October 15, 2013

OECD
Centre for Tax Policy and Administration
2, Rue Andre Pascal
75775 Paris Cedex 16
France

<u>Re: OECD Action Plan on Base Erosion and Profit Shifting</u>

The Global Financial Markets Association ("GFMA")[1] welcomes the OECD Committee on Fiscal Affairs' efforts to curtail base erosion and profit shifting ("BEPS") by multinational enterprises. We are writing to comment on the BEPS Action Plan that was released on July 31st, 2013.

While we understand and appreciate the concerns that are driving the Committee's efforts, we are concerned that certain aspects of the Action Plan could have unintended consequences for the financial services industry. In order to minimize the risk of possible unintended impact, GFMA requests that the Committee consider the potential implications of the action items for the financial services industry.

In this regard, multinational financial services businesses are subject to extensive regulatory and tax requirements that address many of the issues discussed in the Action Plan. The manner in which financial services groups structure, capitalize and conduct their activities in particular countries is determined primarily by regulatory considerations. Regulated financial services companies are effectively precluded from engaging in much of the conduct that the Action Plan seeks to proscribe.

Moreover, the activities of multinational financial services businesses are subject to highly-developed tax rules (examples include the US active financing exemption, the UK branch capital rules, and multilateral understandings regarding the

[1] The Global Financial Markets Association (GFMA) brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, visit **http://www.gfma.org**.

allocation of taxing responsibility for income derived by global trading businesses). Those rules are the product of thoughtful development over a period of many years. Policymakers should take advantage of areas where well-developed and workable rules already exist, rather than seeking to replace them. The financial services industry is also among the few major industries that do business through a global branch network. As a result, the allocation capital and expenses among branches affects our industry more than other industries. The theoretical and practical difficulty of these issues can be illustrated by the prolonged debate concerning the appropriate methodology for allocating capital, income and expenses to branches.

We are most concerned about the potential for unintended consequences in the context of Action Items 3, 4 and 9, because those action items deal with issues that are particularly relevant to our industry. GFMA requests that the Committee take special care to avoid unintended consequences for financial services businesses.

Action Item 3 is intended to strengthen controlled foreign corporation ("CFC") rules. Typically, CFC rules draw a distinction between active income and passive (and/or mobile) income. Defining active income for financial services companies deserves careful consideration, due to the special characteristics of the industry. We urge that any new rules recommended in this area preserve parity of treatment between active financial businesses and other kinds of active non-financial businesses.

Action Item 4 is intended to prevent base erosion by limiting deductions for interest expense and other financial payments. This action item also refers to internal derivatives used in intra-bank dealings (in one of the only specific references to banks in the Action Plan).

- In order to avoid severe unfavorable consequences for financial services companies, it is imperative that any amounts subject to disallowance be determined by reference to *net* interest expense (the amount by which a taxpayer's interest expense exceeds its interest income). For financial services companies, interest expense represents a core cost of doing business, and is essentially equivalent to costs of goods sold for a manufacturing company. A rule disallowing deductions for gross interest expense would result in the disallowance of core business costs incurred by financial services institutions – an unfair result.

- Any limitation on deductions for financial payments that are "economically equivalent" to interest expense will need to be drafted carefully in order to avoid unintended and inappropriate consequences. GFMA would be happy to assist policymakers in developing a workable definition to prevent over-inclusion.

- The reference to internal derivatives used in intra-bank dealings should be refined to clearly delimit its intended scope. Intragroup hedging arrangements in the financial services industry generally are entered into for non-tax reasons, and often involve the transfer of risk from one highly regulated, high-tax jurisdiction to another. For example, a bank may rely on intragroup hedging arrangements to transfer risks to "natural home" jurisdictions where economic exposure relating to a product or currency is managed. Intra-bank dealings should not be subject to challenge when they are entered into on arm's length terms and do not involve the transfer of profits to a tax haven jurisdiction.

Action Item 9 is intended to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. This is designed to provide a basis for challenging arrangements in which profits are streamed from high-tax jurisdictions to a passive subsidiary located in a tax haven jurisdiction that makes essentially no contribution to the success of the enterprise. GFMA suggests that the following points be considered:

- Financial services businesses are particularly sensitive to the potential implications of this action item, because the allocation of capital and risk in our industry is largely determined by regulatory and business considerations. In general, tax rules should not penalize financial services businesses for trying effectively to manage their capital and diversify their risks. For example, capital management is an important business driver for intercompany reinsurance. Tax rules that rely on ambiguous or subjective standards are likely to interfere with sound business practices.

- This action item will need to be implemented carefully in order to minimize the risk of unreasonable consequences. It is critically important to provide detailed standards for determining when a return will be considered inappropriate.

GFMA agrees with the policy objectives of the BEPS Action Plan, and very much appreciates the Committee's willingness to consider measures to achieve those objectives without triggering unintended and unfair consequences for financial services businesses. Please make contact with us if you have any questions, or if we can be of further assistance.

Kind regards,

David Strongin
Interim Executive Director
Global Financial
Markets Association
120 Broadway-35th fl., New York, NY 10271
Office: 212-313-1213

Cc:

Robert B. Stack
Deputy Assistant Secretary, International Tax Affairs
Office of Tax Policy
U.S. Department of Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220