that the Discussion Draft insufficiently recognizes that BEPS Action 3 CFC rules and Action 2 Hybrid Mismatches already deal with the BEPS risk relating to non-taxable income from qualifying equity participations and we encourage OECD to notify countries to be careful for overkill if they intend to introduce both Action 2, 3 and Action 4 tax rules.

Further the Discussion Draft fails to recognize situations where banks are forced to acquire equity participations in its clients, such as in default situations where debt is swapped into equity. It goes beyond the objective of Action 4 to apply anti BEPS tax rules to funding allocated to non-taxable income arising from these situations.

Different rules for non-bank entities in a banking group (Questions 2, 7, 11, 12, 13, 14, 15, 16)
The Discussion Draft notices that a regulated banking group likely includes nonbanking entities such as Holding Companies and finance SPV's and that the BEPS risk involving excessive leverage and interest for those entities is similar to that of other non-banking entities. The Draft includes various alternatives and examples for applying the fixed or group ratio rule with exclusions. We advise OECD to encourage countries *not* to apply different rules to non-banking entities included in regulated banking groups as this may result in unreasonable limitations, administrative and practical burdens and the impossibility for tax consolidation within a banking group. Inherent to being part of a banking group, both regulated and non-regulated group entities enter into all kind of intragroup transactions which cannot without unreasonable effort be eliminated for the purpose anti BEPS calculations.

The Discussion Draft includes various examples where the fixed or group ratio rule is applied with exclusions for interest on bank debt funding. In particular the examples that include Holding Companies earning positive EBITDA are not realistic and it is more likely that the EBITDA of holding companies is negative or close to nihil. We advise to amend the examples accordingly. In your example 2 "Applying the fixed ratio rule to a local group excluding banks and insurance companies" you assumed that Holdco A is in a positive EBITDA position of 10. We amended your example into a scenario where Holdco's are included with negative EBITDA.

Example with Holdco's with negative EBITDA applying the fixed ratio rule excluding banks and insurers

	Holdco A	Holdco B	C Co (operating)	Local group
EBITDA	(10)	(20)	70	(30)
Net interest income/(expense)	(3)	(21)	50	(24)
Benchmark fixed ratio				25%
Interest capacity				0
Net interest income/ (expense) of local group				(24)
Total interest disallowance	(3)	(21)		(24)
Interest taxable/ (deductible)	0	0	50	

We are of the opinion that regulated banking groups should fully remain out of the scope of Action 4 but if the BEPS working group nevertheless prefers to apply different rules for non-banking entities in a regulated group we, taking into account the unreasonable outcomes of the examples, strongly advice to at least carve out holding companies and financing SPV's from those rules.

Grandfathering
As banking groups are under the supervision of regulators they are not able to amend their financing structure overnight. Banking groups may need a sufficient period of time to adjust their financing structure to avoid unreasonable outcomes if fixed or group ratio rules with exclusions might be introduced after all. In that scenario we advise OECD to recommend countries to introduce grandfathering rules that leave existing financing structures out of scope and allows banking groups to make adjustments where necessary to avoid unreasonable outcomes.

We again thank you for the opportunity to provide our input and are obviously available for any questions you may have or assistance you need to explain the reasoning to leave regulated banking groups out of the scope of BEPS 4.

Yours sincerely,

Eelco Dubbeling
Managing Director