Tax deductibility of corporate interest expense

International Tax Large Corporate

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The CIOT has called on the government to delay changes to tax relief for corporate interest expense to help businesses adjust to the new regime smoothly and prevent the complexity having a negative impact on inward investment to the UK.

In our response to the second consultation on *Tax Deductibility of Corporate Interest Expense*, the CIOT said that the mooted start date of April 2017 was too ambitious given the scale and complexity of the new regime. We suggested that there was no need to rush in changes in this area because there were already various rules that limited the tax deductibility of corporate interest expense, such as the Worldwide Debt Cap (WWDC) restrictions and the GAAR.

The CIOT would like a more usual and reasonable timetable for the introduction of such a structural change to the tax system. This would allow businesses time to understand and plan for the impact of the new regime on their business, and to point out any problems with the draft legislation so that it can be corrected before enactment. A delay of two years (our response suggested a start date of 1 January 2019) would give the government time to properly review the impact of the new regime on the UK's competitiveness, and enable further consultation on the detail of the legislation, allowing the policy to be translated into statute accurately and effectively. The work now being carried out by the OECD in this area was another reason to delay.

Our response said the government should not be going so much faster and further than the rest of the world in introducing a measure that could affect many commercial structures. The complexity of applying a formulaic rule as proposed make it imperative that the rules are properly thought through and that the legislation is correct, it operates smoothly, and does not dent the UK's competitiveness globally, in particular, compared with other European countries.

We pointed out that the requirement for the UK to maintain a highly competitive tax regime that does not impose undue administrative burdens is arguably more important than ever given the uncertainty caused by the referendum decision to leave the EU. The country needs stability and measures that demonstrate that the UK is a competitive place to do business to encourage inward investment.

We acknowledged the government's intention to lead the way in implementing the BEPS recommendations and that the CIOT has consistently been supportive of this approach in principle. However, a timetable to implementation of at least two years would not be detrimental to the government's overall support of the BEPS project given that the UK would still be in the first wave of 'early adopters'. This would also be in line with the timetable other OECD member countries are working to, particularly in the EU.

Next, we pointed out that the proposed UK regime did not take full advantage of the flexibility offered by OECD recommendations. In the UK there is no intention for grandfathering provisions and the public benefit project exclusion is narrowly drawn, which is a concern given the focus on using the private sector to provide long-term finance for public sector infrastructure.

We explained that we would like the UK rules to allow for grandfathering, either generally or for specific sectors that rely on long-term funding, carry forward/back allowances and the group ratio uplift that the OECD and EU recommend.

Rather than having a specific start date for all groups, it would be preferable for the new rules to take effect for accounting periods beginning on or after a specific date. This would prevent the need for many groups to have to deal with a ‘straddle period’ and remove some of the complexity from the proposals. This would also fit better with the WWDC rules, which took effect for accounting periods beginning on or after 1 January 2010 and could then be turned off from the same date as the new rules apply.

On the repeal of the WWDC rules, we said that, notwithstanding that the OECD report on BEPS Action 4 did suggest that states might wish to have a debt cap type of rule, there was no need for any debt cap rules in addition to OECD recommendations. The minimal risk to the exchequer does not justify the additional complexity.

Consequently, our recommendation was to repeal the WWDC rules without any modified replacement because this would have the benefit of simplicity.

However, we noted that the government considered there would be risk to the exchequer if some form of debt cap rule was not maintained. Therefore, assuming there is to be some form of debt cap regime, we said that we were undecided whether the most sensible course of action would be to retain the existing WWDC rules in their entirety or for there to be a modified debt cap rule as proposed. We said we would like to comment further on the preferable course of action as the detail of the modified debt cap rule is developed and it becomes clear whether gateways will be included, for example. In the meantime our response set out some specific concerns on the proposed modified debt cap rule and some observations on the existing WWDC rules.

Our full response, which also addressed many of the specific questions on the detail of the proposals posed by the consultation document, can be found on the CIOT website.