COMMENTS RECEIVED ON PUBLIC DISCUSSION DRAFT

BEPS ACTION 6: PREVENTING THE GRANTING OF TREATY BENEFITS IN INAPPROPRIATE CIRCUMSTANCES

11 April 2014
Dear Marlies,

Please find below BIAC’s comments on the OECD Discussion Draft on preventing the granting of Treaty benefits in inappropriate circumstances, issued on 14 March 2014 (“The Discussion Draft”).

As we all know, the Base Erosion and Profit Shifting (BEPS) project has an ambitious timeframe which puts pressure on the OECD, tax administrations, business and other stakeholders to ensure that the output is effective but also targeted and proportionate. We thank you for being flexible in your contacts with stakeholders, and your willingness to release an early document to allow more effective engagement with you on these topics. Given the timeframe, and understanding the pressures you face, BIAC has sought to draft a consensus document to represent business views more generally, rather than simply passing on views from our members.

Purpose and Benefits of Treaties

Tax Treaties are principally entered into to promote international trade by removing double taxation. This has been one of the most significant of all the OECD's contributions to the growth in international trade over the past fifty years, and it is well accepted that entering into such Treaties benefits the States concerned significantly. Restricting the application of Treaty protection should therefore be approached with considerable caution lest it result in a heavy cost for international trade, and be contrary to the aims of the OECD. Such restriction should only occur in clear cases of abuse.

Furthermore, in order to focus on abusive transactions, and not create double taxation which defeats the objectives of the OECD, it is also recommended that the Treaty benefits are only denied for the offending transaction, and not more broadly.

Purpose of Action Item 6

BIAC supports the broad aims of the BEPS initiatives, to tackle abusive, tax avoidance by a minority of taxpayers. In relation to Action Item 6, however, this must be addressed in a balanced and efficient manner, allowing the clarity and certainty of Treaty benefits appropriate to the vast majority of taxpayers entering into genuine commercial transactions.

The primary route to tackling avoidance must be through local tax law. Treaties should remain focused on removing double taxation and promoting international trade. The only avoidance to
be addressed in Treaties should be where benefits are obtained under the Treaty in an unintended manner; or where the Treaty would otherwise override the local law aimed at tackling the offending avoidance.

**Complexity, Clarity and Predictability**

BIAC supports the principle that Treaties should not create *unintended* opportunities for double non-taxation. BIAC also supports removal of Treaty benefits, where a structure has been artificially established solely for the purpose of obtaining treaty benefits. However, it is important that there should be protection for bona fide commercial arrangements.

BIAC has concerns over the layers of rules currently being proposed, including a Limitation on Benefits Article, a General Anti-Avoidance Rule, together with a series of Specific Anti-Avoidance Rules. These will be in addition to pre-existing rules, such as beneficial ownership of income. We believe these layers will add considerable complexity, cost, and uncertainty.

The Model convention should provide that either a Limitation on Benefits or a General Anti-Avoidance Rule approach should be adopted, and not both. Whichever approach is taken, this should be simple and not overly restrictive, whilst providing protection against “treaty shopping”.

In order to resolve conflicts effectively, a more streamlined dispute resolution process is required, with, ultimately, a mandatory binding arbitration mechanism.

**Defining abusive circumstances**

BIAC welcomes the initiative to set out examples of what may be considered abusive. However, we believe that more work is required in this area. To give just one key example, para. 29 defines abuse as being where obtaining Treaty benefits is “one of the main purposes”. This is framed far too widely. The difficulties of the approach are highlighted by example C in paragraph 33, where the inference is that obtaining treaty benefits is one of the main purposes of the structure selected, but the conclusion is the opposite.

**Confidentiality**

The confidentiality of information provided by taxpayers is a core principle of an efficient and effective tax administration that both protects businesses commercially and enables more open communication with tax authorities. We strongly believe that underlying information should only be provided by taxpayers to their home (State of residence) tax administrations, to then be shared through existing exchange of information channels with the necessary confidentiality requirements.

**The Purpose of Treaties**

To close by reiterating an earlier point, Tax Treaties have been one of the OECD’s greatest successes, facilitating cross border trade and investment to the benefit of countless millions across the world who have seen increased opportunities and increased prosperity. It would be unfortunate if the BEPS project, unintentionally, reversed the process. But that could happen.

Emblematic of this is the proposed preamble which devotes one line to referring to the prevention of double taxation and three lines to the prevention of abuse. The purpose of a Tax Treaty is to facilitate cross-border trade and investment through the removal of barriers to investment, including double taxation. It is *entirely necessary and appropriate* to prevent abuse of treaties, but *it is not the purpose of the Treaty* to prevent that abuse. If we lose sight of that, and the tail begins to wag the dog, then we will have lost something very precious.

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We hope that you find our comments useful. Again, we understand (and applaud) that this is a non-consensus document released early to allow comment, which, therefore, covers the broadest possible range of options. As you consider changes, we hope that the final report will be significantly more focussed and we stand ready to help in any way we can.

Sincerely,

Will Morris
Chair, BIAC Tax Committee

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CC:
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Views on the recommended “three-pronged” approach:
- Title and preamble (addressed in Section B)
- Limitation on Benefits
- General Anti-Abuse Rule

Overall

1. BIAC supports a common OECD framework to address Treaty abuse issues. We would recommend, as a point of Policy, that the OECD pause Treaty abuse discussions, to focus on addressing the underlying concerns, such as via the Hybrids work, since many of the concerns arising in the Treaty Abuse Discussion Document may then fall away.

2. Treaties are principally designed to remove the barrier of double taxation, in order to promote cross border trade and investment. They are bilateral arrangements entered into by States in order to deliver the agreed allocation of taxing rights. Unilateral discretions to deny benefits based on subjective criteria are therefore not only cause for concern for taxpayers, but also for governments, as taxing rights may be usurped. The value of Treaties is significantly reduced if the applicability is less certain.

3. There should be a clear and common understanding of what constitutes “abuse” (see also comments in point [14] below). The current test (“one of the main purposes”) is too widely framed, and needs to be far more focused in order to retain clarity and certainty of treatment for the majority of taxpayers. We would recommend focusing on substance.

4. Application of Treaty benefits should not be considered to be abuse, and BIAC is concerned that anti-avoidance provisions not be used selectively to deny benefits that States have agreed under the Treaty to provide. If there is a problem with the Treaty, then the Treaty should be revised.

5. It is noted in the “Action Plan on Base Erosion and Profit Shifting, OECD, 19 July 2013” that “No or low taxation is not per se a cause of concern, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it.” Companies should not be seen to be abusing Treaty benefits where a genuine business is set up (perhaps specifically attracted by benefits, enacted for the express purpose of attracting business), one of the implications of which is a preferable Treaty being available.

6. We believe that the three-pronged approach will be unnecessarily burdensome. The layers of rules that need to be assessed; the complexity of those rules; potential interpretations and different applications by States in practice, give rise to an increased administrative burden, and uncertainty. We do understand and support the idea that abuse of Treaty provisions should be prevented, in order to secure the benefit of Treaties more broadly. However, we feel that the Model Convention should provide that either a LoB, or a General Anti-Abuse Rule approach should be adopted, and not both. If they are well constructed and appropriately targeted against artificial structures, then they should in principle address the same scenarios, whilst not denying treaty benefits for genuine commercial arrangements. Adopting both in the same Treaty would almost
certainly add complexity and uncertainty whilst not providing any additional protection against “treaty shopping”.

7. Tax avoidance should be addressed through co-ordinated and consistent local tax laws, using approaches such as the work under Action 2 (“hybrids”). Treaties should in principle focus on tackling double taxation issues. However, BIAC supports the initiative that Treaties should not create unintended opportunities for double non-taxation. BIAC therefore supports removal of Treaty benefits, where a structure has been artificially set up solely for that purpose; or where the Treaty would otherwise override the local law aimed at tackling the offending avoidance.

8. Tax incentives: where tax incentives are made available, and such incentives are not judged “harmful” on objective criteria, then taking advantage of such incentives should not be seen as abusive, and specifically in terms of Action 6, not as Treaty abuse. Treatment of Tax sparing (which could be considered a form of double non-taxation), needs to be clarified specifically.

9. Where a State is seen to be entering into Harmful Tax Practices that should also be addressed under appropriate local legislation; or by entering into a Protocol addressing the issue appropriately. Anti-avoidance clauses should not be used by one State to counter or address tax policy decisions made by the other State. We are concerned that simply denying Treaty benefits for existing structures in such cases, will lead to tax base effectively being moved from one Treaty partner to another with resulting double taxation (and effects on investment).

10. States should assess Treaty risks before entering into an agreement; and have an obligation to exit treaties that are seen to be consistently abused, in a controlled and transparent manner, in order to retain predictability of treatment, rather than seeking to apply them selectively.

11. Given the existence of specific anti avoidance rules (“SAAR”s), the GAAR should be very limited and focused, as there is no need to capture these areas a second time under a GAAR.

12. In order to address situations not anticipated by the Treaty, there should be provisions to request upfront Competent Authority confirmation that a structure is not abusive, and therefore the anti-Abuse provisions (whether Limitation on Benefits, or General Anti-Avoidance Rule) do not apply. Failure to agree (upfront or at a later stage) should result in a mandatory binding arbitration procedure, with a clear and limited timeframe.

13. The Anti-Avoidance provisions should recognise that holding, financing and investment activities (including licensing) are normal and legitimate business activities that should not suffer blanket exclusions from Treaty protection. Any perceived avoidance should be addressed through local law, and not by removing Treaty benefits from genuine structures.

14. It is preferred that the outcome of Action 6 will be implemented as and when Treaties are renegotiated. Since there is unlikely to be a single approach that will suit all States, it is currently preferred that Action 15 should not incorporate the outcomes of Action 6, and should not add further requirements in addition to the outcome of Action 6.

15. We note that there will be a significant increase on the resource requirement of Competent Authorities, and we have a concern over the responsiveness, clarity and certainty of treatment as a result. We recommend that increased reliance on Competent
Authority procedures be backed by a corresponding increase in the availability of appropriately trained and experienced Tax Authority resources for such procedures.

**Title and Preamble**

16. Title and preamble – see comments below in relation to Section B of the Discussion Document.

**Limitation on Benefits ("LoB")**

17. General. Regarding LoB articles, if the OECD chooses to adopt a LoB article to restrict treaty shopping, the article should be crafted to take into account global business operations of companies as well as trading arrangements between countries. With respect to current LoB articles, such provisions are complex and can unnecessarily restrict the application of a treaty where there is no treaty shopping. Although not included here for copyright reasons, the complexity can be seen when analysing a given Treaty in order to ascertain whether Treaty benefits may apply, and results of such analysis, in flowchart format, can be found on the internet. Such complexity undermines the value of Treaties, and should be avoided in order to protect cross-border trade and investment. LoB articles should be as simple and unrestrictive as possible, in order to present a reasonable method of tackling perceived treaty shopping. It is noted that example C (paragraph 33) may fall foul of the precise mechanics of the LoB articles, whilst it is concluded that there is no abuse in those circumstances; as such, it is preferable that LoB articles allow for bona fide commercial activities which do not involve "treaty shopping" such as in example C (paragraph 33). There are different versions of LoB clauses in various existing treaties (for example, US/UK; US/NL; Japan/Switzerland; Japan/NL), which adds to complexity. In finalising LoB clauses for the Model Convention, BIAC would encourage careful consideration of these alternative wordings, to ensure that only abusive transactions are targeted, and allowing bilateral conventions to be most fit for purpose for the relevant States.

18. Where there are both high local country taxes and high local country withholding taxes ("WHT"), particularly in developing countries, the OECD should encourage such countries to align their WHT to internationally accepted norms to discourage treaty shopping. On the other hand, the existence of low local country tax rates should not create a presumption of treaty shopping as the OECD develops its recommendations. For example, in today’s globalised economy, offshore holding/treasury/IP/insurance companies are used to facilitate investment and operational activity to take advantage of a favourable domestic business climate, legal system, access to labour and markets, etc., and should not be presumed to involve treaty shopping.

19. Subsidiaries (paragraph 11). Included in the proposed LoB article is a provision to address treaty applicability for subsidiaries, based on a threshold residency ownership requirement and a base erosion test. The ownership requirement further requires each intermediate company to be a resident of that contracting state. To the extent a LoB article is adopted, BIAC believes that this requirement is duplicative and unwarranted, would add to the complexity of LoB articles, and would further restrict the application of treaties to enhance cross border trade and investment.
20. Derivative benefits (paragraphs 13 and 17). Included as a discussion point in the proposed LoB article is a provision that would extend treaty benefits to residents of third countries where they are subject to treaties that have similar benefits.
   
a. To the extent a LoB article is adopted, it is essential that a “derivative benefits” clause be included to avoid inappropriately restricting treaty benefits where there is no treaty shopping. BIAC believes that the OECD should consider such a clause to take into account “equivalent beneficiary” ownership, where similar treaty benefits are provided under another treaty.
   
b. BIAC further believes that testing intermediary companies in the ownership structure as “equivalent beneficiaries” is duplicative and unwarranted, would add to the complexity of LOB articles, and would further restrict the application of treaties to enhance cross-border trade and investment.
   
c. The OECD should include substantive considerations, in order to protect genuine commercial structures, where ownership or income requirements are not met under a proposed derivative benefits article. In this manner, taxpayers would still be able to rely on treaty application in such non-abusive situations, rather than rely on subjective treaty administrative relief provisions (see below).
   
d. It is noted for completeness, that excluding a “derivative benefits” clause may create conflicts with the principle of Freedom of Establishment for situations where such EU law is applicable.

21. Headquarter (“HQ”) companies. The proposed LoB article does not contain a HQ company provision. BIAC believes that it is essential to include a provision for regional HQ companies to qualify for Treaty benefits, given the nature of regional business investments and trade, and the bona fide use of regional companies to manage such business. Such provision should be drafted so that HQ of non-quoted multinational enterprises should qualify for Treaty relief, where there is no “abuse” as defined. See general comment above. Similarly, where parties enter into a joint venture agreement, a holding entity is often required as a vehicle to hold business assets, including any local business entities contributed by joint venture partners. Such holding company can be intentionally located in a third country to neutralise influence of any given partner, but should still be able to attract the benefits of the relevant Treaty/ies.

22. Active Trade or Business. The proposed LoB article includes a provision that allows residents of a contracting state to qualify for treaty relief where the resident is engaged in the active conduct of a trade or business (other than making or managing investments for the resident’s account—excluding banking, insurance or securities activities carried on by a bank, insurance company or registered securities dealer) and the income is derived in connection with or incidental to that trade or business. BIAC believes that such a rule should be applied to other industries where the taxpayer has genuine economic substance, and that testing should be done at a group level (rather than separate company) basis.

23. Administrative relief. Generally, most taxpayers seek objective rules to confirm treaty applicability. Any new LoB article should contain reasonable objective tests that can be applied by taxpayers and confirmed by tax authorities. Where a LoB article is adopted, but the treaty is inapplicable to a given taxpayer because of overly restrictive provisions, it is essential that taxpayers have access to timely administrative relief by Competent Authorities in order to apply the relevant treaty where there is no treaty shopping. In this regard, the OECD should provide clear guidance on reasonable information
requirements, timing aspects and other procedural matters (e.g., consultation with the other treaty partner) in order to avoid cumbersome and time consuming processes that could result in negative impacts to cross-border investment and trade activities.

24. Collective Investment Vehicles ("CIVs"). Under the proposed LOB article many CIVs would be denied treaty benefits. Treaty eligibility for CIVs was specifically confirmed in the Commentary to Article 1 of the Model Tax Convention (updated 22 July 2010). BIAC proposes that it be made clear that the treatment of CIVs as discussed in the Commentary and the CIV Report approved by the CFA are not impacted, unless CIVs are specifically "abusive" as defined therein. Any changes under Action 6 must retain the overriding goal that investors in a CIV should be no worse off than if they made the investment directly.

25. Indirect relief for persons operating exclusively for charitable purposes. The LoB provision allows for exemption for certain persons (para. 2d.) which is line with the international consensus that these persons should have tax treaty eligibility. However, this should also be the case if these persons operate via a person that was constituted and operated to invest funds for the benefit of the charity.

26. Dual Listed Companies. In the case of dual listed companies (see for example, Article 23, paragraph 6(c) of the Australia-Japan treaty), the LOB should provide for the determination of “principal class of shares” after excluding any special voting shares or cross-DLC shareholdings that exist to allow for an effective and efficient operating of the dual listed company arrangement.

27. LoB Example (paragraph 15). As noted above, companies should not be considered to abuse Treaty benefits where a genuine business is set up (perhaps specifically attracted by local country benefits, enacted for the express purpose of attracting business), where a preferable Treaty is available. This is in principle very similar to Example C (paragraph 33). Furthermore, in Example (paragraph 15), if there were potential tax avoidance, it is a local country (State T) matter and not a treaty matter-- and yet the proposed route to tackle the perceived tax avoidance is by denying relief under the S-R Treaty. BIAC believes that local tax arrangements are best addressed through local tax law, rather than by denying Treaty benefits.

General Anti-Abuse Rule

28. General Anti-Abuse Rule ("GAAR"). Comments are specifically invited as to what the Commentary should cover. The proposed GAAR is too widely defined, adding to uncertainty, and countering the aim of Treaties to enhance economic activity by tackling double taxation. It is noted that the GAAR must also ensure clarity and certainty of treatment, and be simple to administer.

   a. As noted above, it is considered excessive to introduce all three prongs. This will lead to increased complexity, uncertainty, and administrative costs. Either a GAAR or an LoB approach should be used, whilst noting that this will reduce the desired commonality, but to the benefit of improved clarity and certainty compared to adopting both in all Treaties.

1 Reference is also made to a response submitted separately by the Investment Company Institute.
b. As the overarching aim of a Treaty is to encourage the exchange of goods and services, and the movement of capital and persons, then to the extent the GAAR applies to an offending transaction, it should not prevent the application of the Treaty to other transactions. (However, it is noted that if the offence is the entity itself, then the Treaty would not apply at all in those circumstances).

c. For a GAAR to be workable, it must be well constructed, more narrowly defined to target abuse, and ensure a sufficiently certain outcome for the majority of taxpayers. It should not catch genuine commercial structures (including, but not limited to dual listed structures).

d. More work is required in defining what is “abusive”. For example, the wording in paragraph 29 varies between abuse being where obtaining Treaty benefits is “one of the main purposes”; to being “...an arrangement [which] can only be reasonably explained by a benefit that arises under a treaty...” (emphasis added). The difficulties of the former approach are highlighted by example C in paragraph 33, where the inference is that obtaining treaty benefits is one of the main purposes of the structure selected, but the conclusion is the opposite. Whilst we would support the conclusion – indeed attracting business is one of the reasons for States entering into such Treaties – it is not clear from the example of the logic as to what the proposals consider does and does not constitute abuse. In a commercial transaction, it is prudent to seek tax input. The drive for the transaction is not from tax motives, but tax is often a consideration. Therefore, tax may still fall foul of being considered one of the main purposes. This lack of clarity, and catching genuine commercial arrangements inadvertently, is further reason why the “one of the main purposes” approach is not considered sufficiently clear, and will give rise to significant uncertainty, and the potential for inconsistent application by different tax authorities, and resulting increased likelihood of double taxation. The GAAR should be limited to circumstances where a structure has been (wholly) artificially set up solely to secure a treaty benefit.

e. The proposed wording for Article X, paragraph 6 includes various concerns:

   i. “it is reasonable to conclude” is very broad with no burden of proof on tax authorities;

   ii. “one of the main purposes” as noted above is too widely framed;

   iii. “unless it is established” passes the burden of proof to the taxpayer; and

   iv. “object and purpose of the relevant provision” may be difficult to define since each State may have a different view on the meaning of the Treaty provisions.

