



# Policy Statement

## Taxation of Intra Group Financing

*Prepared by the Commission on Taxation*

Intra group financing is an important part of an efficient use of the financial resources of an enterprise. Loans between affiliated companies, including cross-border arrangements, are a natural part of intra group financing. It is essential that financing within business groups receives a fair and neutral tax treatment, and that loans and interest payments are taxed, both in cross-border and in domestic situations, in accordance with basic principles of income taxation.

However, several governments have recently shown a more aggressive attitude with regard to the taxation of interest payments within business groups with a focus on cross-border payments. ICC finds some of those developments worrisome, since they considerably increase the risk of international double taxation and create new additional compliance burdens for international business.

### **ICC would therefore like to express its views on the tax treatment of intra group financing.**

Although countries have different starting positions towards rules affecting cross-border transactions, it should be possible to promote similar and neutral treatment of cross-border interest payments and to remove tax obstacles. The OECD communications on a range of topics are widely accepted examples of the application of sound taxation principles to international transactions, aimed at avoiding international double taxation (Model Tax Convention, Transfer Pricing Guidelines).

In the case of intra group financing, the natural common starting point is the **OECD 1995 Transfer Pricing Guidelines**. They offer sufficient support to determine whether or not the remuneration for capital is at arm's length. These Guidelines should be the primary rule for the treatment of international interest payments, both for Governments and tax authorities on the one hand and for the business sector on the other.

As a general rule, interest payments, as long as they are at **arm's length**, should be treated as such by the countries involved, even if the debt to equity ratio would exceed thin capitalization ceilings.

A secondary test may be added by way of a **safe harbour rule**, a mechanism which allows interest deductions when certain ratios are respected (debt-to-equity, interest-to-profit) or when certain thresholds for interest rates are met. Such safe harbour rules should, however, only serve as a safety net in the sense that interest payments within the rule should always be accepted.

Other approaches, such as **global or sectoral tests** are not welcomed. They would reduce the opportunities of reaching consensus on the basis of a mutual agreement procedure under a tax treaty, given the different starting positions of the residence countries of the debtor company and the creditor company involved.

ICC would in particular voice its concern that the introduction of a **worldwide ratio test** would pose serious risks for the proper application of the arm's length test.

ICC also notes that the **OECD report on "Thin Capitalization"** issued by the Committee on Fiscal Affairs on November 26, 1986, considers in detail how the arm's length principle should be applied in the context of thin capitalization. At paragraph 50 the report states: "The Committee generally agreed that, in principle, the application of rules designed to deal with thin capitalization ought not normally to increase the taxable profits of the relevant domestic enterprise to any amount greater than the arm's length profit ..." Similarly, in its Section V, entitled "Conclusions and Suggestions," paragraph 84 of the report concludes that Article 9 of the OECD Model Treaty (dealing with the arm's length principle) "does not prevent the application of national rules on thin capitalization insofar (but only insofar) as their effect is to assimilate the profits of the borrower to an amount corresponding to the profits which would have accrued in an arm's length situation ..."

Recent court decisions by the **European Court of Justice** have clearly demonstrated the need for national tax regimes on intra group financing to be in accordance with the European Community (EC) Treaty. As a consequence, a number of elements in national tax regimes of the EU Members States have been challenged and changes in the tax codes have been made. States are currently contemplating various policy responses to the situation created by the new decisions. There is evidence that EU Member States are trying to avoid the problem of discrimination of international transactions by tightening their national taxation rules and by imposing intra group financing limitations on purely domestic transactions as well. This is certainly not an appropriate answer to the requests made by the European Court of Justice. ICC would like to stress that compliance with existing rules should not imply an increase in the **compliance burden for businesses**. The documentation requirements in the transfer pricing area are already too burdensome, and extending the application of such rules to intra-group transactions is not warranted.

**As a summary, ICC would like to underscore:**

- **The paramount importance of the arm's length principle:**  
The OECD Transfer Pricing Guidelines offer sufficient support to determine whether or not the remuneration for capital is at arm's length.
- **The possibility of a secondary test by way of a safe harbour mechanism:**  
This test should, however, only serve as a safety net and not as the primary rule.
- **Interest payments, as long as they are at arm's length, should be accepted as deductible for tax purposes:**  
This principle should also apply if the debt-to-equity ratio exceeds existing thin capitalization ceilings.
- **The introduction of a worldwide-ratio test would pose serious risks for the proper application of the arm's length principle:**  
ICC would like to express its early and serious concerns regarding the introduction of such global tests.
- **Intra group financing limitations should not be extended to purely domestic transactions:**  
EU Member States (and other countries) should refrain from such a solution in order to - formally - comply with the requirements of the European Court of Justice.
- **Documentation requirements on transfer pricing should not be extended to intra-group transactions:**  
ICC considers any such development as a hindrance to a proper and business-oriented structure for corporate activities. The costs associated with such requirements would unduly hamper investment activities.

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