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11 July 2011

Jeffrey Owens
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2, rue André Pascal
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Dear Jeffrey,

I am writing on behalf of the Loan Market Association in relation to the OECD discussion draft of 29 April 2011 concerning the clarification of the meaning of "beneficial owner" in the OECD model tax convention.

The Loan Market Association is Europe's trade association for participants in the syndicated loan markets and welcomes the opportunity to comment on the discussion document.

Introduction

Whilst the Loan Market Association supports attempts to prevent commercial parties from abusing double taxation treaties, we consider that the changes proposed in the discussion document will, at best, create uncertainty for our members, and at worst, deprive them of the benefit of treaties even when they are entering into ordinary commercial lending transactions with no treaty abuse motive.

In either case, we consider that the inevitable effect of the proposed changes will be to discourage cross-border lending at a time when liquidity in the global financial markets is at a premium.

We set out below what we consider to be the practical consequences of the proposed changes and our suggestions for a more targeted approach.

Practical consequences

The discussion document describes a beneficial owner as a recipient of interest that has the "full right to use and enjoy the interest that it receives" and goes onto state that "the use and enjoyment of the interest must be distinguished from the legal ownership".

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By way of example of a recipient that would not be a beneficial owner, the discussion document refers to recipients who are under a contractual obligation to pass the interest on, and also to recipients who, whilst under no such contractual obligation, do not have the full right to use and enjoy the interest receipts *in substance*, having regard to the prevailing facts and circumstances.

Taken to its logical conclusion, this seems to mean that potentially all financial institutions might cease to be "beneficial owners" of their interest receipts for the purposes of the tax convention. Most financial institutions are, in essence, intermediaries. In the vast majority of cases they raise funds (e.g. by way of unit trust investments, equity, long term debt financing, short term debt financing or retail/corporate deposits) which incur either funding costs or obligations to account for profits. Those funds are used to make loans to borrowers and the resulting interest receipts are used to pay those funding costs or to distribute to investors as profit. Of course, part of the interest represents a small turn/profit margin for performing this function but even a financial institution's profit will ultimately be distributed to its equity investors or unitholders. Pension funds are the clearest example of this but the same principle will also apply to banks, insurance companies and the majority of other financial institutions; for example, many banks will obtain short-term matched funding in the interbank market for loans they make to corporate borrowers (with the level of interest paid by the borrower being determined by reference to banks' borrowing costs in the interbank market). Indeed, where the recipient is a member of a multinational group, one could argue that no one other than the ultimate shareholders of the parent company has the "full right to use and enjoy" a given income stream.

It seems to us entirely legitimate to make changes to the model tax convention in order to prevent abuse of treaties, but in view of the above, the changes in the discussion document will capture a range of transactions that are clearly not abusive, including, potentially, ordinary cross-border loans made by banks to corporate borrowers.

If the changes in the discussion document are adopted, this risks creating significant uncertainty in the market, with financial institutions no longer being sure whether they can lend cross-border in entirely commercial transactions and corporate borrowers unsure whether they can continue to make payments to financial institution lenders without withholding tax under existing arrangements. We would urge the OECD to consider these potential consequences very carefully.

Suggestions

We believe that the proposed changes to the model tax convention are unworkable and that the clearest approach would be to leave the commentary on beneficial ownership in its current form and to address any concerns regarding the abuse of treaties, such as "treaty shopping", in specific anti-abuse rules. (In this regard, we would also note that the existing commentary concerning fiduciaries and conduits/administrators is already clear and well understood in the market.)

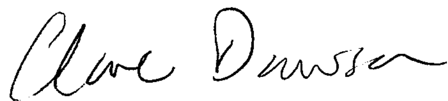
If, on the other hand, the beneficial ownership concept is to be revised to counter perceived abuse, then we think it important that a practical approach is taken which does not create the uncertainty described above. The United Kingdom's approach is a useful example of such an approach. Through guidance published by HM Revenue & Customs, a clear distinction is drawn between arrangements that run contrary to the purposes for which treaties were agreed and ordinary commercial transactions that are not tax-driven. This approach was taken

following the decision in *Indofood International Finance Limited v JP Morgan Chase Bank N.A.* ([2006] All ER (D) 18), precisely so as not to create uncertainty for ordinary lending transactions.

We would hope that the current proposals would be either abandoned or amended to take into account these concerns.

Finally, we would note that we have seen the representations made on behalf of the City of London Law Society regarding the discussion document and we endorse those representations.

Yours sincerely



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