29. Comments are specifically invited on the examples in paragraph 33. Overall, BIAC considers that Treaties should not be used to tackle perceived tax avoidance, other than where the structure is only set up to obtain such benefits and is not a genuine commercial structure.

a. Example A. In principle, this should be considered under action 2 addressing hybrids and repos. From a Treaty perspective, if there is a genuine beneficial ownership change, with associated movement of capital, then the aims of the Treaty are met, and benefits should not be denied. However, if there is no change in beneficial ownership, then this should already be tackled under
existing provisions. The GAAR should be structured, so that genuine transactions are not caught, and ambiguity is not created over the treatment of such genuine transactions.

b. Example B. As for example A, if the risk and rewards are such that there is a genuine change in beneficial ownership of the dividend flows, and an associated movement of capital, then the aims of the Treaty appear to be met, and treaty relief should not be denied in such circumstances. This is a different question from whether there is avoidance in other ways, and again, this should fall under the remit of action 2. If the structure is a genuine commercial one, then the Treaty should not be used as a way to deny relief due to inadequate local tax law. Treaty relief should only be denied where there is abuse of the Treaty, not where there is genuine transfer of risks, rewards, and beneficial ownership of flows.

c. Example C. Whilst the conclusion is a sensible one (see also comments above), it is not clear how it is arrived at – perhaps as the underlying business was always intended, and merely selecting a territory with a preferred Treaty is one of the intentions of entering into the Treaty. However, the background implies that tax is one of the main purposes, and therefore if that is the test, it would seem to fall foul of the GAAR. It is therefore recommended that abuse be defined in a clearer, more focused manner.

d. Example D. We note, and agree with, the comment that “the intent of tax treaties is to provide benefits to encourage cross-border investment”. We also agree with the conclusion that this scenario does not constitute abuse of the Treaty. However, as for Example C, if the test were “one of the main purposes” it is not clear how the conclusion is arrived at.

b) Other specific examples

30. We note, and agree with, the observations in paragraphs 37 and 39 that these are best dealt with outside the Treaty abuse considerations. This is aligned with our earlier observation that tax avoidance should be addressed through local tax laws; and Treaties should in principle focus on tackling double taxation issues.

31. Paragraph 43 seeks comments as to an appropriate holding period. The aims must be primarily to remove double taxation, whilst protecting against abusive behaviour. We would therefore propose a [3 month] period in order to continue to apply as broadly as possible. Furthermore, if the shares are held for that period of time, but partly after the relevant dividend is paid, there should be a mechanism to recover any withholding tax suffered. This would reflect the fact that there was no intention to abuse the Treaty benefits, and that the risks and rewards of share ownership had passed at the time the relevant dividend was paid, so protecting the majority of taxpayers.

32. Paragraphs 45, 46 and 49 are very specific circumstances. In principle, if the structures are artificial, then benefits should be denied. However, there should remain a bona fide commercial reasons exception so as not to hinder genuine business activities, for which the Treaty’s purpose is to remove double taxation.

33. Tie-breaker rule. See “Other Comments” at the end of this paper.
34. Anti-Abuse rule for PE situated in third States. BIAC has a fundamental concern that there is an underlying assumption of a tax avoidance motive. If States enact incentives specifically aimed at attracting business, then when businesses structure themselves accordingly, this should not be considered to be tax avoidance. In principle, it is no different from example C, just with a PE instead of a third company. The existence of a low effective tax rate should not be a concern, provided the structure is a genuine commercial set up. This is as anticipated in "Action Plan on Base Erosion and Profit Shifting, OECD, 19 July 2013" where it is confirmed that “No or low taxation is not per se a cause of concern, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it.” Therefore, the test should be whether the structure is artificial. Specifically:

   a. The proposed wording in paragraph 56 is solely focused on an effective tax rate, which is in stark contrast to the wording of the action plan referred to above, where no or low taxation is not the driving concern; and

   b. Genuine commercial activities can include holding, financing and investment activities;

   c. If the final structure gives rise to a tax result that is not considered desirable (note that this does not necessarily arise due to any form of avoidance), this should be addressed through local tax law, and not by removing Treaty benefits where a genuine structure exists.

A.2. Abuse of domestic tax law using Treaty benefits

35. We agree with the comment in paragraph 58, that appropriate action should be largely through other Actions under the BEPS program. However, in order for that approach to work, Treaties cannot override specific sections of local law, as stated in paragraph 59. We recommend that the Model convention include specific, clear pieces of local legislation that are not overridden by the Treaty, so as to avoid uncertainty and protracted discussions with tax authorities. This is considered to be clearer than the approach adopted in paragraph 70. Local law changes should not immediately impact the application of the Treaty, without a specific Protocol, ensuring both parties are aware of the impact on their tax revenues, and include in the Protocol specific references to the new local law that now also overrides the Treaty. This will ensure clarity and certainty of treatment, both for the taxpayer, and the tax authority. Specifically, this also includes new interpretations of existing law, and retroactive law changes, where the bilateral counterparty would not necessarily have expected the situation, any more than the taxpayer.

36. We also recommend that provision be made to ensure that in enforcing local laws, double taxation is not created, just as double non-taxation is to be avoided. Therefore, where one State denies a deduction (such as under thin capitalisation rules), there should be a mechanism for a compensating adjustment in the other State.

37. Paragraph 64 suggests that specific anti-abuse rules apply regardless of whether or not transactions are tax motivated. We would recommend, as already captured above, that there should be exceptions for bona fide commercial activities, since transactions which are not tax motivated should not be seen as constituting Treaty abuse.
B. Clarification that Tax Treaties are not intended to be used to generate Double non-taxation

38. BIAC supports the assertion that Tax Treaties are to remove double taxation (as encapsulated in paragraph 74).

39. However, as noted already, Tax Treaties should not be used as an anti-avoidance tool. The primary route to tackle avoidance must be through local tax law. Treaties should remain focused on removing double taxation and promoting international trade. The only avoidance to be addressed in Treaties should be where benefits are obtained under the Treaty in an artificial manner; or where the Treaty would otherwise override the local law aimed at tackling the offending avoidance. Therefore, paragraph 75 is too widely worded. Tax Treaties should not permit abuse of their benefits; nor should they provide a route for avoiding specified local tax measures. They should not, though, be seen as a mechanism for prevention of tax avoidance, other than as mentioned, or through information exchange to assist identification and challenge of offending structures.

40. Tax evasion is mentioned in paragraph 75 (and 77). Tax Evasion is unlawful, and as such, whilst Tax Treaties may not be the most appropriate source for addressing such activities, BIAC supports all appropriate and legal mechanisms to address such behaviour. In doing so, a clear line must be drawn between unlawful activities, and lawful ones which may or may not be considered avoidance depending on the precise circumstances.

41. We agree with the proposed wording in paragraph 77, that “...the Contracting States do not intend the provisions of the Convention to create opportunities for non-taxation or reduced taxation through tax evasion and avoidance”. We consider this to be different from stating in the preamble that the purpose if the Treaty is to prevent tax evasion and avoidance (which we consider too widely worded, as noted above).

C. Tax Policy Considerations that, in general, Countries should consider before deciding to enter into a Tax Treaty with another country

42. Further to our comments on the preamble, we would propose to reword clause 15.6, as “An important objective of tax treaties being information exchange to assist in ensuring the effectiveness of local tax laws to address the prevention...”.

43. We would recommend including confirmation that making use of specific incentives of one State, designed to attract certain business activities, does not constitute avoidance. If the other State considers the incentives inappropriate, it should be addressed via changes to the Treaty rates in future. That provides clarity between States; for taxpayers; and ensures stability for the short to medium term so that taxpayers are not constantly subjected to knee jerk reactions, and abrupt changes to applicable tax rules.

44. Finally, as noted above, States should consider – and specify – which local laws are not to be overridden by the Treaty, in order to ensure clarity of treatment.
Other Comments

Dual Resident Entities

And

BEPS ACTION 2: NEUTRALISE THE EFFECTS OF HYBRID MISMATCH ARRANGEMENT (Treaty Issues)

We are not commenting in general on this paper. However, there is a clear link, and this needs to be managed effectively. Paragraph 9 of the proposals specifically request that responses in respect of the proposed change to Article 4(3), be included in responses to Action 6, paragraphs 50-53. Our response is therefore carved out from the rest of our responses on Action 6, and we comment as follows:

Dual residence may arise for purely commercial reasons if a legal incorporation in a country is preferred, which results in tax residency under local laws, whilst the Board meets in the country of its headquarters, for example. Any tie-breaker rule needs to provide a clear and predictable result in advance, and therefore we would recommend retaining the “effective management” test in Treaties. Furthermore, using “endeavours” of Competent Authorities to determine single residency will result in no predictable result, and perhaps no result at all, as there is currently no proposed requirement on the Competent Authorities to agree the residency.

We consider the preferred solution for dual resident entities, is to retain “effective management”, but with a recourse to ascertain a single residency via Competent Authorities. Only in exceptional circumstances, where structures are set up for abusive purposes, should there be a possibility of failure to agree on a single residency between Competent Authorities. In such cases, the entity should be carved out of the treaty, which is essentially what the last sentence of the new Article 4(3) does, although it is not currently clear that this should be on an exceptional basis.

Where Competent Authorities are unable to agree the mode of application, the proposal is that there would be no entitlement to relief or exemption, except as agreed by the Competent Authorities. It would be preferable, instead, that companies would not be treated as a resident of either State for purposes of claiming any benefits provided by the treaty. The preferred route leaves open the possibility of benefits that are not based on residence being automatically available. This may be a small class of benefits, but since they do not depend on residence, it would seem appropriate not to exclude them due to dual residency concerns.

Finally, in comparing the draft OECD language to the US Model on this point, the US Model has one paragraph for companies and another paragraph for entities that are not companies. We support the OECD proposal on this point - having one paragraph for everyone.

Transparent entities

In the absence of “abuse” as defined, and provided beneficial ownership of the income is with a resident of one contracting State, the State of residence of the source should not deny Treaty
relief. The source State’s view of the status of the recipient should not be relevant for Treaty purposes (although there may be considerations for Harmful Tax Practices, or to address in local anti-avoidance rules).

The current wording proposed under the second paragraph would appear to permit the source State to deny Treaty relief if the recipient State does not tax the income. We would assert that the rate of tax, or whether the recipient State chooses not to tax at all, the relevant income, should not be a matter for the Treaty, but should also be dealt with under local legislation, or under Harmful Tax Practices. This recommendation is consistent with paragraphs 1-10 above. It is also consistent with the explanation of “ordinary income” in the Action 2 discussion draft, but removing the ambiguity created by the description which should “generally” apply. Provided the beneficial owner of the income is resident in the contracting State, the source State should not deny the agreed relief, irrespective of the rate of tax applied to that income. This applies equally to transparent entities within the recipient State (which would not be considered the beneficial owner of the income by that State due to the transparent nature), or to other situations, such as (but not limited to) a branch in a third State, where the income is beneficially owned in a Contracting State.

We would propose the wording of the second paragraph be amended to read, “…but only to the extent that the income is treated as beneficially owned by a resident of that State…”.
Dear Sirs,

OECD discussion draft BEPS Action 6: Preventing the granting of treaty benefits in inappropriate circumstances

The Alternative Investment Management Association¹ wishes to comment on the proposals set out in the OECD discussion draft on BEPS Action 6.

AIMA is concerned that the measures proposed to be introduced into the OECD Model Tax Convention concerning entitlement to benefits will, if adopted in their present form, have significant effects on the ability of collective investment schemes in general (and not limited to those in the alternative investment sector which AIMA represents) to obtain the benefit of double tax treaties. The part of the new Article proposed in the discussion draft which is concerned with limitation of benefits broadly requires a fund that wishes to claim treaty benefits to have a significant connection with the country in which it is resident for tax purposes, be it an effective listing or a majority of investors there. Many funds are not listed and pool capital from investors across a number of countries and so will not pass such a limitation of benefits threshold. The “derivative benefits” provision considered in the discussion draft is too narrowly drawn to be of assistance.

The BEPS project is, for obvious reasons, focused on the position of multinational corporate groups. These proposals take little account of the position of other persons such as investment funds in particular. AIMA considers the proposals to be inconsistent with the work previously undertaken by the OECD² which concluded that collective investment vehicles that are widely held, hold a diversified portfolio of securities and are subject to investor protection regulation in the country in which they are established should be capable of obtaining the benefit of tax treaties if they qualify as a person that is a resident of the jurisdiction and subject to tax there on its income. It was also recommended that, if a collective investment vehicle did not meet those requirements, its investors should be entitled to treaty benefits either on their own application or through a claim on their behalf by the collective investment vehicle.

Investment funds exist to provide effective pooling of capital and diversification of risk for investors, many of whom (as the OECD has recognised) would be entitled to treaty benefits if making the same investment as the fund, and are a significant source of cross-border investment capital which double taxation treaties are intended to protect.

AIMA believes that any limitation of benefit measures incorporated into the OECD Model Tax Convention should be appropriate and proportionate in their application to collective investment schemes and not act to prevent the

¹ AIMA is the trade body for the hedge fund industry globally; our membership represents all constituencies within the sector - including hedge fund managers, funds of hedge fund managers, prime brokers, fund administrators, accountants and lawyers. Our membership comprises over 1,300 corporate bodies in over 50 countries.

international flow of capital. AIMA believes that the OECD should undertake further work on the application to investment funds of limitation of benefit provisions.

Yours faithfully,

Paul Hale
Director, Head of Tax Affairs
The UK Insurance Industry

The UK insurance industry is the third largest in the world and the largest in Europe. It is a vital part of the UK economy, managing investments amounting to 26% of the UK’s total net worth and contributing £10.4 billion in taxes to the Government. Employing over 290,000 people in the UK alone, the insurance industry is also one of this country’s major exporters, with 28% of its net premium income coming from overseas business.

Insurance helps individuals and businesses protect themselves against the everyday risks they face, enabling people to own homes, travel overseas, provide for a financially secure future and run businesses. Insurance underpins a healthy and prosperous society, enabling businesses and individuals to thrive, safe in the knowledge that problems can be handled and risks carefully managed. Every day, our members pay out £147 million in benefits to pensioners and long-term savers as well as £60 million in general insurance claims.

The ABI

The Association of British Insurers (ABI) is the voice of insurance, representing the general insurance, protection, investment and long-term savings industry. It was formed in 1985 to represent the whole of the industry and today has over 300 members, accounting for some 90% of premiums in the UK.

The ABI’s role is to:

• Be the voice of the UK insurance industry, leading debate and speaking up for insurers;
• Represent the UK insurance industry to government, regulators and policy makers in the UK, EU and internationally, driving effective public policy and regulation;
• Advocate high standards of customer service within the industry and provide useful information to the public about insurance; and
• Promote the benefits of insurance to the government, regulators, policy makers and the public.

Summary of ABI response to the Discussion Draft

1. The ABI welcomes the opportunity to comment on OECD Public Discussion Draft on BEPS Action Point 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, issued on 14 March 2014 (“Discussion Draft”).
2. The ABI supports the aims of the OECD BEPS Action Plan to address weaknesses in the international tax environment. Our comments reflect our desire to ensure that measures utilised are workable, well targeted, and proportionate in the context of the efficiency of commercial insurance operations, including investment product offerings. In the spirit of working constructively with the OECD and member governments, we offer information and suggestions as to how proposals could be improved to help achieve objectives whilst at the same time avoiding inadvertent consequences impacting on the normal conduct of business.

3. We suggest that the multiple layers of rules currently proposed, including a Limitation on Benefits (LoB) Article, a General Anti-Avoidance Rule and a series of Specific Anti-Avoidance rules, need to be re-assessed. The complexity of the proposed rules, and potential for differential interpretations and applications in practice in their interaction, gives rise to at best increased administrative burden and at worst uncertainty.

4. In particular, we urge the OECD to recognise that the difficulties in applying a LoB provision to widely-held Collective Investment Vehicles (CIVs) would result in unnecessarily denying access to Treaty relief, unfairly penalising investors. Life insurers are major investors in CIVs and in many cases also run separate fund management operations. We strongly recommend either the removal of the LoB Article or, if this is not considered appropriate, the inclusion of a definition which allows a “widely held” fund to be considered a “qualifying person”.

5. We also strongly recommend that consideration of “primary place of management and control” takes place as part of the work on BEPS action point 7 and not in isolation as part of this review.

Limitation on Benefits and CIVs

6. We are concerned that a Limitation of Benefit (LOB) clause along the lines proposed in the Discussion Draft will create unintended uncertainty to the ability of taxpayers to access Treaty benefits when undertaking genuine commercial transactions and considering legitimate business models. As well as an unwelcome increased administrative burden, uncertainty and lack of ready treaty access for legitimate structures and transactions creates a disproportionate result.

7. We urge the OECD to reconsider these proposals in light of the findings of “The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles” published by the OECD in 2010 (the “CIV Report”). CIVs provide access to investment capital and thus are vital to the proper functioning of capital markets. CIVs are the investment vehicle of choice for retail investors and pension schemes as they allow investors to pool their investments alongside other investors in order to maximise return, increase investment diversification and risk management, and receive the benefit of experienced fund managers. The CIV report recognises that it is vital to preserve the principle of neutrality for investment held through CIVs with respect to direct investment.

8. CIVs represent a key source of investment capital and for this reason many CIVs will sell cross border, providing diversified access to non-domestic markets for investors.
The ability of CIVs to access readily the protection afforded to direct investors by double tax treaties is vital to ensuring that CIVs remain a viable product for saving and investment, and that capital invested through CIVs is available for cross border investment and the long-term financing of economies.

9. As drafted, the proposed LOB clause will mean that CIVs and their underlying investors will not receive any treaty benefits or the benefit will be restricted. This is because the proposed LOB article at 2e(ii) restricts the benefit of the treaty if more than 50% of the gross income of the CIV is paid or accrued by persons not resident in either Contracting State (even where such persons could have received the benefit under another treaty if they had invested directly).

10. The loss of tax treaty access would have severe consequences to the fund's yield and ultimately to the underlying investors in the fund, many of whom are saving for their long term needs including retirement. It could also lead to pricing difficulties arising from the uncertainty in respect of which withholding taxes to apply depending upon whether treaty rates are accessible or not. Unless CIVs can readily access treaty benefits, tax neutrality will be compromised and investors will suffer double taxation.

Recommendations regarding LoB

Sole Reliance on General Anti-Avoidance Rule

11. Whilst it would be possible, as noted below, to craft a definition of “qualifying person” for LoB purposes which removes the more typical CIVs by reference to particular characteristics, the LoB approach is by nature formulaic and funds which fail to fit within the test are excluded from relief without any consideration of commercial purpose or the presence of inappropriate tax motivations. The LoB approach can therefore unnecessarily exclude from treaty relief genuine commercial structures, without inappropriate tax motivation, which do not fall precisely within its terms.

12. For example, typical real estate investment funds are unlikely to be able to meet the definition of qualifying persons under the proposed LoB approach. More often than not the fund vehicle for a real estate fund is transparent, to generate both tax efficiencies for some investors (e.g., pension funds) and other advantages in terms of drafting terms and conditions. Holding companies which own the real estate investments would typically sit underneath the fund vehicle. It is these holding companies which would be making claim to treaty relief and rather than the fund vehicle above. The holding company is included for a variety of reasons which includes reducing the administrative burden for the fund and its multiple investors by assisting with claiming treaty benefits and/or processing withholding tax reclaims which could otherwise apply if the holding company was not included.

13. It is not clear how clause 2(e) of the proposed LoB article could apply to the typical structure of these real estate funds nor how an Equivalent Beneficiary rule could be made to work in practice for a globally marketed fund with investors across multiple jurisdictions. Using real estate funds as an example, we believe that use of a targeted general anti-avoidance rule in place of a LoB article should remove
uncertainty for investors and provide access to investment opportunities whilst addressing the risk of double non-taxation.

14. In order not to stifle the role of CIVs in the proper functioning of capital markets, we strongly recommend removing the proposed LoB article from the proposed changes to the Model Convention. Instead we recommend placing reliance on a targeted general anti-avoidance rule.

*Provide options to Contracting States to choose either LoB Article or GAAR*

15. If the removal of the proposed LoB article is not deemed appropriate, we would recommend that the Model convention make it clear that either a LoB article, or a General Anti-Avoidance Rule approach should be adopted, and not both.

*Refine Definition of Qualifying Person in Proposed LoB Article*

16. If the removal of the LoB article is not deemed appropriate, we would recommend refining the definition of “qualifying person” for LoB purposes to include CIVs which are widely held.

17. A definition of qualifying persons to include funds which are “widely held” should be drafted to include funds which (i) are publicly available/widely marketed or (ii) funds which meet a “not intentionally closely held” test (such as the “genuine diversity of ownership” test in UK legislation ¹).

