July 15, 2011

Jeffrey Owens
Director, CTPA
OECD
2, rue André Pascal
75775 Paris
FRANCE

Re: Comments on Discussion Draft – Clarification of the Meaning of "Beneficial Ownership" in the OECD Model Tax Convention

Dear Sir:

This letter is in response to the request by the OECD Committee on Fiscal Affairs for comments on its discussion draft, released on 29 April 2011, of proposed changes to the meaning of "beneficial ownership" in the Commentary to Articles 10, 11 and 12 of the OECD Model Tax Convention (the "Discussion Draft").

USCIB promotes open markets, competitiveness and innovation, sustainable development and corporate responsibility, supported by international engagement and prudent regulation. Its members include top U.S.-based global companies and professional services firms from every sector of our economy, with operations in every region of the world. With a unique global network encompassing the International Chamber of Commerce, the International Organization of Employers and the Business and Industry Advisory Committee to the OECD, USCIB provides business views to policy makers and regulatory authorities worldwide, and works to facilitate international trade and investment.

While we do not believe the Discussion Draft was intended to have any application to the derivatives market, some of the words could be misconstrued in a way that could impact the market. We therefore suggest, as noted below, that the Discussion Draft be clarified to avoid such misconstruction. We will also suggest clarification of the Discussion Draft to avoid confusion in relation to the practice of many multinational enterprises of "dividend sweeping" of lower tier subsidiaries as a cash management technique. We will conclude with the suggestion that the Discussion Draft be clarified to not affect transfer pricing payments between related entities.

The Importance of Derivatives in the Global Economy

Derivatives are used by a wide range of parties for various purposes such as risk management, financing and price discovery, in addition to hedging.[1] The derivatives market is very large and plays an important role in the global economy. The Chairman of the US Commodity Futures Trading Commission stated that as at December 2010 the notional value of OTC derivatives in the US alone was thought to be approximately US$300 *trillion*.[2]

The overall size of the market globally is expected to increase rapidly as derivatives become more important. This was acknowledged in a recent OECD report of a World Bank, IMF and OECD forum, which stated: "There has been a sharp growth in derivatives in both mature and emerging markets. …Derivatives help complete the market by increasing investment, trading and asset management opportunities. … Derivatives are clearly needed by market participants, dealers and investors. …"[3]

Given the growing importance of derivatives globally, and the critical role they play in the financial world, the effect of any uncertainties in the treatment of derivatives or disruption to the derivatives market should not be underestimated.

The Discussion Draft's Proposed Clarification

The Discussion Draft states that its objective is to clarify the meaning of beneficial ownership in the context of dividends, interest and royalties. The proposed clarification states that the recipient of a dividend, interest or royalty will be not be treated as the beneficial owner of such a payment if there is an obligation -- because of a contractual, fiduciary or other duty -- to pass the payment on to another person. The Discussion Draft also makes clear that the meaning of "beneficial owner" for domestic law purposes is only applicable to the extent it is consistent with the aforementioned principle.

1. Proposal in the Context of the Derivatives Markets

In the financial sector, income equivalent payments are an important constituent part of derivative transactions and guidance which either ignores this important area or

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[1] Randall Dodd (Director, Derivatives Study Center), "Derivatives Markets: Sources of Vulnerability in US Financial Markets" November 15, 2001 (updated May 10, 2004), www.financialpolicy.org/fpfspr8.pdf.

[2] Gary Gensler (Chairman, Commodity Futures Trading Commission) remarks to the Atlantic Council, January 12, 2010, http://www.acus.org/event/gary-gensler-financial-reforms-global-economic-recovery/prepared-remarks.

[3] Finance Division, OECD Directorate for Financial and Enterprise Affairs, Use of Derivatives for Debt Management and Domestic Debt Market Development: Key Conclusions from the Ninth Annual Bond Market Forum of the OECD, the World Bank and the IMF, www.oecd.org/dataoecd/49/45/39354012.pdf, Paris, May 22-23, 2007.

addresses the issue only obliquely merely serves to heighten the uncertainty of how the OECD guidance is to be applied.

If a financial institution hedges a derivative by buying securities and the institution has to make an income equivalent payment on the derivative, the draft commentary may be misconstrued to suggest that the institution was not the beneficial owner of the income it received on the security on the grounds that it did not "hav[e] the full right to use and enjoy the income unconstrained by a contractual or legal obligation to pass the payment received to another person."

However, a derivative does not require any particular income to be paid across and certainly does not require any payment received to be passed to another person. It merely requires that a payment is to be made, calculated by reference to an amount of income paid by the issuer of the security. A derivative does not dictate any hedging. A prudent issuer of derivative contracts may well hedge its exposure in respect of those contractual obligations but is not obliged to do so. The contractual obligations to pay income equivalent amounts under a derivative arise irrespective of whether any income is received by the party obliged to make a payment.

The observation that a derivative does not require a payment received to be passed to another person holds true for derivatives which provide 100% exposure to the asset(s) underlying the derivative. In such cases, a change in the value of the underlying asset is exactly mirrored by a corresponding change in the value of the derivative. Such derivatives are known as "Delta One" and are commonly used in financial markets. Examples of "Delta One" products are exchange traded funds ("ETFs"), equity swaps, linear certificates, futures, forwards, trackers, and forward rate agreements.

We are concerned that the suggestion that one must look at the "substance" of the facts and circumstances, could be misconstrued as effectively replacing a "beneficial ownership" test with an "economic ownership" test, especially in the case of Delta One products. We do not believe this was the intent of the OECD.

Because of the potential that OECD's intent could be misconstrued, it would be useful to clarify that the draft is not intended to have any application to a financial institution merely because that institution pays amounts on a derivative by reference to payments on a reference security.

2. Proposal in the Context of "Dividend Sweeping"

The treasury function at many multinational enterprises typically has a goal of optimizing cash management and to utilize cash balances in subsidiary companies efficiently and effectively. One strategy is to "sweep" dividends received by lower tier companies to higher tier entities where the cash can then be used for multiple purposes, such as reinvestment within the group of companies or the payment of onward dividends to ultimate shareholders. The same could be said for interest payments or royalty payments received by lower tier subsidiaries that are "swept" up the chain of group companies.

Some Treasury Departments of multinational enterprises have adopted explicit written policies or have developed practices where “dividend sweeping” (including interest and royalties) is performed on a quarterly basis. Such a written policy or longstanding practice of efficient cash management by Treasury Departments of multinational enterprises should not be seen as affecting beneficial ownership and the Discussion Draft should be made explicit on this point.

3. Proposal in the Context of Transfer Pricing

Transfer pricing rules by countries throughout the world require that related parties deal with each other on an arms-length basis. Where one related party performs investment or trading services for another related entity, then some payment relating to the return on such activities would be paid, in accordance with transfer pricing policies, to the entity providing the services. It is assumed, but the Discussion Draft should make clear, that payments under transfer pricing requirements do not affect beneficial ownership.

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As stated above, while we do not believe the Discussion Draft was intended to have any application to the derivatives market, to cash management functions such as dividend sweeping or to transfer pricing, some of the words in the Discussion Draft could be misconstrued in a way that could cause confusion. We therefore suggest that the Discussion Draft be clarified to avoid such misconstruction and we stand ready to assist in future discussions.

For questions or further information contact:

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