

COMMENTS RECEIVED FROM CITIGROUP

OECD REVISED DISCUSSION DRAFT ON THE ATTRIBUTION OF PROFITS TO PERMANENT ESTABLISHMENTS - PART II (BANKS) AND PART III (ENTERPRISES CARRYING ON GLOBAL TRADING OF FINANCIAL INSTRUMENTS)

Introduction

Citigroup Inc. (Citigroup and, together with its subsidiary companies) is a diversified global financial services holding company whose business provides a broad range of financial services to consumer and corporate customers in over 100 countries and territories.

Accordingly, Citigroup welcomes the opportunity to offer comment on the OECD's Discussion Draft on the attribution of profits to permanent establishments (PE's Part II (Banks)).

We have participated in the debate on the Report and in the responses submitted on the Report by industry groups, in particular the response submitted by the London Investment Banking Association and the British Bankers Association.

Generally, we have sought not to repeat the issues raised from this collective industry discussions, which have been summarised and which we endorse. Rather, we wish to highlight what we view as the critical issues in the approach of the Report.

We find the review of the topic to be thorough and well researched. Considerable care and effort has been taken in describing the business and we compliment the OECD on this work. However, we are very concerned at a number of conclusions, which have been drawn from this review and we are concerned that these may fundamentally affect the manner in which business is concluded.

Part II Introduction.

It is disappointing that the emphasis has moved between the publication of the 2001 and current drafts and that some of the key underlying principles have been diluted or reversed.

Para 3 of the Introduction to the 2001 draft states that 'the intention is to formulate the preferred approach to attributing to a PE under Article 7 given modern-day multinational operations and trade'. This is further supported by Para 4 of Part I of the General Considerations which emphasises need for a 'consensus position' regarding the interpretation of Article 7 (of the OECD Model Treaty) is essential to achieve the goal of eliminating the risk of double, or less than single taxation. In addition para 25 concludes that 'the current lack of consensus is unsatisfactory as it results in the real risk of double, or less than single, taxation especially where different approaches are taken.

Para 120 of the 2003 draft states ‘ the consultation process has also shown that it will not be possible to develop a single internationally accepted approach for making the attribution of capital, including ‘free’ capital.’

Whereas there may well have been diversity in the ‘views and interests’ of the responses to the 2001 Draft (para 4 refers) there was a strong consensus that there should be a single or preferred approach and that the above stated goal should be achieved. The apparent change of emphasis has arisen as a result of OECD members’ views as opposed to those of contributors to the 2001 Draft.

The inference from the 2003 draft is that the risk of less than single taxation will certainly be avoided but double taxation is probable.

Para 123 mentions that the Mutual Agreement Procedure of Article 25 is available to resolve disputes between the host and home jurisdiction. While this may be appropriate for bilateral situations, we as an organisation with branches in the majority of OECD member states (and non-OECD states) envisage protracted negotiations if Part II is adopted as drafted.

It follows, therefore, that other steps must be taken to avoid the propensity for double taxation. In this respect we strongly urge the amendment of the Draft to provide the taxpayer with the option of applying a single consistent method on a world-wide basis (within the framework of the Draft). In addition this will assist in reducing the systems and administration costs that will inevitably be involved in providing this information to Taxing Authorities.

Distinct and separate enterprise

The ‘hypothesised’ distinct and separate enterprise (Article 7 of the Model Treat) appears to be more distinct from a subsidiary (Article 9 of the Model Treaty) in the

Revised Draft. We consider that this is a lost opportunity to create a level playing field and clearly discriminates against the operation of banking business through branches.

This is clearly demonstrated by the approach taken on internal guarantee fees and gives the clear impression that the approach taken is to the disadvantage of the taxpayer. We accept that all PE’s of a bank will rely on the creditworthiness of the head office in reality but by ‘hypothesising’ a distinct and separate enterprise we are moving away from reality. The concept only works (and is acceptable) if a wider, commercial perspective is taken. Accordingly, we urge that there be greater correlation between the operation of banking business through a branch and subsidiary company.

Part III Introduction

Citigroup Inc. is a diversified global financial services holding company whose business provides a broad range of financial services to consumer and corporate customers in over 100 countries and territories.