18. Any such test to demonstrate that funds are not intentionally closely held should be straightforward and objective in application, and we suggest including the following elements in the test:

- The fund documentation should state that the fund will be marketed and made widely available to specific intended categories of investors;
- The terms and conditions of the fund should not be set in such a way as to limit investors to a select group within the stated categories of investors by deterring a reasonable investor within a target market from investing in the fund;
- The fund must be marketed and made sufficiently widely available with the aim of reaching, and in an appropriate manner, in attracting, the intended categories of investors; and
- Where the CIV investment is held by the long term fund of a life company, that such investments should be considered as being widely held.

¹ The genuine dispersal of ownership (GDO) condition aims to prevent small groups of investors from taking advantage of the favourable UK tax treatment available to investors in widely pooled schemes, using closely held arrangements that may in reality be for the benefit of a tightly restricted group, for example a group of family members or a group of companies in common ownership. Further detail on the GDO condition can be seen in the HMRC manual at http://www.hmrc.gov.uk/manuals/ctmanual/CTM48160.htm.
Supplement Proposed LoB Article with an Equivalent Beneficiary Test

19. The Discussion Draft considers whether the addition of an “Equivalent Beneficiary” element to proposed LoB article would provide additional avenues to achieve treaty relief for legitimate commercial structures, equivalent beneficiaries being investors who in their own right could access a similar withholding tax rate under a tax treaty of a country in which they are resident.

20. Whilst we believe that there is merit in this approach in certain situations, our view is that in practice such “look-through” provisions could give rise to both pricing and operational difficulties in widely-held funds (similar to that experienced currently with tax transparent funds). Based on our experience of tax transparent funds to date, it is necessary to have separate share classes for each investor type (e.g., UK pension fund investors investing in US underlying investments would typically be in one share class to benefit from the 0% US WHT rate on dividends), the number of which will depend on both on the jurisdiction of residence of the investor and on the jurisdiction(s) into which investments are made. Different share classes allow the correct tax documentation to be solicited and held for each investor type for each particular country of investment so that the same WHT rate is applied across a particular share class on dividends received from each country of investment (such segregation being necessary for pricing reasons). The complexity for fund managers and custodians in actually processing client on boarding and operating multiple WHT rates for multiple countries for even one fund/sub-fund is considerable and multiplied out across the majority of funds operated would create a substantial administrative burden, the cost of which would have to be passed onto investors making cross-border indirect investment less attractive. In the absence of TRACE (treaty relief and compliance enhancement) being implemented across all the OECD (and non-OECD) jurisdictions, an Equivalent Beneficiaries element is frankly unworkable where funds investing in multiple jurisdictions are not closely held.

21. For these practical reasons, our preference would be to have the Equivalent Beneficiary element only as an alternative to the “widely held” test described above.

Discretionary Benefits

22. If the removal of the LoB article is not deemed appropriate, we welcome the draft text of clause 4 of that proposed article which specifically states that Treaty Benefits should be granted to persons who are not qualifying persons, provided:

"the establishment, acquisition or maintenance of such person and the conduct of its operations did not have as one of its principal purposes the obtaining of benefits under this Convention"

Our experience with existing treaties utilising LoB articles is that such treaties often do not state the circumstances in which a Competent Authority should grant such discretionary benefits to persons who would otherwise fail to be considered as qualifying persons under the article; this text is an improvement on many LoB articles in existing treaties. Seeking discretionary benefits is typically a lengthy administrative process and in order for this clause to be most effective, we would strongly
recommend that member governments and their Competent Authorities should commit to provide flexible, quick and readily accessible methods of arbitrating and confirming that such treaty benefits are available to non-qualifying persons who can demonstrate that no mischievous or inappropriate purpose exists.

“Active Conduct” of a trade or business

23. If the removal of the LoB article is not deemed appropriate, we would recommend that the test is amended so as not to inadvertently penalise regulatory branches required by Insurance companies in certain circumstances.

24. Paragraph 3 of the proposed LoB article provides, broadly, that a resident of a Contracting State will be entitled to benefits of a treaty with respect to an item of income derived from the other Contracting State if the resident is engaged in the active conduct of a trade or business in the first-mentioned Contracting State and the income derived is connected to that trade or business. This is subject to an additional condition that the trade or business in that first-mentioned Contracting State is substantial in relation to the trade or business activity carried on by the resident in the other Contracting State. In the case of the insurance industry, branch structures are an essential means of managing capital and meeting regulatory requirements. Insurance groups will often operate through multiple regulated entities in a particular region, depending on product or line of business, and each regulated entity may have multiple branches. In the EEA, where regulatory passporting is possible, it is common to select a “home” EEA residence for multiple entities and their underlying branch networks by reference to the overall commercial environment, not least of which is the preferred “home” regulator. It will not necessarily be the case that each and every branch in the network of each and every entity will have “substantial” activity in the home location, potentially resulting in a failure to achieve treaty benefits, even though there has been no suggestion of treaty shopping. Consideration of “substance” should allow for genuine, commercially driven, branch network structures and should also allow for the inclusion of the entire substance of a multinational group in the home residence location, rather than considering this point entity by entity. This is particularly important in the insurance sector, where employees are often required to be employed by a separate employment entity on behalf of the (multiple) regulated operating entities, and entity by entity considerations of substance can become meaningless.

25. As noted in paragraph 22 above, whilst the Competent Authority process provided for by draft paragraph 4 of the LoB article may enable a particular group to apply for treaty benefits notwithstanding that it is unable to fulfil the strict requirements of paragraphs 2 or 3, this is typically a lengthy administrative process and introduces significant uncertainty.

Implications of definition of “primary place of management and control”

26. We strongly recommend that careful consideration be given to the wider implications for Article 4 (residence) of the Model Convention arising from the definition of “primary place of management and control” as set out at 5(d) of the proposed article. The
impact on Article 5 also needs to be considered in the context of the work on Action 7 - Prevent the artificial avoidance of PE status.

27. Clause 5(d) of the proposed LoB article states that a company’s “primary place of management and control” will be in the Contracting State of which it is a resident only if executive officers and senior management employees exercise day-to-day responsibility for more of the strategic, financial and operational policy decision making for the company (including its direct and indirect subsidiaries) in that Contracting State than in any other state and the staff of such persons conduct more of the day-to-day activities necessary for preparing and making those decisions in that Contracting State than in any other state” (our emphasis).

28. It is not at all clear how this definition of “primary place of management and control” would sit with the interpretation of the “place of effective management” concept under Article 4 (nor do the proposed revisions to the Commentary to Article 4 make it clear in practice how widely these considerations in the proposed Article should be applied). Neither is it clear how the definition should be interpreted when considering whether a permanent establishment has been created under Article 5. Whilst the concept of “primary place of management and control” is outlined for narrow LoB purposes, any read-across of the concept to Articles 4 & 5 creates inconsistencies. For example:

- In considering whether the “staff of such persons” conduct more of their day-to-day activities in the Contracting State, what weight should be given to outsourcing models? There are potential issues with tax neutrality if use of outsourced or insourced models can, taken in isolation, significantly affect the outcome as to a corporate’s residence;

- This definition does not sit well with regulatory definitions of residence or establishment, which aligns more closely with the Article 4 definition of “effective place of management”. The second element of the proposed test has the potential to introduce a discord between the regulatory definition and that for tax, creating uncertainty and compliance costs;

- This definition references the ability to effect decision making for the direct and indirect subsidiaries of the company without consideration of the implications for the place of effective management and residence of those subsidiaries; and

- The second leg to the definition by reference to staff performing preparatory work also appears to be at odds with the Freedom of Services and Freedom of Establishment principles of the EU single market and does not appear to be in line with the KERT analysis of part IV of the 2010 OECD report on the attribution of profits to the permanent establishments of Insurance companies.
29. In summary, such a clause should not be considered in isolation from the conclusions of the work on BEPS Action point 7 (and their impact on Article 5) nor can it be introduced without consideration of the impact on Article 4. It introduces concepts which potentially impact long-standing and non-contentious interpretation of existing concepts. This needs to be considered and debated as part of the Action 7 work and decisions on the options should not be made until work on the other relevant BEPS actions is completed. Otherwise, it is likely there will be unnecessary complications which may have an inadvertent negative impact on business.
9 April 2014

By email to: taxtreaties@oecd.org

Dear Sir,

Discussion draft on preventing the granting of treaty benefits in inappropriate circumstances

AFME\(^1\) and the BBA\(^2\) welcome the opportunity to respond to the OECD's discussion draft entitled “BEPS Action 6: Preventing the granting of treaty benefits in inappropriate circumstances” published on 14 March 2014 (the discussion draft). We wish to make clear that while AFME and the BBA have separate and distinct memberships, for the purposes of the OECD discussion draft, both organisations have decided to submit a single, combined response since our respective members share some key concerns with the OECD's proposals in the discussion draft.

General Comments

We welcome that the OECD is consulting with business on its proposals. We believe that this approach is to the benefit of both policymakers and business and helps to avoid any unintended consequences arising from the OECD’s initial proposals. We believe that it is also valuable for the OECD to take account of the views of business on the practical aspects of operating the intended policy.

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\(^1\) The Association for Financial Markets in Europe (AFME) represents a broad range of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks and other financial institutions. AFME advocates stable, competitive and sustainable European financial markets, which support economic growth and benefit society.

\(^2\) The British Bankers’ Association (BBA) is the leading association for the UK banking and financial services sector, speaking for 180 banking members, headquartered in 50 jurisdictions and operating in over 180 territories worldwide jurisdictions, on the full range of UK or international banking issues. Collectively providing the full range of services, our member banks make up the world’s largest international banking centre.
The discussion draft contains a number of proposals each of which is designed to prevent the granting of treaty benefits in inappropriate circumstances. A concern from the banking sector is that, taken as a whole, the proposals represent a disproportionate response to any potential abuse of the tax treaty system.

We also have a concern that a number of the proposals will introduce uncertainty into whether treaty relief is available in ordinary commercial circumstances, and that the proposed approach risks fundamentally undermining the usefulness of tax treaty networks that states have spent decades putting in place in order to facilitate international trade.

We would encourage the OECD to seek a consensus on which proposals may best facilitate a targeted and effective response to any potential abuse, rather than introducing broad measures which may significantly impact commercial activity that is not motivated by base erosion and profit shifting (BEPS).

A key objective for double taxation agreements (DTAs) is the promotion of international trade. The proposed rules for preventing the granting of tax treaty benefits may adversely affect taxpayers who are seeking treaty benefits for their genuine commercial and investment transactions. It will be essential that any proposals aimed at preventing abuse provide taxpayers with clarity and certainty on how treaty benefits will be accessed. The negative effects that tax uncertainty has on cross-border trade should not be underestimated.

We note also that the introduction of new rules may result in a significant increase in the number of treaty-related tax refund claims. Proposals leading to reduced relief at source contradict the objectives of the Treaty Relief and Compliance Enhancement (TRACE) system, another tax-related project undertaken by the OECD which is aimed at moving towards a “relief at source” system. Whilst the TRACE and BEPS projects have different objectives, we are disappointed by the apparent lack of coordination.

Given the relatively short time available it has been hard to consider all aspects of the discussion draft and we are therefore providing specific comments on some of the most important issues of concern to us. We may write to you again with further comments once we have had a chance to consider the proposals in greater detail.

**Limitation-on-benefits provision and rules aimed at arrangements where one of the main purposes is to obtain treaty benefits**

Although we understand that the OECD Model Tax Convention (MTC) and commentary should be designed to prevent cases of treaty shopping and double non-taxation, we are concerned that the introduction of a limitation-on-benefits (LOB) provision and/or a more general anti-avoidance rule (GAAR) could introduce - for taxpayers and tax
administrations alike – a great deal of uncertainty. Such uncertainty may erode the benefits that DTAs provide with respect to cross-border trade and therefore potentially deny treaty benefits to those who would otherwise be entitled to them.

We would therefore encourage the OECD to work with the existing tools that tax administrations already have at their disposal – and with which taxpayers and tax authorities are familiar – to deter treaty shopping and double non-taxation. This could involve for example, providing additional guidance on these concepts in the commentary to the MTC. We note, for example, that the beneficial ownership and permanent establishment concepts have already undergone considerable analysis by OECD member states and that a number of revisions to the OECD’s MTC and commentary have already been made to the mutual benefit of both taxpayers and tax administrations.

We are surprised, in particular, that the OECD should be giving such a strong recommendation that LOB provisions be included in tax treaties. This concept has had relatively little use in double tax treaties to date, and the terms and concepts used are therefore not particularly well understood or settled internationally. We suggest that the introduction of an LOB requires more detailed consideration by taxpayers and tax authorities to ensure that there are no consequences which inadvertently impact the rightful access to treaty benefits by taxpayers. We have commented in more detail in Appendix 1 to this letter on some specific concerns relating to the suggested draft LOB provision in Article X (Entitlement to Benefits) (set out in paragraph 11 of the discussion draft).

In the event that the OECD decides to move forward with its current proposals recommending the introduction of a GAAR, we would consider it essential that further examples be provided to clarify borderline situations as to when Paragraph 6 (the GAAR provision) may apply. We would be happy to assist the OECD in developing further examples if that would be helpful.

Finally, we are concerned that measures aimed at counteracting treaty abuse should not have the effect of deterring normal commercial transactions between unrelated parties. We note that the scope for abuse between unrelated third parties is generally much lower than between connected parties. We therefore suggest that the OECD considers that any tightening of conditions for obtaining treaty relief should only apply to related party transactions.

**Collective Investment Vehicles**

It is not immediately clear whether sufficient consideration has been given to situations where cross-border investments are made by or through Collective Investment Vehicles (CIVs) which are used - directly or indirectly - by individuals for the purposes of savings
and investment. DTAs play a critical role in removing barriers to cross-border trade and investment for CIVs and we are concerned that some of the measures aimed at combating treaty shopping will have a disproportionate impact on CIVs resulting in their being unable to gain access to the benefits of double tax treaties and therefore discouraging their investment activity.

We note that in January 2009, the Informal Consultative Group’s (ICG) report on withholding tax procedures made a number of “best practice” recommendations, including the allowance of relief at source.

The Committee on Fiscal Affairs (CFA) approved the creation of a pilot group to take forward the work of the ICG and develop standardised documentation to implement the best practices outlined in the ICG’s report. We note three important outcomes resulting from the work of the pilot group.

First, the ICG-originated report, “The Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles” (the CIV Report), was adopted by the CFA on 23 April 2010.

Second, a 2010 update of the Commentary on Article 1 of the OECD MTC adopted the CIV Report’s conclusions, including those relating to addressing governments’ concerns regarding treaty shopping opportunities through CIVs.

Third, the TRACE Implementation Package (IP) was endorsed in January 2013 by the CFA and included model mutual agreements designed to implement the conclusions of the CIV Report.

The CIV Report contained an extensive discussion of treaty shopping issues in relation to CIVs. The work undertaken to produce the CIV Report and the TRACE IP required intensive effort on the part of a large number of government and industry representatives over a period of five years and there was extensive consultation with the private sector. The CIV Report and Trace IP reflect the OECD’s strong interest in ensuring that clear and practical rules are available to allow treaty benefits to income derived by CIVs.

We note that the OECD’s work on the TRACE project is seen by industry as a huge step towards simplifying and harmonising treaty relief withholding procedures and reducing costs for taxpayers and governments.

The discussion draft proposes an LOB provision that could effectively remove all treaty access for the vast majority of CIVs. Should the OECD decide to move forward with its current proposals, we strongly encourage the introduction of specific provisions (e.g., an “equivalent beneficiaries” provision in the LOB clause) to address the special
situation of CIVs. We recommend that the OECD amend the proposed LOB provision to include an additional safe harbour for any CIV of the type described in the CIV Report. This will be essential to ensuring that banks have legal certainty when providing treaty relief services to CIVs and CIV unit holders.

**Tie-breaker rule for determining the treaty residence of dual resident persons other than individuals (paragraphs 50 to 53 of the discussion draft)**

We note the suggested change to the tie-breaker rule for determining the treaty residence of dual resident companies and, in particular, that cases of dual residence should be determined by the contracting states by mutual agreement on a case-by-case basis. We think that this approach introduces uncertainty for business, and are not convinced that the case has been made for this change. Given the short period of consultation on the discussion draft, we therefore think that there needs to be further investigation of the range of circumstances in which dual resident companies arise, in consultation with business, before any change of this nature is made.

If this change is to be taken forward, we believe that provisions should be included so that contracting states are under a positive obligation to reach mutual agreement, in a reasonable timeframe and we would recommend that conflict resolution provisions are also included. Furthermore, consideration needs to be given to the publication of a list of circumstances or examples providing guidance. We also suggest that the OECD's proposals make clear that the new procedure would not apply to cases of dual residence which have already been determined previously.

**Anti-abuse rule for permanent establishments situated in third States (paragraphs 54 to 56 of the discussion draft)**

We note that that the suggested anti-abuse rule is aimed at cases of ‘triangulation’ involving the transfer of assets to a permanent establishment (PE) in a third country which provides favourable treatment for certain income, while the source state provides treaty benefits on the underlying income and the head office state of the PE exempts profits of the PE.

We understand that the suggested anti-abuse rule requires that the profits of the PE are subject to a combined effective rate of tax in the PE’s head office state and PE location that is 60% or more of the general corporate income tax rate in the head office state. We note that the provision does not apply to income derived in connection with an active trade or business.

Banks and regulated securities dealers operate principally via branch networks and we recommend that the commentary to the anti-abuse rule makes clear that it will not apply to the ordinary course business of branches for banks and regulated securities dealers. For example, where the Asian branch of an EU headquartered bank conducts
cross-border financial services business which is taxed at a low rate domestically and
the branch profits are tax exempt in the headquarter location, we would not expect the
source state to argue that income is not derived in connection with the active conduct of
a trade.

**Concerns regarding implementation**

We note that there does not appear to be any practical guidance in the discussion draft
on how the recommended changes might be implemented efficiently by countries. For
example, it is not clear whether it is expected that countries will be encouraged to sign
up to a multi-lateral instrument (as set out in Action Item 15 of the Action Plan on
BEPS) or whether countries are expected to make changes on a treaty-by-treaty basis.

**Abuse of domestic law provisions using tax treaty benefits (paragraphs 57 to 70
of the discussion draft)**

We note that the discussion draft proposals for the MTC will allow Contracting States to
invoke their domestic anti-abuse provisions, irrespective of the specific treaty
otherwise applying, except in a limited number of cases. This is to avoid the situation in
which treaties can be used to prevent the application of domestic anti-abuse rules.

The proposals were discussed during the development of the OECD’s TRACE work,
where governments sometimes could not agree on a common, harmonised set of
procedural requirements for obtaining treaty relief at source. We are concerned that the
introduction of a broad main purpose test would lead to the denial of tax treaty relief at
source without the provision of detailed information provided at the time when income
is paid and tax withholding applied.

Tax withholding agents who deal with a high volume of portfolio investment structures
would find it difficult to process detailed and complex factual enquiries when operating
a relief at source system.

Should the proposals outlined in paragraphs 57 to 70 be adopted, we suggest that it is
made clear that any enquiries are not designed to disrupt a standardised relief at source
system.

Finally, we are grateful for the opportunity to share our comments with the OECD on
the discussion draft and we would be happy to discuss any of the above in greater detail
with the OECD and would be pleased to contribute further as the OECD’s work develops.

Yours faithfully,

Richard Middleton                Sarah Wulff-Cochrane
Specific concerns relating to the suggested LOB provision in Article X (Entitlement to Benefits)

Article X(2)

We refer to Article X(2)(c) which states that a company will be a “qualified person” if:

“(i) the principal class of its shares (and any disproportionate class of shares) is regularly traded on one or more recognized stock exchanges, and either:
   A) its principal class of shares is primarily traded on one or more recognized stock exchanges located in the Contracting State of which the company is a resident; or
   B) the company's primary place of management and control is in the Contracting State of which it is a resident; or
(ii) at least 50 percent of the aggregate voting power and value of the shares (and at least 50 percent of any disproportionate class of shares) in the company is owned directly or indirectly by five or fewer companies entitled to benefits under subdivision i) of this subparagraph, provided that, in the case of indirect ownership, each intermediate owner is a resident of either Contracting State;”

We note that Article X(2)(c)(i)(A) requires that the principal class of shares is primarily traded on one or more recognized stock exchanges located in the Contracting State of which the company is a resident.

