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INVESTMENT
ASSOCIATION

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Dear Sir/ Madam

HM Treasury and HMRC consultation: tax deductibility of corporate interest expense

The Investment Association[1] welcomes the opportunity to respond to HM Treasury and HMRC's consultation on the tax deductibility of corporate interest expense. There are two aspects we would like to discuss: timing of introduction of new rules, and specific facets of the proposals relevant to funds.

TIMING

The government announced at Budget 2016 that new rules on interest deductibility, to address base erosion and profit shifting through interest, would be introduced from 1 April 2017. The political and economic landscape has changed significantly since then and so we would caution against introducing new rules so soon. Brexit will result in an uncertain business landscape for some time, during which maintaining the UK's competitiveness and attractiveness as a place to do business is more important than ever. A stable and reliable tax regime is especially important in times of uncertainty. Postponing the introduction of new rules until economic forecasts become clearer would therefore be preferable.

As we highlighted in our response to the previous HM Treasury consultation on corporate interest expense[2], debt finance is vital for investment in business. This is particularly so for businesses that require significant upfront capital investment or have limited credit history. We caution against a restriction on the deductibility of interest that would increase the cost

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[1] The Investment Association is the trade body that represents UK investment managers, whose 200 members collectively manage over £5.5 trillion on behalf of clients. Our purpose is to ensure investment managers are in the best possible position to:

- Build people's resilience to financial adversity
- Help people achieve their financial aspirations
- Enable people to maintain a decent standard of living as they grow older
- Contribute to economic growth through the efficient allocation of capital

The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks & shares ISAs. The UK is the second largest investment management centre in the world and manages 37% of European assets. More information can be viewed on our website.

[2] IA response dated 14 January 2016

of capital for many businesses at this time, particularly small and medium businesses that have limited access to equity markets.

Other factors also suggest that introducing new rules from 1 April 2017 seems rushed. For example, the OECD continues to work on particular areas of the best practice approach to tackle base erosion and profit shifting involving interest. The OECD published a discussion draft on the group ratio rule on 11 July. That consultation closes on 16 August 2016, in other words, after this one.

The OECD's final report recognises that new rules on interest deductibility could involve a significant cost for some entities. The OECD therefore expects countries introducing a fixed ratio rule and group ratio rule to give entities reasonable time to restructure existing financing arrangements before the rules come into effect. Bringing new rules in from 1 April 2017, when the detail of those rules still remains uncertain, cannot be considered to be reasonable amount of time. This point of view is reinforced by the government's proposal that grandfathering will only be available in relation to public benefit infrastructure and then only in exceptional circumstances.

Finally, the EU council directive on laying down rules against tax avoidance practices of 5 July is important as it covers interest deductibility amongst other things. The directive may become less relevant as the UK moves towards leaving the EU, but it remains an important factor in the timing of adoption of new rules in the UK. The relative competitiveness of the UK and other member states is critical, particularly during that period of transition. The directive gives member states until 31 December 2018 to transpose the provisions on interest deductibility into national law. Member states that currently have targeted rules that are equally effective to the interest limitation rules are allowed even longer. They may continue to apply their own targeted rules until the end of the first full fiscal year following the OECD publishing agreement on a minimum standard with regard to BEPS Action 4, but not beyond 1 January 2024.

APPLICATION OF NEW RULES TO FUNDS

We address questions relevant to funds below.

Question 27: Are there any further issues relating to AIFS (including TEFs) or Investment Trust Companies that need to be considered for the purposes of this consultation?

It is helpful to have been given clarification that interest distributions from authorised investment funds (including TEFs) are outside the scope of interest for the purpose of new rules on interest deductibility. With the fixed ratio rule applying to net interest expense, we do not see much, if any, impact of the rules on authorised investment funds.

Question 28: Are there any other fund structures, not considered in this consultation document, that require special consideration?

Question 29: As a result of the proposed exclusion from the group of subsidiaries held at fair value, views are invited as to whether a specific rule is required to prevent collective investment vehicles from being the ultimate parent company of a group.

Equally for alternative funds, the clarification that a collective investment vehicle cannot be the ultimate parent of a worldwide group is helpful. However unlike for the debt cap regime, this would not prevent the limitation rule applying to a fund on a standalone basis.

Question 31: To what extent are PAIFs likely to be impacted by the proposals in their current form? If applicable, how could the rules be adapted so that they protect the property rental profits of PAIFs from excessive interest deductions just as they do for other property rental groups?

The points we've made in relation to questions 27, 28 and 29 apply equally to PAIFs as they do to other types of authorised investment fund. We are not aware of any concerns specific to PAIFs.

Thank you again for the opportunity to respond to the consultation and we hope to continue to be able to contribute. If you would like to discuss anything in this letter, I am available at jorge.morley-smith@theia.org or on +44 (0)20 7831 0898.

Yours faithfully

Jorge Morley-Smith
Director, Business Support & Promotion