THE INVESTMENT ASSOCIATION
INVESTMENT MATTERS

Email: interestdeductions@oecd.org

The Investment Association
65 Kingsway, London, WC2B 6TD

T +44 20 7831 0898
W theinvestmentassociation.org
Twitter @InvAssoc

Date: 6 February 2015

Dear Sir/ Madam

OECD discussion draft on BEPS action 4: interest deductions and other financial payments

The Investment Association[1] welcomes the opportunity to comment on the BEPS Action 4 consultation.

We recognise the need to address any double non-taxation which arises as a result of deductible interest or other similar payments. However, in setting out to achieve this, it's important to recognise the ways in which businesses operate and why, and ensure that the commerciality of operations is not undermined. We also support the broader objectives of the BEPS Action Plan.

We fully endorse the analysis and comments put forward by the Association of Real Estate Funds (AREF) in its response to this consultation paper. The paper highlights the role of debt finance in property fund structures.

We would like to emphasise that debt plays a significant role in structuring many forms of investment fund. Investment funds serve an important social purpose in the pooling of capital from a number of sources to finance economic activity. Capital may be pooled from pensions and other forms of savings vehicle used by citizens, as well as from life assurance companies, endowments and charities. The capital raised is used to finance small and medium-sized enterprises (SMEs) through private equity investment, infrastructure projects, and commercial and residential property.

As the volume of traditional lending to SMEs and infrastructure projects has been in decline, the need for these alternative sources of financing has never been greater.

[1] The Investment Association (formerly the Investment Management Association) represents the asset management industry operating in the UK. Our Members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of around £5.4 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles.

As is explained in the AREF letter, debt is vitally important in ensuring that investments through funds achieve the same outcome for tax purposes as direct investment. This tax neutrality is critical to the viability of funds. Funds often comprise various legal entities, and interest deductions in fund structures ensure that tax is not levied more than once.

We urge that any specific recommendations in relation to limiting interest deductions should take into account the specific nature of fund investment, the types of fund structures, the purpose of funds, and their role in providing a vital source of capital to the economy.

We would also like to expand on the points made by AREF on questions 7, 16 and 27 by giving an example of a typical investor in investment funds.

Question 7: Are there any practical issues with respect to the operation of (a) interest allocation rules or (b) group ratio rules, in addition to those set out in the consultation document?

Question 16: What specific issues or problems would be faced in applying a group-wide rule to a group engaged in several different sectors? Would an assets or earnings-based approach be more suitable for this kind of group?

Question 27: Would a fixed ratio rule pose particular problems for entities in certain sectors? If so, which sectors would be affected and how could this be addressed?

Life assurance companies often invest in collective investment schemes open to a wide range of investors. They do this to support their liabilities to policyholders. Given the quantum of assets invested by life assurance companies, it is relatively common for a life assurance company to hold a majority interest in a collective investment scheme such that the scheme is included on the consolidated balance sheet of the relevant life group.

The effect of this would be that any form of group-wide rule (whether an interest allocation rule or a group ratio rule) or fixed ratio rule applicable to the life group would also be applied to the collective investment scheme. The funding requirements of collective investment schemes are often very different to those of the rest of a life group, so applying one rule to both would almost inevitably lead to interest deductions being partially denied.

Thank you again for the opportunity to comment on the discussion draft. We hope to continue to be able to contribute to the consultation and I am available at your convenience to discuss anything in this letter at jmorley-smith@investmentuk.org or on +44 (0)20 7831 0898.

Yours sincerely

Jorge Morley-Smith
Director, Head of Tax