It is not clear to us what the rationale is for limiting the choice of stock exchange to the Contracting State in which the relevant company is resident and whether this would be compatible with EU law. We understand that companies will generally list where they can most effectively raise capital. We would request that the main gateway provision in Article X(2)(c)(i)(A) is amended so that it would be possible for the principal class of shares to be traded on one or more recognized stock exchanges located in a non-contracting state. If the contracting states consider listings on certain exchanges to lack commercial substance, we suggest that those exchanges could be denied “recognized stock exchange” status for the relevant treaty purposes.

We also note the requirement in Article X(2)(c)(ii) for intermediate owners to be a resident of either Contracting State. We are concerned that such a provision does not reflect how most multinational groups are organised in reality, for instance using regional hubs. Furthermore, for groups which have grown through acquisition legacy
holding structures it may take time - and in some cases it may be impracticable from a legal, accounting or regulatory perspective - to alter the holding structure. Finally, it is not clear to us whether this provision would be compatible with EU law. There needs to be considerably more flexibility in any LOB approach, so that normal commercial group structures do not lead to a loss of treaty benefits.

We also note that structures using orphanised special purpose vehicles (SPVs) are likely to require the agreement of the source state tax authority that treaty benefits apply. These are commonly used in a range of financing transactions that are not tax motivated, for example securitisations. Where the debt issued by the SPV is to be rated there is a need for a high degree of certainty as to the cash flow on the debt, which in turn means that the tax treatment of the SPV's income needs to be certain. The uncertainty, or denial of treaty benefits, which could arise from the operation of an LOB provision is incompatible with the commercial requirements. One possibility is that this would lead to a wide range of clearance applications to tax authorities. We are unsure whether tax authorities would be resourced to deal with clearances for individual transactions on a commercially acceptable timetable. In the securitisation context, we have noted that rating agencies would be likely to require advance clearance which could lead to potentially adverse commercial consequences as, for example, it could delay a bank in the source state divesting of financial assets through a securitisation structure.

Article X(3)

We note that Article X(3)(a) provides an alternative gateway provision where a resident is engaged in the “active conduct of a trade or business (other than the business of making or managing investments for the resident’s own account, unless these activities are banking, insurance or securities activities carried on by a bank, insurance company or registered securities dealer respectively), and the income derived from the other Contracting State is derived in connection with, or is incidental to, that trade or business”.

We note the following concerns in relation to this:

1. it needs to be made clear that source states cannot argue that a regulated bank’s activities can be divided into ‘active’ and ‘non-active’ parts, such that a source jurisdiction possibly argues that the subsidiary claiming treaty benefits was not doing so in relation to ‘active’ banking activities;

2. the reference to “making or managing investments for the resident’s own account” could make the application of treaty benefits doubtful where the asset giving rise to the cash-flow in respect of which treaty benefit is claimed is held as a hedge to an instrument issued outside the group or interest in the asset is sub-
participated to a person outside the group. It needs to be made clear that this is not intended to be the case.

We also suggest that Article X(3)(c) – which deals with connected parties - needs to make clear that indirect subsidiaries also benefit from Article X(3).
AFEP welcomes the OECD’s request for comments on the discussion draft released on March 14, 2014 regarding action 6 of the BEPS Action Plan dealing with treaty abuse.

As a preliminary comment, it is striking that, under its introduction, the draft report poses as an objective of BEPS Action 6 that “tight treaty anti-abuse clauses coupled with the exercise of taxing rights under domestic laws will contribute to restore source taxation...” The absence of reference in this introduction, like the one existing under the current paragraph 9.5 of commentaries under article 1, that “it is important to note, however, that it should not be lightly assumed that a tax payer is entering into the type of abusive transactions” raises the concern of some lack of balance in the overall approach proposed.

The emphasis put to add new anti-abuse provisions into tax treaties, as well as a clear intent into the title and preamble of tax treaties, without any counter-weight that evidence of a such an abuse should be clearly brought forward by the tax authorities is most likely, under current international practices as they are experienced in many controversies faced by MNEs, going to reduce drastically legal security as to treaty applicability and will impact negatively the capacity of MNEs to organize freely their state of affairs investing in different countries through the various legal entities composing their group.

As to treaty provisions and/or domestic rules to prevent the granting of treaty benefits in inappropriate circumstances:

As to the generalization of a limitation-on-benefits provision:

The introduction of a LOB clause in more tax treaties may provide for a fair and objective mean to avoid most treaty shopping circumstances but it should not be under estimated that:

- many countries are under-equipped to apply such a clause and are not culturally used to apply such successive objective tests. This may create intricate discussion points and increase the compliance burden of MNEs;
- a LOB clause should not operate in such a way so as to exclude from treaty benefits MNEs which at some point in time may be under ownership by private investment funds ‘vehicles which themselves may be owned by investors of several countries;
- recourse to competent authority’s assessment under paragraph 4 of the draft clause should be organized under a legal frame free of financial charge because it is unfair to request that a tax payer must pay substantial administrative costs to bring evidence of a non-abusive intent;
- some kind of non-governmental appeal body should be entitled to further examine a recourse to competent authority that treaty benefits are not being abused of;
- in addition, the insertion of a “derivative benefits” provision seem highly appropriate to bring flexibility and allow treaty benefits to be granted to entities belonging to a group which would have enjoyed similar benefits if they were standalone entities. The situation described under paragraph 15 of the draft of a potential BEPS concern should be rather addressed either by BEPS Action 3 (CFC rules) or BEPS Action 4 (harmful practices) but not by BEPS Action 6.
As to rules aimed at arrangements one of the main purposes of which is to obtain treaty benefits:

The proposed introduction into tax treaties of such a widely drafted general anti-base provision is likely to cause major concerns of legal stability and predictability around treaty protection and could, as a matter of fact, make the rule of Law intended by tax treaties highly dependent to pure subjective assessment by local tax authorities.

As mentioned by the draft discussion, existing commentaries under article 1 of the Model Convention already allow member States of the OECD to make use of their domestic GAAR and the need for an actual addition to the Model Convention itself seems contradictory with the prior existing statement in the commentaries that current wording of the Model Convention already authorizes the application of such general anti-abuse rule.

Most importantly, the proposed wording of such a new treaty rule appears in breach of minimal predictability required under tax treaties in that:

- deriving an actual tax benefit should only be among one of the main purposes of the transaction for it to be considered abusive. This is extremely wide and subjective and goes far beyond what the EU is requiring for a GAAR provision to be introduced which requires the tax benefit to be the essential purpose and which must be evidenced by a serial of objective factors. The OECD proposed approach may moreover be against Constitutional Law of several countries for which GAAR provisions should remain clearly an exception;

- the burden of proof that the tax benefit obtained is in accordance with the object and purpose of the relevant provisions of the treaty lies under the proposed approach exclusively on the head of the tax payer. This is not in line with a state of Law where any abuse should be clearly demonstrated by the party which files such an argument and no clear distinction between the object and the purpose of a tax treaty is provided for under the draft discussion.

Under examples shown in paragraph 33, facts and circumstances allowing evidencing an acceptable motive should also be provided. For instance, under the first example, may the tax payer justify the assignment of the dividend because it was to refund a cash advance made by the financial institution?

Conversely, introducing minimum holding periods before treaty benefits may be relied upon seem to AFEP an adequate anti-abuse rule since it provides for a fully objective test that tax payers will be in position to measure beforehand.

Finally, the proposed specific anti-abuse rule under paragraph 54 for permanent establishments situated in third States seem also to bring excessive complexity. In practice firstly, the capacity to transfer assets to permanent establishments of a third State will be limited by capital gain taxation rules applicable in the residence State and, secondly, upon an initial investment, using a permanent establishment of a third State rather than using the home office to make an investment seems perfectly admissible and aligned with the theory to treat permanent establishments as if they were a separate and independent enterprise which is the only authorized approach by the OECD.

As a conclusion, AFEP has been very honored to share its views with the OECD as to this important discussion draft on Action 6 and hopes that it will help the OECD in pursuing its works with a fully balanced approach in order to avoid that tax treaties may become much less relevant in the future for international trade in a legally secured environment.
9 April 2014

VIA E-MAIL

Ms. Marlies de Ruiter  
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Re: Comments on Discussion Draft on BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

Dear Ms. de Ruiter:

This letter is submitted on behalf of the members of the Association of Global Custodians (“AGC” or “Association”) to provide you with their views regarding the OECD Discussion Draft on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, issued on 14 March 2014 (the “Discussion Draft”) pursuant to Action 6 of the BEPS Action Plan.

The AGC members have been keenly following (and in some cases actively participating in) the work of the Organisation for Economic Co-Operation and Development (“OECD”) for many years on various key tax developments and welcome the opportunity to provide comments to you on the Discussion Draft.

The Association is an informal group of 11 member banks that provide securities safekeeping and asset serving functions to cross-border institutional investors worldwide including investment funds, pension funds, and insurance companies.

In providing global custody services, AGC members routinely seek appropriate tax treaty withholding tax relief on behalf of custody clients. We typically collectively
process millions of such relief claims each year, affecting substantial amounts of cross-border portfolio investment flows in and out of countries worldwide. A significant portion of the income for which our members process treaty relief claims is income received by Collective Investment Vehicles (“CIVs”). As such, we experience on a daily basis the costs, inefficiencies, and excessive withholding that arises when the procedures for claiming lawful relief are unduly burdensome or complicated for the investors involved, or when the standards for entitlement to treaty relief are too unclear or complicated to effectively accommodate treaty relief claims, whether at source or by refund.

Tax treaties play a critical role in removing barriers to cross-border trade and investment. The AGC members devote considerable resources to ensuring that they make treaty claims effectively and properly for eligible clients.

Our members fully support the principle that countries are entitled to ensure that the benefits they grant by treaty are not availed of in inappropriate circumstances. That being said, we are keenly aware of the need for proportionality in designing solutions to treaty abuse concerns, lest by curing the disease we kill the patient.

Our primary concern with the Discussion Draft is that its proposed rules to prevent the granting of tax treaty benefits in inappropriate circumstances will adversely affect the majority of taxpayers legitimately seeking treaty benefits for their genuine commercial and investment transactions. We are concerned that the proposals will lead to uncertainty and lack of clarity, thereby disrupting the process for obtaining legitimate treaty relief for high volume cross-border investment flows and undermining the very purpose of treaties. More particularly, we are concerned that the proposals, as drafted, might result in the removal of treaty access to a vast majority of CIVs.

Therefore, our comments on the Discussion Draft focus on the potential operational implications to governments and business should the OECD’s proposals, as drafted, be widely adopted by governments. Our comments are primarily focused on the following concerns, as explained below:

- The Discussion Draft’s proposals, including its recommended Limitation on Benefits (“LOB”) provision, do not appear to take into account the substantial work done by the OECD in recent years to develop guidance and recommendations on the substantive and procedural rules for applying treaty benefits to income derived by CIVs.

- The proposed “main purpose test” set forth at paragraph 18 of the Discussion Draft would introduce an unacceptable level of uncertainty concerning entitlement to treaty benefits on cross-border investment flows.

- Certain other specific anti-abuse rules proposed by the Discussion Draft could likewise introduce significant levels of uncertainty or procedural difficulties, thereby rendering appropriate treaty relief effectively unattainable in many cases.
Failure to take into account prior work on treaty entitlement for CIVs and on TRACE

In the absence of clarity and certainty regarding clients’ entitlement to treaty benefits, custodians and other market operators and infrastructure providers would be wary of providing tax treaty relief inappropriately. Therefore, where new rules are introduced to limit treaty benefits, any resulting uncertainty could mean that tax treaty relief at source is restricted, or removed, resulting in a vast increase in the number of treaty-related tax refund claims. Suggestions leading to reduced relief at source cut across and are diametrically opposed to the objectives of the TRACE (Treaty Relief and Compliance Enhancement) system, another tax related project undertaken by the OECD. The OECD’s TRACE project has been a signal initiative, aimed at simplifying and harmonising countries’ treaty relief withholding procedures, thereby streamlining processes, reducing costs for taxpayers and governments, and giving investors their rights while improving tax compliance. We have previously commented to the OECD in strong support of the TRACE project (see our letter of 26 July 2013 urging the OECD to ensure that TRACE is implemented simultaneously with the OECD’s current proposals on a Common Reporting Standard (“CRS”) for multilateral automatic exchange of information), and we are very concerned with any proposal that could undermine the goals of the TRACE work.

Moreover, as the OECD is aware, in 2006 the OECD’s Committee on Fiscal Affairs (“CFA”) created the Informal Consultative Group (“ICG”) on the Taxation of CIVs. The ICG was asked to report on:

• Technical issues relating to the granting of treaty benefits with respect to the income of CIVs; and

• Possible improvements to current procedures for claiming treaty benefits by all cross-border portfolio investors.

In January 2009 the ICG’s report on withholding tax procedures made a number of “best practice” recommendations, including the allowance of relief at source, based upon pooled claims made by authorised financial intermediaries for their customers, coupled with detailed information reporting obligations on those intermediaries. The CFA approved the creation of a Pilot Group to take forward the work of the ICG and develop standardised documentation to implement the best practices outlined in the ICG’s report.

There were ultimately two resulting outputs from this work, which was continued through subsequent groups established by the CFA, the Pilot Group and the TRACE Group:

• First, the ICG-originated report, “The Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles” (the “CIV Report”), was adopted by the CFA on 23 April 2010, and a related 2010 update to the Commentary on Article 1 of the OECD Model Tax
Convention adopted the report’s conclusions, including those relating to addressing governments’ concerns regarding treaty shopping opportunities through CIVs.

• Second, the TRACE Implementation Package (“IP”) endorsed in January 2013 by the CFA, included Model Mutual Agreements designed to implement the conclusions of the CIV Report.

The CIV Report contained an extensive discussion of treaty shopping issues in relation to CIVs. It adopted a flexible approach, suggesting that whether or not countries would want to introduce Limitation on Benefits (“LOB”) restrictions would depend on “the economic characteristics of the various types of CIVs that are prevalent in each of the Contracting States” (e.g., indicating that there is less danger of treaty shopping where distributions by the CIV to non-resident investors are subject to a withholding tax). The CIV Report further indicated:

In the case of CIVs, an anti-treaty shopping provision generally would seek to determine whether a CIV is being used for treaty shopping by determining whether the owners, or a specific proportion of the owners, of interests in the CIV are residents of the Contracting State in which the CIV is organised or, in some cases, whether the owners of interests in the CIV would have been entitled to equivalent benefits had they invested directly. The latter approach would help to ensure that investors who would have been entitled to benefits with respect to income derived from the source State had they received the income directly are not put in a worse position by investing through a CIV located in a third country. The approach thus serves the goals of neutrality as between direct investments and investments through a CIV. It also decreases the risk of double taxation as between the source State and the State of residence of the investor, to the extent that there is a tax treaty between them. It is beneficial for investors, particularly those from small countries, who will consequently enjoy a greater choice of investment vehicles. It also increases economies of scale, which are a primary economic benefit of investing through CIVs. Finally, adopting this approach substantially simplifies compliance procedures. Compliance procedures could be greatly simplified, because in many cases, nearly all of a CIV’s investors will be “equivalent beneficiaries”, given the extent of bilateral treaty coverage and the fact that rates in those treaties are nearly always 10-15% on portfolio dividends.

In other words, the CIV Report encouraged a kind of “derivative benefits” approach, although it noted that not all countries would favour that approach. The CIV Report suggested a variety of different approaches to determine the level of “good” ownership of CIVs, stressing the need to accept “practical and reliable approaches” and to avoid any requirement to do frequent tracing of actual ownership on the grounds that it was impractical for CIVs to do so. It suggested a variety of factors relevant to the
CIVs of particular States that could provide adequate protection against the risk that those CIVs would be used for treaty shopping. It specified that ownership testing of CIVs should be required, if at all, no more frequently than quarterly. The CIV Report stressed the need to coordinate any anti-treaty shopping requirements applied to CIVs with more general anti-treaty shopping provisions in a treaty. The TRACE IP contains a series of model mutual agreements that implement the various approaches endorsed by the CIV Report.

The work undertaken to produce the CIV Report and the TRACE IP required intensive efforts on the part of a large number of both government and industry representatives over a period of five years. There was extensive consultation with the private sector. The documents reflect the OECD’s strong interest in ensuring that clear and practical rules and procedures will be available to allow treaty benefits to flow properly to income derived by CIVs, and that pragmatic approaches to treaty shopping concerns be followed in respect of CIVs.

The Discussion Draft proposes an LOB provision that could effectively remove all treaty access for the vast majority of CIVs. The ownership / base erosion safe harbour, which is the test most likely to be relevant to CIVs, would effectively require a CIV to be able to prove the status of its owners on each of at least 183 days of the year, and would not treat any third country residents as “good” owners. The concern arises that CIVs that are widely-held, diversified, and subject to regulation in the countries in which they are established would be unable to meet the objective tests. This conflicts with the approaches outlined in the CIV Report and TRACE IP mentioned above.

Moreover, the need to prove treaty eligibility for those CIVs that are primarily distributed domestically and would not be restricted by the proposed LOB clause suggests that governments would need to introduce additional legislation and procedures in order to validate treaty relief claims, including systems to validate, on a per income event basis, the make-up of the underlying unit holders. This will undoubtedly mean a move away from existing tax treaty relief at source models to a tax reclaim system. We note that such a move would run directly contrary to the recommendations endorsed by the CFA in the TRACE project, which favour streamlined, relief at source mechanisms.

The proposals would potentially lead to a vast increase in the number of treaty refund claims to be processed by source countries, resulting in increased administration costs and increasingly burdensome procedures for CIVs in furnishing source country tax authorities with additional information.

Finally, CIVs would experience significant delays in obtaining their due treaty entitlements. Individuals saving through CIVs for retirement, education, or other short or long term needs benefit when the procedures for seeking tax treaty benefits that have been negotiated by their governments are uniform, streamlined, and administrable. Having treaty rate withholding apply at source, rather than by seeking refunds, is particularly important to CIVs because of the certainty provided. This is because a CIV typically calculates its net asset value (“NAV”) on a daily basis. The NAV is the price at
which investors make purchases and sales in a CIV. Knowing with certainty the source

country taxation helps to ensure the NAV is priced correctly.

If the CIV is only able to recognise treaty refunds on a receipts basis because of

uncertainty around recovery, investors invested in the fund when it suffered the higher

withholding rate may no longer be invested at the time of an eventual refund (and

therefore not benefit from that refund).

Finally the proposed LOB changes would introduce a real disincentive to the

establishment of cross-border CIVs, something that both the European Union UCITS

(Undertakings for Collective Investment in Transferable Securities) and AIFMD
(Alternative Investment Fund Managers Directive) Directives have been encouraging for

many years.

We therefore recommend that the OECD amend the proposed LOB provision to

include an additional safe harbour either for any CIV of the type described in the CIV

Report (i.e., funds that are widely-held, hold a diversified portfolio of securities and are

subject to investor-protection regulation in the country in which they are established), or

alternatively for income derived by such a CIV according to conditions based upon

those found in the model mutual agreements in the TRACE IP (e.g., based on

paragraph 2 of the “Bilateral – Equivalent Beneficiaries” model mutual agreement,

regarding income derived by a CIV to the extent the CIV is beneficially owned by

“equivalent beneficiaries”, defined to include both residents of the CIV’s Contracting

State and residents of other States who would be entitled to equivalent relief from

source State tax on income from the source State to the same extent as any resident of

the CIV’s State). If the alternative approach is adopted, the OECD should also provide

for methods of determining ownership of the CIV based on those described in the CIV

Report and implemented through the TRACE IP mutual agreements.

**The Main Purpose Test**

The Discussion Draft also proposes adding a so-called “main purpose test” to the

Model Tax Convention, to operate as an anti-abuse provision in addition to the LOB

provision. We understand that this provision would deny treaty benefits in cases where

obtaining the benefit was one of the main purposes of an arrangement or transaction,

unless it is established that granting the benefit would be in accordance with the object

and purpose of the relevant treaty provisions.

