BUSINESSEUROPE

THE DIRECTOR GENERAL

Mr Jacob J. Lew
Secretary of the Treasury
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220
United States of America

29 June 2016

Dear Secretary Lew,

On behalf of our members, I am writing to express deep concerns over the recently proposed Treasury regulations in the United States on debt-equity under Internal Revenue Code section 385, released by the Treasury Department on April 4, 2016. They would, if they became final, severely impact the ability of European companies to invest in the US and maintain normal financing activities.

Therefore, we respectfully request to thoroughly review and redraft the proposal in a number of areas, taking into consideration the following suggestions and remarks:

- The per se reclassification of debt into equity is not compatible with double taxation treaties and should be therefore be withdrawn.
- The documentation of certain instruments upon issuance and over the life of the instrument, should be reviewed and considerably narrowed.
- In order to aid transition, to the new rules, we strongly recommend changing the effective date for the proposed debt-equity recharacterization rule. We suggest this new rule does not apply to debt instruments that are issued on or after April 4, 2016, but instead applies to debt instruments that are issued 90 days after the proposed regulations are finalized.
- Finally, given the complexity of these proposals, we advise extending the public comment period from July 7, 2016, to at least October 5, 2016.

In October 2016, the final OECD recommendations on BEPS were published. BusinessEurope has been very engaged in this process in order to contribute to an outcome that considers the needs of both fiscal authorities and taxpayers. The same principles are guiding our involvement when it comes to the implementation of the OECD recommendations into national law.

We believe that BEPS concerns are best addressed on a coordinated and multilateral basis in order for the solutions to be sustainable and consistently applied. Unilateral actions from national legislators or regional organizations are only second best solutions and should therefore be avoided.

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Unfortunately, we observe that many countries are taking unilateral actions in their respective national tax law, with detrimental effects on businesses. An example of this are the aforementioned recently proposed regulations by the US Treasury Department under U.S. IRC section 385 which cover the classification of debt and equity for U.S. tax purposes. BusinessEurope is, among many others, deeply concerned about the impact of these proposed regulations on the normal financing activities of European companies.

Efficient and flexible corporate financing is crucial for investments and growth and should not be undermined. We urge you to take measures to help ensure that the U.S. maintains an attractive environment for investment. The aim should be to make existing legislation more efficient and predictable and only address situations where there is excessive debt rather than introducing an unworkable solution through the regulatory process.

The U.S. Treasury's proposed regulations would, under varying circumstances, reclassify inter-company debt as equity investment in the borrower for tax purposes. The proposed rules, if finalized, would create significant business problems for those businesses operating in the United States and especially for foreign-headquartered companies. BusinessEurope is concerned that, due to the arbitrary rules contained in the proposed section 385 regulations which create significant uncertainty regarding the classification of financial arrangements, foreign based multinational companies will be required to substantially alter their treasury functions in order to assure they can continue to claim legitimate interest deductions in funding their business operations. The changes in the financing structure of these companies will increase their cost of capital and discourage investment in the U.S.

The proposed section 385 regulations are not limited to earnings stripping but in fact affect everyday transactions between related parties in a multinational enterprise and would apply to debt instruments that do not have any base erosion potential. Furthermore, loans between foreign subsidiaries that have nothing to do with the US activities of a company would be re-characterized under the funding rule.

The documentation and per se recast rules, if finalized, would create significant tax treaty issues. The consequence of these rules would be that a debt instrument would be treated as equity in the United States while otherwise treated as debt by the counterparty country. This raises treaty issues under the interest article, the related taxpayer article, and the double taxation article. Many tax treaties between the U.S. and other countries significantly reduce or eliminate withholding taxes on interest while maintaining a higher rate for dividends.

Also, the proposed regulations would override tax treaties with the US and the general principle that transactions between related parties should be respected if they are conducted at arm's length. The documentation and per se recast rules would render useless the arm's length standard as recharacterization of an instrument could occur regardless of the actual economic arrangement of the parties to the financing. This

could create a dangerous precedent that the US could apply to other related party transactions where the U.S. does not like the tax result.

Finally, the proposed rules also override agreements between the OECD and G-20 countries regarding the treatment of interest payments. In Action 4, the OECD and G-20 countries agreed to a fixed-ratio test to limit the deductibility of interest in a jurisdiction. The proposed regulations, if finalized, would override such agreement. An obvious consequence (not addressed in the proposed regulations) is the creation of hybrid instruments under Action 2. Moreover, the OECD and G-20 countries will address transfer pricing for related party debt in 2016 or 2017.

Interest payments are legitimate business costs and should therefore be deductible. Restrictions on the deductibility should be limited to abusive behaviour without a good commercial rationale. BusinessEurope would welcome more international coordination on the treatment of interest, in order to reduce the burden of compliance and improve certainty for businesses. There should not be an "assumption of guilt", just for the reason of a company having intra-group financing costs. It is a very common, and not tax driven commercial practice, to raise capital in the market through one legal entity that subsequently serves other legal entities of the group.

We truly hope that you will take into consideration the serious concerns of BusinessEurope members when deciding whether and in what form to finalize the proposed section 385 regulations.

We appreciate your attention to this vitally important matter and look forward to hearing from you.

Sincerely,

Markus J. Beyrer