Accordingly, Citigroup welcomes the opportunity to offer comment on the OECD's Discussion Draft on the attribution of profits to permanent establishments (PE's Part III (Enterprises carrying on global trading of financial instruments) (Report)

Generally, we have participated in the debate on the Report and in the responses submitted on the Report by industry groups, in particular the response submitted by the London Investment Banking Association and the British Bankers Association.

We have sought not to repeat the issues raised from these collective industry discussions, which have been summarised and which we endorse. Rather, we wish to highlight what we view as the critical issues in the approach of the Report.

First, we find the review of the topic to be thorough and well researched. Considerable care and effort has been taken in describing the business and we compliment the OECD on this work. However, we are very concerned at a number of conclusions, which have been drawn from this review and we are concerned that these may fundamentally affect the manner in which business is concluded.

1. D-3 global trading through dependent agent PEs (256 – 261)

We believe the prescriptive approach taken in this difficult area is unworkable and unhelpful. It will serve as a barrier to global trading rather than encouraging international economic development. At Paragraph 256 the Report states that it does not examine whether a PE exists under Article 5. We believe this is appropriate and would encourage the remainder of the Report to follow this approach.

Concluding business on a "global" basis presents many issues, which influence the basis and form in which it is conducted. There are considerable difficulties of recognising a PE for tax when other disciplines (e.g. the regulatory environment) does not. Indeed the regulatory environment, may well have been the factor that has forced an organisation into operating through a "dependent agent enterprise" in a particular jurisdiction and to operate through a PE may be illegal. While it may be appropriate to "ensure that any other tax consequences" arising from different rules for PEs and subsidiaries in the PE jurisdiction are taken into account, it can be equally appropriate to protect tax payers from those consequences, particularly in a regulated business environment.

We believe it is critical that the Report does not preclude tax payers from being able to choose the form in which activities are conducted in response to all requirements of the jurisdiction and to conduct its business with clarity.

PEs may be one factor, which is discussed in establishing the quantum of profit or loss in a particular jurisdiction. (We would note that we have written on Part II and the issues of capital attribution separately). We would urge that this Report does not preclude the effective assessment of all relevant profit or loss to the dependent agent enterprise in the jurisdiction e.g. by way of the payment of a fee. If agreement cannot be reached to endorse such a “practical” approach, we would urge that the report be silent on this topic.

Further, we believe that the statement at Paragraph 261, “This should also ensure that any other tax consequences arising from different rules for PE’s and subsidiaries in the PE jurisdiction are taken into account”, potentially causes many practical difficulties.

If one follows this approach an entity concluding business on a “global trading” basis, in conjunction with a dependant agent enterprise will need to protect itself as far as possible from such consequences in case any Tax Authority asserts the existence of a PE. For instance, if it writes innovative or bespoke derivative contracts through a dependant agent enterprise in jurisdictions where the imposition of withholding is unclear, this will need to be taken into account for each “potential” PE . Typically, the contractual matters of “gross ups” and “tax indemnities” are negotiated. Contracts will need to address the potential consequences for each location in which there is a potential PE. Given that the Report endorses identifying and assessing PEs and the effect is that a profit share may be due in more than one location, an entity conducting business on a global basis may have to address this issue for multiple locations for each contract. This will serve as a barrier to discourage competition and is potentially paralysing to such business and innovation.

We would urge that this Report does not preclude taxpayers being able to conduct their affairs though dependent agent enterprises with clarity. We believe it may be most appropriate not to conclude on this very difficult issue without further study and for the Report to address the key issues of “global trading”. To include this discussion otherwise risks undermining the effort that has produced the Report and its effectiveness.

2. Losses

The Report identifies that problems can arise where losses result from “global” trading. Commercially one does encounter situations where profits and losses are shared on a different basis (e.g. hedge funds). It may therefore be appropriate to allow for a formula that gives such a result

In some instances if an enterprise or PE in a jurisdiction is entitled to a share of profits, but not losses, it may be that the location is more appropriately due a fee rather than a share of the profits. This may be a profit-based fee, but with the level of profit participation appropriately set to recognise the limited or lack of participation in results when there is a loss. Again, there are third party comparables in this area.

Again, we would urge that the Report is not too prescriptive in its conclusions, but provides guidance that the issue may arise, that there may well be third party comparables from which a parallel may be drawn and that the exact facts of each case must be studied.