We are concerned that this provision would introduce major uncertainty into
taxpayers’ claims for treaty relief due to its vague and subjective standard. This is

particularly the case in light of the fact that it would apply in addition to the LOB

provision and other specific anti-abuse provisions in the treaty, including by

re-evaluating the very areas covered by those other provisions. We note that this very

concern about vagueness and subjectivity is what caused the U.S. Senate to reject a

proposed main purpose test in a pending U.S. treaty over 10 years ago and to mandate

that no future U.S. treaties contain such a provision. Where, as here, the main purpose

test is proposed to be included in a treaty that already has an LOB provision addressing
treaty shopping concerns and a beneficial ownership test addressing conduit concerns, the main purpose test seems particularly redundant and unnecessary.

Our concern relates to the fact that this provision, too, fails to take into account the previously completed CIV and TRACE work by the OECD. It could trigger a variety of domestic procedural requirements in participating countries, as each country decided what its anti-abuse fact pattern of concern might be and introduced procedural tests targeted at those concerns. We note that the “bad” and “good” examples included in the Discussion Draft to illustrate the application of this provision (especially Examples A and D) cover portfolio investment benefit issues (entitlement to dividend withholding relief on recently acquired shares, and entitlement of a widely held investment company (CIV) to benefits) which could cause a source State government to introduce particular procedural inquiries as part of its requirements for obtaining relief. This type of problem was the subject of debate during the OECD’s TRACE work, where governments sometimes struggled with the objective of arriving at a common, harmonized set of procedural requirements for obtaining treaty relief at source.

We fear that this problem would reappear widely if governments saw a main purpose test provision as an invitation to deny relief at source, unless complex factual inquiries relevant to smoking out a small minority of abuse cases were satisfied at the withholding stage. Withholding agents faced with a high volume of intermediated portfolio investment structures cannot possibly process such complex and diverse factual inquiries in the operation of a relief at source mechanism. Such inquiries are more appropriate at an audit stage and should not be introduced into a standardised relief at source system. Moreover, we do not see that the “main purpose test” adds any significant protection against treaty abuse that is not already provided by the inclusion of an LOB provision and by the anti-conduit aspect of the beneficial owner requirements.

Accordingly, we recommend deletion of the main purpose test as unnecessary, vague, and subjective and too prone to trigger unworkable procedural hurdles to the smooth functioning of a relief at source system for high volumes of cross-border portfolio income flows. If the test is retained, we recommend that the OECD include in its discussion of the test a reference to the prior work on CIVs and TRACE, and that it emphasise in that context the need to provide practical, streamlined procedural rules for obtaining relief at source for CIVs and other portfolio investors.

**Specific anti-abuse rules**

The Discussion Draft proposes to introduce a variety of specific anti-abuse rules targeted at the abuse of particular treaty provisions. These include proposed rules aimed at dividend characterization and dividend transfer situations and at transactions designed to avoid the application of Article 13(4) relating to the transfer of ownership interests in an entity which primarily derives its value from immovable property situated in the source State.

We would like to emphasise the need, in considering any such anti-abuse rules, to consider as well the procedural implementation of those rules and the question of
whether they can be implemented without effectively choking off relief at source for the vast majority of non-abusive transactions taking place in the market. For example, even in its current form, Article 13(4) requires a snapshot determination of the value of an entity’s underlying assets and the percentage of that value represented by immovable property in a source State. That determination may well depend upon access to information that is not available to a portfolio investor, including one who is acquiring and disposing of shares through public trading on a stock exchange, nor to the withholding agents through whom such an investor may derive payment.

For this reason, and because such situations present little risk of abuse, the OECD Commentary notes that some countries choose to carve out small portfolio investors or stock exchange transactions from the operation of Article 13(4). The need for such carve-outs is even greater where the determination requires not just one, but multiple daily snapshot value determinations over a period of time leading up to a disposition. If such portfolio investors had to prove the non-applicability of Article 13(4) before obtaining relief at source under the other provisions of Article 13, the ability to obtain treaty relief from the source taxation of capital gains would effectively grind to a halt.

Governments, citizens and business would benefit substantially from the enhanced procedures for cross-border-investor tax relief that would be provided by TRACE. Due to the fact that claiming withholding tax relief under treaties and/or a country’s domestic tax laws is often cumbersome, and time and resource intensive, end investors often are effectively forced to forego the tax relief due to them. This has adverse effects not only on the investor but also on the source country and the residence country.

Source country governments which continue to operate tax reclaim systems continue to bear the costs associated with such a system, such as the stamping and certification of tax reclaim forms, processing refund payments and reconciling information reporting. Investors, unable to receive the withholding tax relief provided by treaties, may claim foreign tax credits for excess tax that they cannot recover, to the detriment of their residence governments. TRACE can address these issues, and its streamlined withholding procedures would also make local markets more attractive to cross-border investment.

Accordingly, we urge the OECD to include some reference to the procedural challenges of enforcing complex anti-abuse rules through relief at source mechanisms applicable to portfolio investors without destroying the relief at source system, and that it encourage appropriate carve-outs from such anti-abuse rules (such as those suggested for small portfolio investors and stock exchange transactions under Article 13(4)) to take the pressure off the implementation challenge. Such a reference could include a reference to the TRACE IP endorsed by the CFA as embodying the appropriate level of inquiry for applying treaty relief at the withholding stage.
We appreciate your willingness to consider this submission as you continue your work on developing a final version of the Discussion Draft. The Association stands ready to respond to any follow-up inquiries you may have, and our members would welcome the chance to meet with you, as necessary, to further explain these issues and resolve any questions. For additional information, please contact the undersigned as an initial matter.

Sincerely yours on behalf of the Association,

Mary C. Bennett
Baker & McKenzie LLP
Counsel to the Association
The Luxembourg Investment Fund Association (ALFI) has taken note of the OECD Public Discussion Draft “BEPS Action 6: preventing the granting of treaty benefits in inappropriate Circumstances, dated March 14, 2014 (hereafter referred to as “Discussion Draft”) and is pleased to provide its comments.

The ALFI shares the concerns of the OECD that action is needed to effectively prevent double non-taxation, as well as cases of no or low taxation created by artificial arrangement. The ALFI recognises also that the OECD has been given a mandate by the G20 to address all BEPS issues within an extremely short time frame.

Still we consider that it is imperative that the final paper will manage to balance appropriately all competing considerations and will make sure that the actions undertaken in this Discussion Draft do not go beyond their objectives: the final report should not cause situations where treaty benefits are denied in situations where there is neither a double non taxation nor a low taxation created by artificially arrangements.

**Treaty eligibility of widely held collective investment vehicles (“CIVs”)**

It appears to us that the situation of widely held collective investment vehicles (“CIVs”) has not been taken into account in the Discussion Draft. We consider further that specifically for this type of investment vehicle, the Discussion Draft in its current form (introducing a Limitation of Benefits article as well as a General Anti-Abuse Rule) would create situations where treaty benefits would be denied despite there would be neither double non-taxation nor abuse.

The reasons why portfolio investors pool their funds with other investors in a CIV rather than investing directly are more of commercial nature: diversification, professional investment management, liquidity, cost effectiveness, efficient reinvestment of income, etc.

In addition, as stated under par. 6.32 of the Commentary to article 1 OECD Model Treaty, there should be no treaty shopping in case of no control of the CIV: a CIV which is not controlled, like a publicly traded company, should be entitled to treaty benefits without regard to the residence of its investors. This provision has been justified on the basis that a publicly-traded CIV cannot be used effectively for treaty shopping because the shareholders or unitholders of such a CIV cannot individually exercise control over it. The Discussion Draft does not take this situation into account.

The issue is of importance given the size of the global CIV industry which invests approximately EUR 23 trillion of assets globally.
The ALFI is concerned that the Discussion Draft does not reflect the OECD’s extensive work performed over the past years on treaty eligibility for investors in CIVs (The granting of treaty benefits with respect to the income of collective investment vehicles, “CIV Report”), CIVs within the meaning of the CIV Report being widely-held, diversified, and subject to investor-protection regulation in the country of establishment of the CIV.

The 2010 Update to the OECD Model Tax Convention Article 1 Commentary 1 incorporates the conclusions of the CIV Report and addresses already specifically governments’ concerns about treaty shopping opportunities through CIVs. The aim of the work performed on CIVs over the past years was to overcome existing challenges relating to taxation of CIVs and address the current procedural issues, so that cross-border investors receive the tax relief to which they are entitled in an optimum manner. The Discussion Draft goes in the opposite direction and could make the whole work performed around the issue of treaty eligibility of CIVs become useless.

CIVs addressed in the CIV Report may have hundreds of thousands of investors, which change very rapidly and which are resident in numerous different jurisdictions. This is typically the case of jurisdictions like Luxembourg. Luxembourg, as one of the most popular markets for cross-border fund distribution, with a 67% global market share, is a location where the top 100 management groups distributing cross-border funds represent 92% of the market and the most popular markets from cross-border funds from Luxembourg are Germany, Switzerland, Austria, France and the Netherlands, the UK and Italy.

The CIV Report effectively acknowledges that Governments may take different approaches to CIV treaty eligibility, and the procedures for establishing the tax residence of CIV’s investors. Some CIVs can be treated as treaty eligible in their own right because they are persons, residents, and the beneficial owners of their income. Other CIVs can be treated as treaty eligible only to the extent that their underlying investors are treaty eligible – either directly or as equivalent beneficiaries under a treaty between the investor’s residence country (which is not the residence country of the CIV itself) and the source country. Finally, other CIVs can be treated as transparent, so that their investors can claim treaty relief in their own right.

Some of the investors in CIVs, as the CIV Report explains, lack the financial incentive individually to incur the substantial costs to claim the treaty benefits attributable to the small amounts they have invested. Also, the CIV Report acknowledges that CIVs typically do not know their investors; the majority of CIV interests typically will be held by many securities brokers or other intermediaries holding the interests in a nominee (or "street name") account for their customers. Consequently, the CIV Report states, “it would be impractical for the CIV to collect such information from the relevant intermediaries on a daily basis. Accordingly, Contracting States should be willing to accept practical and reliable approaches that do not require such daily testing.” Some OECD member countries have started embedding the CIV Report in treaties and their approach to granting treaty reliefs.
The Discussion Draft applied to CIVs

If we apply the provisions of the Discussion Draft to CIVs, it would mean in many situations that a CIV could never be granted treaty benefits and this for the following reason: A CIV cannot always determine whether more than 50% of its interests are held by persons who are resident in a treaty-partner country for more than 183 days, since this would mean that the CIV would need to know every day the tax residence of every underlying investor and this information is simply not available.

Applying the Discussion Draft to CIVs would not only eliminate treaty shopping but would instead eliminate the treaty relief negotiated previously, and intentionally, by the investors’ residence countries.

Finally, it is worth considering that the roll out of FATCA, CRS and the enhanced EU savings directive rules greatly reduce the already low risk of CIVs being used to get inappropriate treaty reliefs.

ALFI recommendations

Due to the fact that the Discussion Draft makes currently no reference to CIVs or to the conclusions endorsed by the Committee on Fiscal Affairs (“CFA”), we recommend that the Discussion Draft expressly refers to the CIV Report and the amendments made to the Article 1 of the OECD Commentary, so as to preserve effectively the 2010 CFA-approved procedures for determining treaty eligibility for CIVs and their investors. Not to do so would be to demonstrate serious inconsistency within the OECD.

We consider that the Article 1 OECD Commentary changes – which provide special rules for CIV treaty entitlement – are fully consistent with the LOB clause included in the Discussion Draft. We therefore recommend indicating in the introduction to the Final Report on the BEPS Action 6 Final Report, that it is not intended to address situations – such as the treaty eligibility of CIVs and their investors – that already have been considered fully by the OECD. CIVs should be therefore out of the scope of these provisions.

A specific reference to the CIV Report approved by the CFA, and the relevant paragraphs (6.8 through 6.34) added to the Article 1 Commentary, should be provided. This reference would state that paragraphs 6.8 through 6.34 provide the relevant Action 6 guidance for CIVs; such a reference would eliminate any confusion that otherwise might arise regarding the application to CIVs of an LOB clause or a general anti-abuse rule.
9 April 2014

Tax Treaties, Transfer Pricing and Financial Transactions Division
Centre for Tax Policy and Administration
Organisation for Economic Co-operation and Development

By email: taxtreaties@oecd.org

Dear Sir/Madam

OECD Discussion Draft on BEPS Action 6: Preventing the granting of treaty benefits in appropriate circumstances

AREF\(^1\) is supportive of the efforts of the OECD to reduce treaty abuse and treaty shopping. However, we are concerned that the impact on Collective Investment Schemes (CIVs) in accessing treaty benefits has not been adequately considered.

The 2010 OECD report: The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles (the CIV report) recognised the benefits of investing through a CIV, including providing smaller investors the opportunity to invest in markets they would not otherwise have access to. For this reason and the economic efficiencies provided to investors, CIVs are popular structures for investing into real estate, and are therefore a significant source of capital for long term investment.

The CIV report recognised that one of the main objectives of tax treaties is to reduce tax barriers to cross-border trade and investment. We are concerned that the proposals in the Discussion Draft would jeopardise the level of cross-border investment as many CIVs would unlikely qualify for treaty benefits under the recommendations. In order for CIVs to remain a viable option for real estate investment, it is essential that investors are afforded the protection of double taxation treaties. Furthermore, the recommendations in the Discussion Draft if implemented would also place funds who distribute cross-border at a competitive disadvantage compared to funds whose investors are primarily domestic.

AREF is concerned that the introduction of a limitation on benefits clause as recommended will violate the principle of tax neutrality. The CIV report and the Commentary on Article 1 both recognise the importance of ensuring investors are not worse off by investing in a CIV compared to if they had invested directly. As it stands, many CIVs will not meet the criteria to be considered a “qualified person” under the proposed limitation on benefits clause because CIVs that are widely held might pool investors from many jurisdictions.

Because CIVs are widely held they do not represent a risk of tax avoidance or treaty shopping (as was found by the OECD in the CIV report).

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\(^1\) The Association of Real Estate Funds represents the UK unlisted real estate funds industry and has about 70 member funds with a collective net asset value of over £40 billion under management on behalf of their investors. These member funds represent about 75% of the UK commercial real estate held in CIS and includes £9 billion of net asset value in UK-authorised retail funds (NURS), £17 billion in various forms of UK UCIS and £14 billion invested in offshore (mostly Jersey) domiciled funds.
We therefore recommend that if a LOB clause is adopted, the definition of a qualifying person includes a CIV which is widely held and regulated in its country of residence.

AREF recognises the importance in combatting tax evasion and appreciate the efforts of the OECD to address this important issue. However, we strongly urge the OECD to take into account the policy objectives highlighted in the CIV report and the Commentary to Article 1 to ensure CIVs are not inadvertently negatively impacted by these proposals.

Yours sincerely

John Cartwright
Chief Executive
The Association of Real Estate Funds
Discussion Draft on Preventing the Granting of Treaty Benefits in Inappropriate

General Comments

Tax treaties are essential to regulate taxing rights between jurisdictions to provide taxpayers, and MNC’s in particular, greater certainty in tax outcomes and to minimise the incidence of double taxation. Treaties are vital to cross-border trade and economic growth; therefore, the guidance issued under Action 6 must enhance these advantages for all and not introduce increased uncertainty in relation to legitimate cross border business. Unfortunately, the discussion draft does not achieve the former and introduces significant uncertainty.

Business understands the need to address the inappropriate use of treaties but such measures need to be targeted toward a minority of egregious cases and not jeopardise the majority of international commercial flows of goods and services. The risk of tax authorities asserting unanticipated withholding taxes or delaying access to treaty benefits through long approval processes will lead to increased uncertainty to investment decisions and economic decline. An approach that is proportionate to the issues to be addressed is required in order not to undermine legitimate business.

Furthermore, we understand the tension between the LoB and the main benefits approaches, however, we would strongly urge OECD to propose an either or approach rather than duplicate and in any case dramatically tighten the scope and target the application of these measures, by use of examples as necessary.

The following comments are offered, as ever, in a constructive light in support of OECD overall objectives but aim to narrow the potential scope for denying treaty benefits only in abusive cases. We would welcome the opportunity to discuss these matters further as required.

Limitation of benefits provision

The proposed US-style LoB provision is lengthy and complex and would require extensive analysis by taxpayers to determine eligibility for treaty benefits in each individual case. In addition, we have concerns that the proposed provision could be overly restrictive in its application and may result in residents of a Contracting State being denied treaty benefits in normal commercial circumstances. Given this, we
would support the inclusion of a ‘derivative benefits’ provision, such as that described in paragraph 13.

Whilst paragraph 4 of the proposed LoB clause provides that treaty benefits should not be denied where treaty abuse is not in point, the process for seeking relief under this paragraph would be time consuming.

The tests included at paragraphs 2 and 3 of the proposed LoB clause make use of subjective terms, which would also introduce uncertainty in the application of the clause. Whilst paragraph 5 of the proposed clause provides a degree of clarity in respect of some of the subjective terms used, we believe that the treaty commentary promised at paragraph 12 of the discussion draft should be developed together with examples with a view to providing further certainty of interpretation.

**General anti-abuse rule**

The Treaty GAAR is broad and would result in increased uncertainty to taxpayers. We would prefer the use of more objective anti-avoidance tests, rather than a general anti-avoidance rule. We believe that the adoption of the more subjective, general anti-abuse clause set out at paragraph 18 of the Discussion Draft would introduce a significant degree of uncertainty in the application of treaties, particularly in those Contracting States which have little experience of applying such ‘main purpose’ rules. In addition, different states could view the Treaty GAAR differently, and so a coordinated approach will be needed to make the Treaty GAAR effective and workable. From a practical perspective, it may be difficult to determine whether the benefits of a treaty should apply to transactions with third parties where information will not be readily available.

We note that it is intended for the general anti-abuse clause to be applied independently of the LoB clause. Whilst we understand that there may be benefits to having either a LoB or general anti-abuse clause within the treaty, inclusion of both appears overly protective and is likely to result in difficulties in the application of treaties. Further, similar general anti-avoidance rules are already included in the domestic legislation of many countries. There would therefore likely be three levels of test which would each need to be considered, increasing the likelihood of conflicts of application or interpretation.

Examples to illustrate cases in which the proposed paragraph 6 should or should not apply would be a helpful inclusion in the commentary to the paragraph. However, the examples included in the Discussion Draft illustrate extreme cases and are not particularly useful in clarifying those more subtle cases, which are likely to require more detailed guidance to decide.

One example might be to clarify whether paragraph 6 would apply when choosing the location for the holding company (rather than the location for establishing the subsidiary). For example:
R Co, a company resident of State R, is a group holding company with investments in a number of manufacturing and distribution subsidiaries in overseas locations. One of the subsidiaries, S Co, is in State S. Under the tax convention between State R and State S, the withholding tax rate on dividends is reduced from 30% to 10%. T Co, another company in the same group, is resident of State T and is also a group holding company with investments in a number of overseas trading entities. Under the tax convention between State S and State T, the withholding tax rate on dividends is reduced from 30% to 5%. If S Co were to be sold from R Co to T Co to obtain the benefit of the reduced withholding tax rate on dividends, would paragraph 6 apply?

**Dividend transfer transactions**

The clause proposed at paragraph 43 of the Discussion Draft, which requires a minimum holding period to be satisfied in order for dividend treaty benefits to apply, does not appear to be overly onerous provided that the specified holding period is reasonable. In our view a minimum holding period of no more than six months would be reasonable.

**Tie-breaker rule for determining treaty residence of dual-resident persons other than individuals**

We have concerns that the use of mutual agreement procedures would lead to a significant increase in the time and resources required (by both tax payer and tax authorities) to determine the residence of dual-resident persons. In comparison, the application of the traditional tie-breaker rule would appear to be significantly more efficient and certain.

I trust the comments are useful for your deliberations and as mentioned I would be happy to discuss in more detail.

Yours sincerely,

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**Ian Brimicombe**  
VP Corporate Finance
April 9, 2014

**Preventing the Granting of Treaty Benefits in Inappropriate Circumstances**

Comments by the Banking and Finance Company Working Group on BEPS

1. **Introduction and Summary of Comments**

These comments are being submitted to the OECD by the Banking and Finance Company Working Group on Base Erosion and Profit Shifting (BEPS), which consists of banks and finance companies conducting international business, in response to the OECD’s *Discussion Draft on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances* (March 19, 2014).

Our comments on the Discussion Draft may be summarized as follows:

- We do not agree that tax treaties should include a general anti-abuse rule of the type recommended in the Discussion Draft. Such a general rule would create significant uncertainty regarding the applicability of treaties in many circumstances, which would seriously impair the intended functioning of treaties as a tool for meshing the tax systems of two countries for purposes of determining the tax treatment of cross-border trade and investment between the countries.
- We have concerns about the recommended limitation-on-benefits (LOB) provision as well. In particular, the need to determine whether an “active trade or business” is carried on by a resident in a particular jurisdiction is a source of uncertainty.
- A derivative-benefits provision should be included in the LOB rule.
- If the title and preamble of tax treaties are to be amended as proposed in the Discussion Draft, the effect of these amendments on the interpretation of treaty provisions needs to be explained in far more detail than is contained in the minimal explanation in the Discussion Draft.

2. **General anti-abuse rule**

The general anti-abuse rule is recommended in the Discussion Draft as a backstop to the more specific LOB clause, in order to ensure that certain treaty-shopping arrangements would not succeed. The only examples of such arrangements in the Discussion Draft are:

- a conduit financing arrangement involving a treaty-qualified intermediary that passes muster under the LOB clause because its stock is traded on a recognized stock exchange located in its country of residence (paragraph 24),
• an assignment to a treaty-qualified accommodation party of the right to receive declared but unpaid dividends on stock of a subsidiary (Example A in paragraph 33), and
• an assignment to a treaty-qualified accommodation party of the beneficial interest in non-voting preferred stock of a subsidiary (Example B in paragraph 33).

The Discussion Draft recognizes that the recommended rule is general in nature and states the OECD’s intention that the rule would be supplemented by “a detailed Commentary that would explain its main features.” Much of the section of the Discussion Draft that addresses the general anti-abuse rule is devoted to “explanations that could be included in the Commentary” regarding the rule. It seems clear that if a proposed rule must be explained in a lengthy commentary, the rule itself is too vague. The vagueness of the rule will create confusion for taxpayers and lead to increased controversy between taxpayers and tax administrators.

Moreover, the explanations in the Discussion Draft do not clarify the scope of the proposed rule, as demonstrated by Example D (in paragraph 33 of the Discussion Draft) in which the Discussion Draft does not state a definite conclusion as to whether the general anti-abuse rule applies to the facts that have been described. The stated conclusion is that the rule should not apply to the stated case “unless [the treaty-qualified resident’s] investment is part of an arrangement or relates to another transaction undertaken for a main purpose of obtaining the benefit of the Convention.” In other words, the example appears to suggest that the rule should not apply, unless it should apply. We are concerned that it is so difficult to determine the scope of this rule.

Tax treaties are meant to provide the benefits of certainty and reduced tax rates to residents of the two contracting states. The recommended general anti-abuse rule would cast doubt on the availability of these benefits in almost every case where the taxpayer had taken the treaty benefits into account in deciding whether or not to enter into the relevant transaction. The creation of this level of uncertainty is contrary to the purpose of tax treaties.

Moreover, as financial institutions, we are particularly concerned about uncertainty with respect to the application of tax treaties, as we are often withholding agents regarding payments of interest, dividends, and other income items that may be subject to withholding tax. Tax treaties affect the applicable rate of tax, and the withholding agent typically would be liable for any under witholding of tax. Therefore, it is extremely important that any entitlement to treaty benefits asserted by the recipient of a payment be verifiable and clear.

To address the cases noted above which are given as examples in the Discussion Draft, a general anti-abuse rule is not the best approach. A better approach would be to craft a targeted provision to address such cases. For example, such a targeted provision might deny the benefit of reduced withholding tax rates in cases where the qualified resident acquired the right to receive the relevant payments from a related person who would not have been entitled to equivalent treaty benefits and the qualified resident has no meaningful risk of loss.
3. **LOB provision**

The recommendation that all treaties contain an LOB provision such as the one set out in the Discussion Draft gives rise to similar concerns about uncertainty. The proposed LOB article is lengthy, containing many terms and concepts that may be fairly well understood in certain countries but not so well understood in other countries.

For example, paragraph 3.a of the proposed LOB article requires a determination as to whether a resident “is engaged in the active conduct of a trade or business in the [resident’s] Contracting State (other than the business of making or managing investments for the resident’s own account, unless these activities are banking, insurance or securities activities carried on by a bank, insurance company or registered securities dealer respectively)”. Determining whether certain activities constitute “the active conduct of a trade or business” involves uncertainty. Further uncertainty arises from the need to determine the place in which such trade or business is conducted, and still more uncertainty arises in the case of a financial institution regarding the question of whether particular activities are “banking activities,” “insurance activities” or “securities activities”.

We suggest that it would be worth considering a more limited recommendation regarding the use of an LOB article or other type of anti-treaty-shopping provision in treaties, namely, that the two countries that are negotiating a bilateral tax treaty should carefully evaluate which type of provision will be least likely to create uncertainty for their residents and adopt an appropriately drafted provision. A “one size fits all” approach is not workable.

4. **Derivative benefits provision**

A derivative benefits provision such as that set out in paragraph 13 of the Discussion Draft is advisable, for the reasons given in paragraph 14 of the Discussion Draft. With respect to the example in paragraph 15 of the Discussion Draft, the perceived tax avoidance concern seems to lie in the fact that State S grants treaty benefits on outbound royalty payments to all State R residents despite the fact that State R imposes very little tax on such royalties. This could be dealt with in a number of ways, e.g. action by State S to impose withholding at full rates on royalties that benefit from a very low rate in State R, or through recommendations against harmful tax practices under Action 5 of the OECD’s Action Plan on BEPS, which would require substantial business activity in order to qualify for a preferential tax regime.

5. **Proposed changes to the title and preamble of tax treaties**

The Discussion Draft recommends the inclusion of language in the title and preamble of tax treaties to clarify that the treaty is not meant to facilitate double non-taxation or reduce taxes for the benefit of residents of third countries. In paragraphs 76 and 77 of the Discussion Draft, the OECD indicates that this would affect the interpretation and application of the provisions of the treaty.
Given that the OECD Model Convention has been in existence for many decades, and the interpretation of its provisions is contained in a Commentary that has been relied on for all of those years, taxpayers need guidance on how the current interpretation of particular treaty provisions would be affected in the future by the proposed new language in the title and preamble. The Discussion Draft proposes changes to the Introduction to the Model Tax Convention in this regard, but there is no explanation of the interpretive effect other than the general statements in proposed new paragraph 16.2 in the Introduction (in paragraph 77 of the Discussion Draft, at p. 29).

At the same time, taxpayers should be given the benefit of some type of grandfathering of the existing interpretation of the affected provisions.

6. Dual resident companies tie-breaker rule

In paragraphs 50 to 53 of the Discussion Draft, it is proposed that the residence of a dual resident entity be determined on a case-by-case basis by the competent authorities of the Contracting States having regard to all relevant factors. This would replace the current tie-breaker rule, which looks solely at the place of effective management. No reason is given for this proposal, except for the observation in paragraph 52 that, when the use of a mutual-agreement approach was discussed in the past, “the view of many countries was that cases where a company is a dual-resident often involve tax avoidance arrangements.”

We are concerned that the proposed mutual-agreement approach would create uncertainty unnecessarily. History shows that competent authorities sometimes fail to come to an agreement. If the current tie-breaker rule based on the place of effective management is problematic, we suggest that the problem needs to be explained so that stakeholders can consider whether the recommended change is advisable or whether there are more targeted approaches to addressing the problem that should be considered.

In any event, if the mutual-agreement approach is to be recommended, we would urge the OECD to include a time limit within which the competent authorities must reach agreement, and to provide as much guidance as possible in the form of examples in the Commentary on Article 4.
Re: Comments on OECD Discussion Draft on BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances.

Dear Sir/Madam:

It is our pleasure to provide comments on the OECD BEPS Action 6 Discussion Draft supporting our belief that any effective income tax treaty network should allow taxpayers to enter into transactions with a level of certainty while balancing attempts to combat “treaty abuse.” With this in mind, we propose modifying the Discussion Draft by a) eliminating the proposed subjective main purpose test, b) eliminating the proposed preamble anti-treaty shopping and tax avoidance language, and c) adding a derivative benefits clause.

Main Purpose Test

The Discussion Draft’s paragraph 18 includes a rule which generally states that “…a benefit under this Convention shall not be granted…if it is reasonable to conclude…that obtaining that benefit was one of the main purposes of any arrangement or transaction that resulted directly or indirectly in that benefit.” This has become known as the “Main Purpose Test.”

Our aversions to the proposed subjective main purpose test include a) greater transactional uncertainty, b) reduced treaty reliance, and c) increased competent authority dependence. Unfortunately, such “main purpose test” subjectivity casts a wide net allowing governments the authority to deny income tax treaty benefits to otherwise legitimate business transactions that were not meant to be covered. For example, in the Discussion Draft’s paragraph 15 IP example, a government, under the main purpose test, may assert that such an arrangement was set up with the main purpose of avoiding tax and gaining treaty benefits despite legitimate business reasons for such a transaction (e.g., more efficient IP management, better IP situs, etc.). In this example, State S may ultimately deny treaty benefits to state R based purely on a subjective test which looks toward whether the government believes that securing treaty benefits was the main purpose of the transaction. This main purpose test may deter taxpayers from entering into legitimate types of transactions solely because of a treaty’s “main purpose test” and such taxpayer’s unwillingness to subject itself to a transaction’s accompanying uncertainty.

It is clear that the Discussion Draft provides a thoughtful discourse designed to generate treaty language which precludes income tax treaty benefits in abusive situations. Nonetheless, such discussion, any such relevant treaty
language still needs to provide for certainty as to how a taxpayer’s business transaction will fare. Treaty language which results in uncertainty as to how a business transaction will be treated will limit the effectiveness and purpose of the treaty. The Discussion Draft’s paragraph 19 suggestion that examples or commentary will provide effective guidance is unworkable in situations where the subjective intent of a taxpayer is to be determined solely by governmental authority.

We are not in favor of a main purpose test without a conclusive mechanism designed to initiate a mandatory and timely competent authority process. Such a process would need to be timely, mutually binding, allow for compensatory adjustments, and provide definitive and conclusive harmonization among treaty partners. We recommend eliminating the Discussion Draft’s paragraph 18 subjective main purpose test, which we believe undermines the basic purpose of a treaty, which is to avoid double taxation and provide each countries’ residents a heightened level of certainty with regards to the specific tax result of an applicable business transaction.

**Treaty Preamble**

It is our view that a treaty’s focus should be on preventing double taxation and not primarily focused on avoiding double non-taxation. Such situations should be addressed as exceptions to the treaty’s purpose and not serve as the overriding rationale for the treaty.

A preamble should not be used for rule-making. The inclusion of treaty preamble language that expresses the sentiment that - the treaty Countries wish to prevent tax avoidance and treaty shopping - will add an unwarranted level of complexity to treaty analysis. The inclusion of such a statement of intent will require residents relying on a treaty to not only assure themselves of the language within the treaty but, in addition, be comfortable that the preamble does not in some way override the relevant treaty provision. An anti-abuse intent sensitive preamble may inadvertently serve to cloak the entire treaty with a perceived broad and unworkable anti-abuse rule. A taxpayer should be able to rely on a treaty as drafted and such a statement of intent is not necessary and creates uncertainty. This uncertainty generates additional hindrances to international business transactions and undermines the well-established body of international tax law.

**Derivative Benefits Clause**

The Draft should include a derivative benefits clause in the entitlement to benefits article. We believe a resident of a contracting state should be entitled to treaty benefits to the same extent that the owner of the resident company would have been entitled had the item of income been earned directly by that owner. Such derivative benefits clause should be narrowly focused on the avoidance of double taxation and not on the OECD’s pure tax avoidance concerns (see Discussion Draft’s paragraph 15 IP example).
For example, a BASF subsidiary who is the beneficial owner of an item of income and resident in a contracting state should be entitled to treaty benefits as a result of its own qualification in meeting the treaty’s limitation on benefits (LOB) article. The fact (as illustrated in the Discussion Draft’s paragraph 15 IP example) that OPCO 2 receives a preferential tax rate in a low tax jurisdiction (State R) should not disqualify OPCO 2 from treaty entitlement in its own right. Moreover, as a general principle, a BASF subsidiary who is the beneficial owner of an item of income that is resident in a contracting state should be entitled to treaty benefits in the same manner as the BASF parent company would have been if the item of income had been directly earned by the BASF parent company. Accordingly, in such a case, the subsidiary has received no greater benefit than its parent would have otherwise directly received. As such, there does not seem to be an appropriately founded concern to limit the granting of treaty benefits to OPCO 2 in the Discussion Draft’s paragraph 15 IP example. Once again, the mere fact that OPCO 2 operates in a low tax jurisdiction (State R) does not provide an appropriate basis to negate treaty entitlement for such a customary multi-tiered business structure where no treaty concern is evidenced.

Moreover, the seemingly implicit concern of the low tax burden on IP income as described in the Discussion Draft’s paragraph 15 IP example is thought to be the subject of and under the direct jurisdiction of the Revised Discussion Draft on Transfer Pricing Aspects of Intangibles. This unwarranted “doubling up”/overlap of these principles creates unnecessary topical and jurisdictional confusion in formulating a coordinated OECD Action Plan and should be removed from coverage in BEPS Action 6.

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We appreciate this opportunity to provide comments on the OECD BEPS Action 6 Discussion Draft. Our comments come in an effort to provide clear and predictable treaty guidance which enables certainty for both businesses and governments.

Sincerely,

Robert N. Smith
Vice President
BEPS MONITORING GROUP

Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

This response is submitted by the BEPS Monitoring Group (BMG). The BMG is a group of experts on various aspects of international tax, set up by a number of civil society organizations which research and campaign for tax justice including the Global Alliance for Tax Justice, Tax Justice Network, Christian Aid, Action Aid, Oxfam, Tax Research UK. This response has not been approved in advance by these organisations, which do not necessarily accept every detail or specific point made here, but they support the work of the BMG and endorse its general perspectives.

This response has been prepared by Tomas Balco and Tatiana Falcão, with comments and input from Jeffrey Kadet, Francis Weyzig, Sol Picciotto and other members of the Group.

We welcome the opportunity to comment on the Discussion Draft on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances published by the OECD on 17th March 2014, under Action 6 of the BEPS Action Plan.

We will begin with some general comments, and then address the possible actions identified in the report.

1. GENERAL


This report, like others resulting from the BEPS project, includes proposals to revise the text of the model Convention. We note that Action 15 envisages the preparation of a multilateral Convention, which would aim to avoid the lengthy delays that would be caused by comprehensive renegotiations of bilateral tax treaties, and ensure that the tax treaty network can be quickly adapted to the rapidly changing nature of the world economy. We recognize that it is not possible to decide what the content should be at this early stage, while the feasibility, form, and implications of such a convention are being investigated by the expert group appointed for this purpose. Nevertheless, we suggest that it is important that the other working parties and groups dealing with specific substantial issues, where they propose changes to the model treaty, should also identify whether such provisions would be appropriate for inclusion in the multilateral convention, and the form that they might take.

Also, in view of the importance of achieving the widest possible implementation of standard provisions, it is essential that any Multilateral Convention should be open to all states to join.

Provisions which might be included in a multilateral convention could be of two kinds. One would be those which should have a general applicability and should be regarded as core provisions of such a treaty, so that participating states would be required to accept them without the possibility of reservations. Others would more appropriately operate only on a basis of reciprocity, so that states could be permitted to choose whether to accept them, and they would be bound only in relation to others accepting the same obligation.

To be clear, we recommend a twin-track approach, involving both changes to the Model to be implemented by states in bilateral treaties, as well as inclusion of appropriate provisions in the Multilateral Convention to be developed as part of the BEPS project. Proposed changes to the Model, especially the one proposed for a Limitation of Benefits (LoB) provision, could provide a workable interim solution only if the proposed clauses are broadly supported. This requires that the OECD discusses with a broad group of OECD and non-OECD countries whether the proposed model clauses will be workable for them. The OECD should formulate alternative options if necessary, such as a purpose test (in a separate article and covering all
treaty benefits). The OECD should work with many countries, preferably through the UN Tax Committee, to minimize the problems that could be caused by a proliferation of variations of the proposed standard text.

Furthermore, this will only provide a workable solution if countries offer to include anti-abuse clauses without strings attached, in other words, without a requirement to renegotiate other aspects of the treaty. This has been successfully done by the OECD for the inclusion of revised information exchange clauses in recent years, and that experience could provide a good model to build on.

Moreover, if the OECD decides to proceed with anti-avoidance clauses in bilateral tax treaties as a way of addressing treaty abuse, it should be made very clear that all countries are expected to offer and accept anti-avoidance clauses. It would not be fair or effective if some countries with investor-friendly treaty networks do include anti-abuse provisions but others do not, since treaty shopping would still be possible via those other countries. We are especially concerned about non-OECD countries such as Mauritius, Hong Kong and the UAE which are very actively concluding treaties, including many with developing countries. Again, the OECD could build on the experience with information exchange, by setting a target for all countries, for example to include anti-abuse clauses covering all treaty benefits in 90% of a country’s existing treaty network before 2016, and call on its members to cancel tax treaties with countries that fail to meet this target.

1. 2. A General Object and Purpose Article.

In our view, both the OECD Model and the proposed Multilateral Convention should include a core provision making it clear that tax treaties aim at prevention of both double taxation and double non-taxation. As the Report points out, the model treaty was developed, and was always intended, to ensure prevention of both double taxation and tax avoidance and evasion. Hence, the inclusion of a provision to make this clearly explicit in the Model Convention, as well as in the proposed Multilateral Convention, should command wide support from states.

This provision should take the form of a substantive article, and not simply a statement in the Preamble, as is proposed in para. 75 of the Discussion Draft. While statements in a treaty’s Preamble are indeed considered part of that treaty, as the report states (para. 76), they act as aids to interpretation of substantive articles. In our view it would be far preferable to include a substantive article in all tax treaties, stating their Object and Purpose.

This would avoid speculation with respect to the object and purpose of a particular treaty, especially since many treaties fail to include the Preamble, and it is often overlooked even as a guide to interpretation.

Such an article should be worded in positive terms, and not simply as a safeguard against abuse. We suggest the following wording (taken from the Tax Annex of the St Petersburg Declaration). For use in the Model Convention:

   The object and purpose of this treaty are to ensure that profits are taxed where economic activities occur and value is created. Any relief provided for in any such treaty shall not apply if the effect would be to defeat this object and purpose.

For use in the proposed Multilateral Convention:

   The object and purpose of this treaty, and of all treaties in relation to which it is to take effect, are to ensure that profits are taxed where economic activities occur and value is created. Any relief provided for in any such treaty shall not apply if the effect would be to defeat this object and purpose.
Such wording is clear and direct, and avoids the circumlocutions involved in formulations, such as those proposed in the Report (para. 75). To state that the intention of the treaty is to eliminate double taxation, with only a caveat about abuse, gives priority to the principal intention. It also raises a host of potential questions about what constitutes ‘non-taxation or reduced taxation’, as well as ‘tax evasion or avoidance’.

However, this could be supplemented by a more targeted Object and Purpose provision, the wording of which we suggest should be:

The benefits of this Convention shall not apply to an item of income if it was the main purpose or one of the main purposes of the creation or assignment of the rights in respect of which the income is paid to take advantage of this Convention by means of that creation or assignment.

It should likewise be understood that a change to the Preamble or the inclusion of an additional clause in the Object and Purpose segment of the Model Convention will inevitably give rise to a technical discussion over the object and purpose of treaties negotiated prior to the 2014 modification. We suggest that this be be addressed in the report of the Expert Group on the Multilateral Convention, to make clear that these new provisions are for purposes of clarification, and hence intended to apply also to earlier treaties.

2. SPECIFIC PROPOSALS

2.1 Limitation-on-benefits provision

In our view a Limitation-on-benefits provision can be an effective instrument to mitigate the tax treaty abuse in conduit transactions. We therefore support this approach.

We suggest the following to help successfully implement the provision:

- in view of the limited international experience with its use and application, which is confined mainly to OECD countries such as the US and Japan, it is important that this experience is collected, analyzed and published; particularly relevant would be the recent experience of renegotiation of treaties by the Netherlands, including an understanding of why countries such as China have preferred a ‘main purpose’ provision to a detailed LoB clause;

- the wording of the provision is, perhaps of necessity, complex and difficult to understand; it should if possible be simplified, and in any case properly explained in the Commentary; for example, explanations should be given, with examples, of what constitutes ‘active conduct of trade or business’ and ‘income derived from … that trade or business’, particularly to clarify that it does not cover income from unrelated business;

- the LOB provision provides a legal framework to disallow treaty benefits; the Commentary must make clear that any entity claiming the benefits of a treaty must prove to the satisfaction of the authorities of the source country that it is in fact a ‘qualified person’ or entitled to the benefits with respect to the relevant item of income; this could be facilitated if states are encouraged in the Commentary to establish procedures for certification of ‘qualified person’ status, as well as for communicating directly with treaty partners through spontaneous supply of information regarding unqualified claimants, e.g. for companies which have few or no employees or domestic sources of income;

- while we support the safe haven clause in para. 4, allowing tax authorities to grant treaty benefits in a discretionary manner if they determine that there is no treaty abuse
involved, to address possible abuse and undue pressure on tax authorities the OECD should strongly recommend that tax authorities publish a yearly overview of all persons/entities involved in transactions qualifying under this article (not necessarily the items of income or amounts);

- point 17 invites comments on 'derivative benefits' for 'equivalent beneficiaries'; in a LoB clause for dividends, this helps to clarify the situation in which Parent P (country 1) invests in intermediate holding IH (country 2) that invests in turn in subsidiary S (country 3); a dividend paid from S to IH automatically qualifies for treaty benefits (under the treaty between country 2 and country 3) if a dividend from S to P qualifies for at least the same benefits (under the country 1-country 3 treaty); in our view, this is reasonable; however, this should apply only for benefits and not for royalties or interest; in our view, a 'derivative benefits' provision could be included, but should be restricted to dividends;

- operation of this provision would become much easier as states begin to create the Beneficial Ownership registries called for by the G8 and G20;

- as outlined in section 1, we recommend a twin-track approach, involving both a program of renegotiation of existing bilateral treaties, as well as inclusion in the proposed multilateral convention.

2.2. General anti-abuse provision (New Article X, Para. 6)

The para. 27 example assumes that the transfer of the debt obligation from TCo to RCo occurs after the acquisition. The Commentary should be written to make clear that planning at the time of the acquisition to arrange for RCo to directly acquire the debt will still result in possible application of proposed Paragraph 6.

2.3 Other Specific anti-abuse provisions

(i) Splitting-up of contracts

It is mentioned under this topic that paragraph 18 of the Commentary on Article 5 indicates that the twelve month threshold in article 5 (3) has given rise to abuse, due to the splitting-up of one long contract into several short-term contracts.

We believe that such arrangement could be forestalled (a) through the adoption of a model provision that is more in line with a reduced minimum PE threshold (of 6 months, for instance, as in the UN Model), and/or (b) by targeting those activities where the splitting up of contracts happens more frequently, as is the case of oil and gas exploitation contracts mentioned in paragraph 36.

Regarding the adoption of a shorter time frame for the existence of a PE, recent research from the IBFD\(^1\) is very helpful. It shows that a substantial majority of treaties concluded in the past 15 years provide a minimum period for a PE shorter than 12 months. The conclusion reached by the leading authors of the research is revealing, to say the least:

Of these 1,116 treaties (prescribing a minimum period shorter than 12 months), 559 (50%) were concluded between UN countries (Group A), 485 (43%) between a UN and an OECD country (Group B) and 72 (32%) between two OECD countries (Group C). It is striking that so many OECD/OECD treaties (32%) include a minimum period of less than the 12 months recommended by the OECD Model.

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It is important to take into account:
(1) the shift in focus, from avoidance of double taxation to anti-abuse provisions;
(2) that countries have in fact already been prescribing a minimum period shorter than 12 months to characterize a PE, thus granting greater taxing rights to the source country; and
(3) that it is known that 32% of OECD countries already currently effectively apply a period which is inferior than 12 months for PE characterization purposes, and 43% of OECD member countries would be prepared to accept such a provision, in negotiation with UN countries.

This context provides a good opportunity for the OECD to reconsider the 12 month minimum threshold, and adopt a new minimum threshold which is more in line with what both its member countries and states generally have in practice been negotiating. This would have the triple benefit of providing legal certainty, adopting the actual current practice of the large majority of both developed and developing countries and forestalling abusive practices of the kind described in paragraph 36.

Targeting the activities where the contract splits happen most frequently as expressed under (b) might also be a solution. In order for the commentary to have broad application and not be restricted to those industry situations thought of by the policy makers in 2014, the discussion and any listing made should make it clear that it is only exemplary. This option has been tried out before, and it is known to have caused interpretative confusion upon applying the provision over a prolonged period of time.

(ii) Hiring-out of Labour Cases
No comment required.

(iii) Transactions Intended to Avoid Dividend Characterization
No comments required. Will be dealt with under a different Action Point.

(iv) Dividend Transfer Transactions.
With respect to the request for comments under paragraph 43, we recommend a minimum holding period of 6 months.

(v) Transactions that Circumvent the Application of Art. 13(4)
No comment required.

(vi) Tie-breaker Rule for determining the treaty residence of dual-resident persons other than individuals.
We support the suggested language for article 4 para. 3 and its related Commentary.

The new suggested language would provide that residence should be established through the mutual agreement procedure, and that the requesting (double-resident) entity is not to be entitled to any treaty relief or rights until such agreement is reached. However, OECD data on MAP proceedings show that the average time taken is now generally over two years, and the number of cases is increasing more rapidly than the capacity of Competent Authorities to resolve them. This would disadvantage dual-resident entities not involved in treaty abuse.

Hence we recommend that the proposed modification of article 4(3) and its accompanying commentaries, should be applied through the proposed multilateral treaty. This should also include provisions to make the MAP both more effective and more transparent.
2.4.1 Specific Anti-Treaty Shopping Rule in Domestic Legislation

We were surprised that the report does not suggest a special domestic anti-avoidance rule that a country could add to its domestic law to target tax treaty abuse situations. Such a rule should be expansive in scope, recognizing the many avoidance mechanisms used, and could include the proposed LOB provision, though perhaps broader and simpler in language and application. Such an anti-avoidance rule would permit source country tax authorities to disallow the treaty benefits in abusive transactions. The advantage of such a measure would be its unilateral nature and the speed and relatively low cost of its implementation.

Regarding the actual language for such a rule, we recommend that the Action 6 working group (or other appropriate group) review general anti-avoidance rules enacted by various countries around the world and recommend specific statutory language and explanatory material that represents best practice.

2.4.2 Administrative Measures in Domestic Law

Equally we voice our concern that the report does not propose any administrative measures, which could provide efficient protection from some treaty abuses. Administrative measures are often the easiest to introduce, especially in cases that do not require the introduction of specific laws and approval by the legislative bodies. Such measures can be introduced in some countries either by tax administration bodies or by the Ministry of Finance or other relevant body.

**Measures by the country of source**

The following are examples of measures that could be introduced in the country of source to limit and prevent tax treaty abuse:

- Mode of Application of Tax Treaties

- Administrative guidance on requirements that must be applied by tax agents to apply a tax treaty automatically;

- Decrees regulating application of tax treaties

*Mode of Application of Tax Treaties*

Tax treaty benefits can be made applicable either automatically (with no or limited administrative procedures and steps) or based on a refund mechanism.

A refund mechanism means that first the relevant tax under domestic law is levied, however the recipient of income is entitled to undergo an administrative scrutiny, which verifies the entitlement to tax treaty benefits and if this entitlement is confirmed, than the relevant tax can be refunded.

While the automatic application of tax treaty benefits places a significant burden and also responsibility on the payer of income from the country of source, which should administer the application of treaty benefits, it greatly simplifies the position of the recipient of the income who can completely avoid interaction with the tax authorities in the country of source. Naturally, this mode of tax treaty application is preferred by investors. It may also be favoured by tax authorities since the work to confirm a taxpayer’s qualification for treaty benefits and the return of those benefits to the taxpayer is avoided.

However, this mode can also multiply the risks of tax treaty abuse and places the payer of income into a potential confrontation with the tax authorities.
A refund mechanism permits the tax authorities in the country of source to carry out a high-
level or in-depth analysis of the entitlement to tax treaty benefits and shifts the burden to the
foreign recipient of income. This procedure may also require the exchange of information
between the competent authorities to assure and verify the tax treaty entitlement.

On the other hand, this method may not be appreciated by the foreign counterparts due to
administrative requirements, time and cash flow constraints, and potential exposure to
administrative discretion without clear legal guidelines. While this method permits a
legitimate review of the facts and circumstances to assure there is no tax treaty abuse taking
place, this method may create corruption exposure and opportunities, which is borne out by
experience in developing countries.

Ways can be found to balance the interests of tax administrations in limiting tax treaty abuse
while at the same time assuring smooth investment and trade flows, as well as in avoiding
the potential for corruption (resulting from administrative discretion) and negative cash flow
implications for legitimate enterprises caused by the withholding tax being applied prior to
the refund. We recommend that there should be prescribed ‘best practice’ procedures and
administrative deadlines, which would oblige the tax administration to carry out a timely
review and refund the withheld tax within pre-set statutory time limits.

Alternative means can be also considered, where the tax agent can carry out pre-filing
procedures and obtain administrative approval to apply the tax treaty automatically on the
pre-approved transactions.

Administrative guidance on requirements that must be applied by tax agents to apply tax
treaty automatically

Clear “best practice” guidelines could be provided that give guidance to tax officials for the
automatic application of tax treaties or certain simplified pre-filing or other pre-approval
procedures. Such administrative guidance can stipulate the exact requirements and documents
that the tax official should obtain prior to applying a tax treaty automatically, alternatively
what are the administrative steps and required documentation to apply for a pre-approval for
application of a tax treaty.

Such administrative guidelines may also require tax officials to carry out a degree of due-
diligence on the recipient of the income – specifically:

- Verifying the tax residence of the recipient
  - Obtaining the certificate of residence issued by the contracting state

- Verifying the beneficial ownership of the income
  - This can be difficult, yet the tax official may be required to ask the relevant
    questions and ensure that adequate answers are received to assure that the tax
    treaty benefits are applicable

- Verifying the absence of a tax treaty abuse motive
  - Similarly as in the previous point, the tax agent may be asked to carry out a
due diligence procedure with the recipient of the income and only applying tax
  treaty benefits once assured that the recipient is entitled to them.

Decrees regulating application of tax treaties
Decrees regulating the application of tax treaties are mostly issued by Ministries of Finance as the competent body responsible for negotiation and conclusion of tax treaties and also the competent authority for resolving potential tax disputes. Such decrees can specifically address issues related to tax treaty abuse and point out common abuse scenarios and instruct the tax officials not to apply tax treaties in such cases.

While such decrees are of secondary law nature, their presence in the legal system already has a disciplining effect on the taxpayers, which are less likely to enter into abusive schemes, if they know the competent authority is aware of such behaviour and is likely to scrutinize such transactions.

`Best practice’ recommendations would be very useful to many countries.

**Measures by the country of residence**

While some countries may choose to act as facilitators as well as safe havens for international tax avoidance, thereby causing revenue losses to their treaty partners, other countries having no such facilitator intentions can have the same effect if they freely provide treaty resident certificates without adequate due-diligence.

Countries of residence may minimize cases of treaty abuse by carrying out appropriate due-diligence tests with companies seeking to obtain certificates confirming their residence for tax treaty purposes. Such regular procedures should go a long way to reducing illegitimate claims of treaty relief made to source countries.

`Best practice’ recommendations would be very useful to many countries

**2.5 Abuse of domestic tax rules using treaties**

We also wish to point out abusive transactions which aim at eliminating withholding tax rules in the countries of source using the following practices, which we believe should also be addressed:

- Back to Back service fees – services fees are used to erode the domestic tax base, since they are entitled to deduction, unless the benefit test or another test applies. Furthermore, the treaties are used to eliminate withholding tax at source. Since Article 7 does not contain a beneficial ownership clause, service fees may be simply paid on to the recipient in non-treaty jurisdiction.

- Agency Structures – while the agency structures are mentioned in the OECD commentary in respect of the dividends payments and the beneficial ownership concept, they are not mentioned in respect of other types of income and equally the treaties do not seem to contain rule that would permit the countries of source to disallow the treaty benefits in the situations where income like service fees is paid to an agent, who subsequently does not pay tax on most of the income and pays on the major part of the fee to a principal in non-treaty jurisdiction.

**3. Final Remarks**

We suggest that, in addition to focusing on the modification of language contained in the treaty provisions and in the commentaries, the OECD, while working under the G20 mandate, should also encourage countries to issue a reference document explaining the intended object and purpose of each provision in their treaties, when concluding new treaties or renegotiating old ones. This is currently already a practice in many OECD member states, but could be further developed and implemented in emerging economies, many of which are participating G20 countries.
Publishing national commentaries on tax treaties in which the object, purpose and intention of each specific provision is explained might also provide a very helpful anti-avoidance mechanism, regardless of whether modifications are made or implemented to the OECD model convention. They would be a secondary interpretative instrument for domestic courts, and help to provide greater clarity for taxpayers.

Finally, we must point out that most if not all of these problems of treaty abuse result from the basic assumption that related entities under common control should in principle be treated as separate and independent. In our view, moving towards taxation of multinational corporate groups on a unitary basis is indispensable if the reforms resulting from the BEPS project are to meet the objective laid down by the G20 that firms should be taxed 'where economic activities take place and value is created'. Replacing the separate entity with a unitary entity principle would also make it much simpler to administer treaties than the complex and detailed anti-abuse provisions proposed in this discussion draft.

This does not require a radical move to a fully formulated system of unitary taxation with formulary apportionment based on a single formula agreed world-wide. Adoption of a unitary principle would allow a number of methods, just as under the current separate entity principle. This could include, for example, encouraging countries that are home-countries to MNEs to abandon their territorial and deferral based tax regimes and adopt full-inclusion systems. Doing so would have the same spill-over effects referred to elsewhere in BEPS documents concerning stronger CFC rules that would eliminate the motivation that MNEs have to shift profits from the countries in which they operate or to which they make sales or provide services.

All the reports and other details of the BEPS Monitoring Group are available at http://bepsmonitoringgroup.wordpress.com/
For the attention of:
Tax Treaties, Transfer Pricing and Financial Transactions Division,
OECD/CTPA


BHP Billiton, Reed Elsevier, Rio Tinto and Unilever are all publicly listed enterprises which are organised as dual parented structures (generally known colloquially as “dual listed companies”).

Generally, under this structure there are two parent companies each with its main stock exchange listing in a different country and not necessarily countries within the EU. The shareholders of each parent company cannot convert or exchange the shares of one company for shares of the other.

The dual listed company structure reflects commonality of management, operations, shareholders’ rights, purpose and mission through a series of agreements between the parent companies together with special provisions in their respective articles of association including in some cases for example the creation of special voting shares. Under these arrangements the position of the parent company shareholders is, as far as possible, the same as if they held shares in a single company, with the same dividend entitlement and same rights to participate in the assets of the dual listed companies in the event of a winding up. The parent companies can also agree jointly to guarantee the borrowings of each other and/or their respective subsidiaries so as to enable lenders to rely on dual listed companies’ combined financial strength.

Under a dual listed company structure, entitlement to tax treaty benefits is generally tested by reference to the actual chain of ownership and thus ultimately to one of the parent companies.

In order to avoid what we believe would be unintended consequences, we recommend that the design of the limitation of benefits test and/or an anti-avoidance provision, should acknowledge the particular position of dual listed companies. This could be achieved by way of an explicit statement to the effect that “where a dual listed company structure exists, the special voting shares and/or other agreements that give effect to the dual listed company structure should not be taken into account in considering whether tax treaty entitlement should be limited either by operation of the limitation of benefits clause or by the anti-avoidance main purpose clause”. An alternative would be to draft specific carve outs in either a “standard LOB clause” or in the general article on tax residency (article 4 of the model convention).

Yours faithfully

BHP Billiton                    Reed Elsevier
Rio Tinto                      Unilever
2 April 2014
To: Tax Treaties, Transfer Pricing and Financial Transactions Division
OECD/CTPA
Via e-mail to taxtreaties@oecd.org

CC: The Ministers of Finance in Belgium, Denmark, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Spain, Sweden and the United Kingdom;
CC: The European Commission;
The Council of the European Union

Re: Proposal s with respect to the BEPS Action Plan, Including Action 6 (Prevent Treaty Abuse)

Dear Minister, Dear Sir, Dear Madam,

We write on behalf of investors, globally, who entrust us as global asset managers to invest trillions of dollars so that they can achieve their financial goals, and welcome the opportunity to comment on this important initiative. Overall, we understand the underlying rationale for the OECD’s BEPS project and recognise the importance of ensuring fairness and integrity of tax systems and the positive impact this has on the diverse range of investors. Furthermore, we note that every Action of the BEPS project is focused towards multinational companies. However, we are concerned that many of the BEPS Action Plans (for instance, Action Plans 2-7 and 11, 12 and 15 and, as is pertinent here, Action Plan 6) will have unintended consequences for investors, especially those who invest via collective investment vehicles (CIVs). Without the OECD’s acknowledgement of the impact of the proposals on CIVs, and prompt action to address this, we are concerned that, international capital markets and flows will be unnecessarily impaired.

The role of CIVs

At the outset, it is important to state that CIVs do not have the purpose of achieving double non-taxation, which is a primary target of the BEPS project. That is, when an investor’s domestic tax position is taken into consideration, CIVs typically do not achieve double non-taxation. Rather, they are intended to be tax neutral pooling vehicles and put the investor in the same tax position as they
would be if they invested directly into the assets. In addition, CIVs often have tax-exempt investors, such as pension funds, as their main direct investor classes.

Furthermore, CIVs play an increasingly important role in the global economy and capital markets. Since the financial crisis, classic financial institutions have had to constrain their lending to companies, governments, and consumers. CIVs can and do step into banks’ classic role and provide loans, invest in infrastructure projects and emerging technologies. Oftentimes, CIVs engage in these funding activities on a cross-border basis.

In regards to Action 6, we support the objectives of ensuring that treaty benefits are appropriately applied and that treaties do not result in the creation of double non-taxation. As financial institutions, CIVs are also bearing the costs associated with assisting governments in their fight against tax evasion by implementing FATCA (Foreign Account Tax Compliance Act), AEOI (Automatic exchange of information), and U.K. Crown Dependency Reporting. We are, however, fearful that should the current proposals under BEPS Action 6 apply to CIVs, our clients, a diverse group of investors, will be harmed as well as the efficient functioning of capital markets.

Investors of all sizes and types can achieve efficiencies with respect to pricing, liquidity, and various forms of professional oversight through CIVs. In fact, CIVs are often the only reliable means for individuals to achieve a professionally-managed diversified portfolio at reasonable cost and are a cornerstone in their efforts to save for retirement. While the tax treatment of CIVs is dependent on the specific organisational form and country in which they are organised or managed, all CIVs, by their very nature – which has consistently been demonstrated under domestic laws and international norms – have the consistent goal of ensuring a single level of tax is paid at either the CIV or CIV investor level. This achieves tax neutrality between direct investment and investment through a CIV. CIVs are not designed or intended to achieve double non-taxation. That is, typically, CIV investors bear the burden of tax pursuant to domestic law.

**Treatment of CIVs**

Historically, CIVs entitlement to treaty benefits was inconsistent and dependent on differing interpretations of qualification as a “person” and “resident” under specific treaties. In 2006, the OECD focused on this issue in an attempt to identify those situations where CIVs should be entitled to treaty benefits and create solutions for those instances where CIVs were denied treaty benefits despite tax policy goals to the contrary. The result of this work was the 2010 OECD’s Centre for Tax Policy and Administration (CTPA) report “The Granting Of Treaty Benefits With Respect To The
Income Of Collective Investment Vehicles” and adoption of the report’s recommendations into the current commentary (Article 1 “Persons Covered”, paragraphs 6.8 – 6.34) of the OECD model treaty.

The CIV commentary addresses many of the same issues raised in BEPS Action 6 including treaty shopping, determining treaty eligibility based on the composition of a CIV investor, and extension of benefits to a CIV’s equivalent beneficiaries. Investors and the asset management industry eagerly await the day when OECD member countries have implemented these recommendations through the treaty process and delivered treaty relief to CIVs and their investors via the Treaty Relief and Compliance Enhancement (TRACE) initiative.

Our concerns

Unfortunately, while TRACE has not been implemented, the proposals under BEPS Action 6 would unintentionally prevent an already treaty entitled CIV from qualifying for those benefits in the future and also undermine the basic goal of OECD member countries to extend treaty benefits to CIVs that are not currently entitled. We believe that the existing commentary to Article 1 covering CIVs addresses the concerns contemplated by BEPS Action 6 but does so in a manner recognising the numerous unique characteristics of a CIV as compared to operating companies or other structures. These include, but are not limited to, CIVs which take different structural forms (corporations, trusts, joint ownership arrangements, etc.), different methods for achieving tax neutrality, reliance on a heavily intermediated distribution chain, and differing investor bases. Some CIVs are comprised of “domestic” investors and others have a more global reach as diverse CIVs – their millions of investors should not become collateral damage in BEPS goal of targeting multinational stateless income.

A significant withdrawal of even the current, inconsistent level of treaty access for CIVs would impact the real economy:

1. Reduction of capital flows to industry and investment projects. If CIVs face an unwarranted additional tax burden as compared with direct investment, pooled investment will become unattractive. Whilst no doubt some of that investment will instead be made directly, we think the larger effect will be that capital flows may no longer reach corporate users to the same degree.

2. Distortion of competition between asset management and other sectors. Naturally, we are concerned that the same additional tax burden will redirect investment flows via other investment products, such as synthetic instruments.
3. **Undesirable fragmentation of funds.** One effect of the new limitation on benefits (LoB) clause is to favour domestic funds for domestic investors, as compared with larger funds targeting investors from many countries. In the major asset classes, the result is to reduce efficiency and raise costs to investors. In more specialist asset classes, few asset managers will find it viable to offer a product at all – thus reducing investor choice and investment flows.

Further, we believe there would be a concern for governments within the European Union that compliance with this new OECD approach might require them to deny benefits that are available to domestic investors and to investors from other EU member states. Such an outcome has been found in successive European Court of Justice decisions to be incompatible with the EU Treaty. The uncertain legal position thereby created would of itself create difficulties for the asset management industry.

**Recommendation**

Accordingly, we recommend that any changes enacted as a result of the BEPS Project, including Action 6, are explicitly stated to not apply to CIVs as these issues are already covered in the current commentary to Article 1 “Persons Covered” as mentioned above. If this is not provided for, it will then be necessary to fully reconcile the BEPS Action 6 proposals with the current treatment of CIVs in the current OECD Model Treaty prior to the finalisation of this current Action 6 proposal. This will create unneeded delay in moving forward on Action Plan 6 as well as the TRACE initiative. We therefore recommend that CIVs be explicitly carved-out of the BEPS Project, including Action 6, and dealt with more appropriately under TRACE.

Yours sincerely,

**BlackRock Investment Management (UK) (Limited)**
James Charrington
Chairman for Europe, Middle East and Africa

**Capital Group Companies Global**
Hamish Forsyth
President-Europe

**Fidelity Worldwide Investment**
Jon Skillman
Managing Director, Continental Europe

**M&G Securities Limited**
Grant Speirs
Group Finance Director
Pioneer Investment Management Ltd
Robert Richardson
CEO

Robeco
Roderick Munsters
CEO

Schroder Investment Management Ltd
Massimo Tosato
Chief Executive

State Street Global Advisors
Michael Karpik
Head of Europe, Middle East and Africa

UBS Global Asset Management
Martin Thommen
Head of UBS Funds
10 April 2014

Dear Sir or Madam

BEPS Action 6

I am writing to you on behalf of the British Private Equity and Venture Capital Association (the "BVCA"), which represents the interests of members of the private equity and venture capital industry. The BVCA is the industry body and public body advocate for the private equity and venture capital industry in the UK. More than 500 firms make up the BVCA members, including over 250 private equity, mid-market, venture capital firms and angel investors, together with over 250 professional advisory firms, including legal, accounting, regulatory and tax advisers, corporate financiers, due diligence professionals, environmental advisers, transaction services providers, and placement agents. Additional members include international investors and funds-of-funds, secondary purchasers, university teams and academics and fellow national private equity and venture capital associations globally.

This note has been prepared by and is being sent on behalf of the BVCA’s Tax Committee, whose remit is to represent the interests of members of the industry in taxation matters. The BVCA welcomes the opportunity to submit its comments on the Public Consultation document entitled BEPS ACTION 6: PREVENTING THE GRANTING OF TREATY BENEFITS IN INAPPROPRIATE CIRCUMSTANCES released by the OECD on 14 March 2014 (the "Consultation Document") and how it might affect members of our industry. Our comments in respect of the Consultation Document are set out below.

Introduction

The BVCA fully appreciates the concerns of the OECD that action is needed to prevent "double non-taxation", as well as cases of no or low taxation, associated with practices that artificially segregate taxable income from the activities that generate it. The BVCA also supports a coordinated and comprehensive international approach to tackle these important issues.

Context for private equity

Private equity funds (and venture capital funds, which are not referred to separately in this note for reasons of clarity but operate in a very similar manner) exist to aggregate and deploy
capital in order to generate investment returns. Private equity funds are not vehicles for tax avoidance: they play an important role in matching those seeking to invest capital with companies requiring investment. Investors into private equity funds are typically pension funds, family offices, insurance companies, banks, other investment funds (which may be in corporate, trust, partnership or other form), sovereign wealth entities, not for profit organisations such as local authorities, educational endowment funds and charities and individuals (including officers and employees of the fund manager or vehicles aggregating the interests of such persons). Investment may be made directly into a particular private equity fund or via a “fund of funds”. Ultimately many of these investors will be of a kind which would allow them to benefit from double taxation agreements in their jurisdictions of residence.

British and other European private equity funds typically raise funds from investors in a broad range of jurisdictions, which tends to increase fund size and increase economies of scale, and typically invest in companies in multiple jurisdictions, to diversify risk and maximise investment opportunities. It is therefore critical to many private equity funds that they can operate effectively cross-border.

Private equity operates very differently from the large multi-national organisations on which BEPS is largely focused, and it is vital that these differences are understood and accommodated in order that the industry is not disproportionately disadvantaged, which would in turn lead to a disruption in global investment flows, impacting countries that rely on inward investment and reducing economic growth across the globe.

Implementing the Action 6 proposals as currently drafted could, for example, cause investors in private equity funds to suffer taxation which is not consistent with their substantive treaty position as a matter of principle, for example because a holding company is denied treaty benefits such that its receipts are received net of withholding taxes, with no facility for investors to claim the treaty benefits which would be available had they invested directly. In other words, the proposals will reduce returns to investors by subjecting them to double (or undue) taxation, making the asset class overall less attractive. In turn this is likely to reduce the pool of capital available for business investment. A critical element of our industry is that investors suffer tax based on their tax attributes. So if the investor is a normal taxpayer, the investor should pay the same amount of tax that the investor would pay on a similar investment made direct. Similarly if the investor is exempt, for instance because it is charity or pension fund, then normally it would not expect to pay a higher rate of tax on a private equity investment as compared to any of its other investments.

It is therefore of fundamental importance to the private equity industry, pension fund and similar investors, and potential recipients of investment capital, to work with the OECD to find an approach to the Action 6 proposals which accommodates the private equity industry and its diverse range of stakeholders, while implementing the policy of preventing the granting of treaty benefits in inappropriate circumstances.

Proportionality

The Consultation Document does not adequately consider the impact that the proposals may have on genuine commercial activity. The proposals give rise to significant complexity and uncertainty, which will increase costs for business and make cross-border activity less attractive where the underlying activity will in most cases be of the sort which double taxation treaties seek to facilitate.
A related issue is that recent experience, for example in respect of domestic implementation of FATCA or AIFMD, demonstrates that while the ambition for a particular proposal may well be to effect uniform implementation across a number of jurisdictions, this is unlikely to occur in practice. This further increases the burden on international business.

It is not clear to us that the proposals set out in the Consultation Document are proportionate to the perceived mischief.

**Impact on Collective Investment Vehicles generally**

Many of the challenges presented to the private equity industry by the Consultation Document are borne of the fact that the document does not consider the position of investment funds and other collective investment vehicles (“CIVs”) to any extent. This is perhaps to be expected, given that CIVs are not a particular focus of BEPS, but it remains the case that the failure to consider the position of CIVs has directly led to many of the issues noted in this letter. Private equity funds are a category of CIV and will be referred to as such in this letter.

It is clear from previous OECD publications such as the 2010 OECD report on the treatment of collective investment vehicles, and the January 2013 TRACE implementation package, that the OECD is aware of the particular challenges faced by CIVs in relation to treaties. This recognition is to be welcomed, but we strongly urge the OECD to turn this recognition into a workable plan for the treatment of CIVs. We see two alternatives in this regard:

- That CIVs of all descriptions are explicitly excluded from the current Action 6 agenda, and provision is made in the proposed amendments to the model treaty to make clear that the LOB provision and/or purpose test will not act to restrict the ability of a CIV (or associated investment structure) from accessing treaty benefits. A new work stream would be created to address the particular circumstances of CIVs, building on the past OECD CIV initiatives. This is our preferred approach; or

- alternatively

  - that the position of CIVs of all descriptions should be taken into account as part of the Action 6 work, and that actions to address the particular circumstances of CIVs should be adopted at the same time as and as part of the output of the Action 6 work.

Any proposals should consider how to deal with funds of funds and similar situations where the ultimate beneficiaries of investment returns may not be party or visible to the underlying CIV or where it might not be possible to establish the treaty status of such beneficiaries.

We have commented below on two aspects of the Consultation Document, notwithstanding that we consider that the overall approach to Action 6 needs to be re-worked for CIVs, to include all CIVs which are subject to recognised regulation, including, in an EU context, regulation under rules implementing the Alternative Investment Fund Managers Directive. We would of course be happy to assist the OECD in seeking to develop these proposals into a workable solution for CIVs and holding companies controlled by CIVs.

**Limitation on benefits provision**

We do not consider that a limitation on benefits (“LOB”) provision is proportionate or necessary to meet the policy objective of preventing treaty shopping, if the main purpose provision is properly implemented. As such we consider that the LOB provision should be
abandoned. This is in recognition of the significant cost and complexity which will arise if new arrangements have to take into account both an LOB provision and a main purpose provision (in addition to existing concepts such as beneficial ownership), which taken together would represent a considerable burden and act as a disincentive to international investment.

As currently drafted many private equity investment funds and holding companies owned by such funds would not meet the LOB test because:

- the fund and the holding companies will not be listed;
- neither the fund nor the holding companies will be treated as carrying on an active trade or business for the purposes of the proposed LOB test. Under the formulation of the LOB test currently proposed, the making or managing of investments will be deemed not to satisfy this test unless carried on by a bank, insurance company or securities dealer; and
- the “derivative benefits” provision currently proposed is very narrow. Given that many private equity funds purposefully raise funds from a broad range of jurisdictions, it will rarely be the case that 50% or more of the investors in the fund are resident in the same jurisdiction as the fund or holding company. In any event, it may be very difficult in practice to establish the treaty status of the investors in the fund (see further below).

Further comments on these concerns are as follows:

1. Active trade or business

There are of course a number of good commercial reasons why private equity funds and other CIVs are formed to aggregate investors’ funds and make investments. There are also a number of good commercial reasons why holding companies may be formed, including insulation of legal liability, a desire to hold instruments issued from several jurisdictions via a single platform, flexibility to return investment proceeds to investors, finance requirements (including those required by banks), facilitating co-investment arrangements, and a desire to centralise holding and administrative functions.

As mentioned above, under the LOB test currently proposed, the making or managing of investments will be deemed not to satisfy the “active trade or business” test unless carried on by a bank, insurance company or securities dealer. It is not clear to us why the making and managing of investments in the course of a CIV’s business (or that of a holding company controlled by a CIV) is not considered to be an activity capable of qualifying under paragraph 3 of Article X. We would urge the OECD to expand the paragraph to make clear that such activity may qualify a resident for entitlement to benefits.

2. Derivative benefits provision

Investors in private equity funds are often entitled to treaty benefits, and with further effort it may be that an expanded derivative benefits provision could in some cases afford some relief from the double taxation which certain investors into private equity arrangements are likely to suffer should the proposals proceed as drafted.
At a minimum, the derivative benefits provision should refer to owners who are entitled to equivalent benefits under treaties with third party jurisdictions.

However, there will in any event be significant challenges to applying a derivative benefits provision, for example in the case of investment into private equity funds by other fiscally transparent funds. It might not be possible even to identify the ultimate beneficiaries of such an investment fund, which might invest in the fund through nominees, clearance systems or similar arrangements. Secondary transfers of interests in such funds may exacerbate the problem. Even where the ultimate beneficiaries can be identified, it will often not be possible for the fund to establish their treaty status.

Other requirements to gather information on investors do not provide an answer to this issue. Private equity funds carry out Know-Your-Customer and anti-money laundering checks when investors subscribe for interests in the funds, but of course that process does not yield information about the treaty status of investors. The implementation of FATCA will not result in fund managers having access to information about the treaty status of each ultimate beneficiary of investment returns from the fund, given that the focus of FATCA is, very loosely, on identifying whether recipients of income are likely to be US taxpayers or whether they will themselves be compliant with FATCA, rather than whether they are resident in any other particular jurisdiction or satisfy the conditions of a treaty. The OECD’s proposed Common Reporting Standard, if and when implemented, would provide funds with greater information about the residence of investors, but it will not go so far as to deal with all of the conditions for relief in treaties (for example, whether an investor is acting through a permanent establishment).

3. Specified CIVs to be “qualifying persons”

Given the above, while we do not support the concept of an LOB provision, if this aspect of the proposals does proceed then we would urge the OECD to include specific provision for CIVs in the proposed LOB provision, recognising that this would have to work as part of a wider framework for treaty access for CIVs.

In particular, consideration should be given to including a CIV in the definition of a “qualifying person”, provided that certain conditions are met (for example, that the CIV is not controlled by one or a small number of investors and is subject to recognised regulation, including, in an EU context, regulation under rules implementing the Alternative Investment Fund Managers Directive). Similarly, holding companies controlled by such a CIV should be treated as satisfying the LOB test.

Main purpose provision

Subject to the following discussion we consider that the proposal to include a purpose test along the lines of the new paragraph 6 of Article X set out in the Consultation Document is in principle preferable to the current LOB proposal. We have not been able to identify a circumstance where unacceptable treaty shopping could not be countered by such a test and so, as noted above, we consider that the proposal for an LOB provision should be abandoned and more effort invested in arriving at a purpose test which is proportionate and manageable for international business.

The examples given at paragraph 33 of the Consultation Document make clear that it is acceptable to take treaty access into account when making investment decisions. On the face of it this would seem at odds with the paragraph 6 test, which introduces unwelcome uncertainty. Our members will wish to avoid protracted debate which will inevitably arise in
circumstances where it is accepted that access to treaty benefits was a consideration in arriving at a particular arrangement but there is disagreement over whether or not accessing those benefits was a main purpose or a subsidiary purpose. Such disagreements would be costly and time consuming to resolve and, in the case of private equity, it is quite possible that a fund may wish to sell an investment related to the arrangement after a relatively short holding period, during which it would be unrealistic to resolve such a dispute. As such, the proposals as drafted may disproportionately affect the normal commercial operation of a fund. For these reasons, we consider that the current drafting of the test, which turns on establishing **one of the main purposes**, is unnecessarily broad and should be revised to be a singular test of establishing whether or not access to treaty benefits was **the main purpose** of a particular arrangement.

We agree with the text of paragraph 30 of the Consultation Document, which broadly explains that in order for the test to not apply it is not sufficient to merely assert that access to treaty benefits was not a main purpose of an arrangement; it must be right that all available evidence is taken into account in determining the purpose of an arrangement. However, we do not consider that the objective approach described under Paragraph 29 is appropriate. In answering the question of the main purpose of an arrangement it is the facts and circumstances which the parties actually took into account in arriving at that arrangement, not what an independent third party believes that they should have taken into account, which should be relevant. To do otherwise would, again, be disproportionate and likely to affect normal commercial arrangements as parties will have no appetite for engaging in protracted discussions over what facts and circumstances are relevant to establishing purpose. As such the test should be subjective, not objective.

It should also be clarified that if the relevant transactions or arrangements would have been the same in the absence of the relevant treaty benefits, then the obtaining of treaty benefits cannot be “a main purpose” or “the main purpose” of the transaction or arrangements.

**Conclusion**

To reiterate the comments made above:

- The position of CIVs in relation to treaty access must be considered and addressed before the AP 6 work stream continues. Our preference is that CIVs including private equity are excluded from the current Action 6 work and a new work stream is created to focus on CIVs.

- We do not consider that a limitation on benefits provision is proportionate or necessary in order to meet the policy objective, if a properly considered purpose test is put in place. If the OECD does ultimately decide that a limitation on benefits provision is required then we would urge the OECD to modify the proposed active trade or business concept to include CIVs and holding companies controlled by CIVs, or to include specified CIVs and holding companies controlled by such CIVs within the definition of a “qualifying person”.

- The purpose test should be a subjective and not objective test, and should turn on establishing **the main purpose** of an arrangement. Where it can be demonstrated that arrangements would have been entered into in the absence of treaty benefits it should be made clear that any treaty benefits cannot be the main purpose (or one of the main purposes) of the arrangements.
Thank you in anticipation for taking our comments into account as part of the consultation process. We would welcome an opportunity to engage more fully with the OECD in due course on this matter and would be pleased to discuss any of the comments made.

Yours faithfully,

Dominic Spiri

On behalf of the BVCA Taxation Committee
Dear Sir/Madam

**BEPS Action 6: Preventing the granting of treaty benefits in inappropriate circumstances**

**Introduction**

The British Property Federation (BPF) is the voice of property in the UK, representing businesses owning, managing and investing in property. This includes a broad range of businesses comprising commercial property developers and owners, financial institutions, corporate and local private landlords and those professions that support the industry.

**Executive summary**

The functioning of business in the wider economy relies on investment into commercial real estate. It provides high quality accommodation for businesses and allows them the flexibility to adapt and relocate with changing economic conditions. We are keen to ensure that any proposals aimed at tackling perceived tax abuse do not inadvertently stem the flows of capital into real estate, as that would ultimately harm the quality and availability of business infrastructure.

Given its bulky and illiquid nature, it is common for investors to gain exposure to commercial real estate through collective investment schemes or funds. Such arrangements spread commercial risk among participants and give individual investors access to opportunities they would not have on their own. Investors in commercial real estate funds are a diverse group, ranging from institutional investors such as pension and sovereign wealth funds to individual retail investors. Ultimately, however, the majority of investment into commercial real estate in the UK (and in most mature economies) provides pensions and savings for ordinary households around the world.

Real estate funds are designed to ensure that investors are taxed as if they had invested in property assets directly while affording them the above noted benefits of collective investment. In order to facilitate this, real estate funds are typically structured in a ‘tax transparent’ manner. In this context, the ability to reclaim any withholding tax suffered via double tax treaties is crucial.

We are concerned that the OECD’s proposals on treaty abuse do not recognise the valuable function which real estate investment structures (indeed, investment structures more generally) provide to both the real economy and to savers. In particular, the proposed ‘entitlement to benefit’ clause does not work very well in a funds context and as currently drafted could seriously harm the economic viability of collective real estate investment by destroying the ability to achieve tax transparency.
It is also disappointing that the OECD appears to have completely disregarded its 2010 paper “The granting of treaty benefits with respect to the income of collective investment vehicles” (the OECD CIVs report).¹ That paper explored the potential application of the ‘equivalent beneficiary’ concept, which rightly considers the status of ultimate investors in a fund in determining whether treaty benefits should be available to entities in that fund structure.

The current effort to limit the inappropriate use of tax treaties should recognise that for the most part, reliance on tax treaties by collective investment schemes and funds is not inappropriate. The current proposals should accordingly be modified so as to respect the approach reflected in the OECD CIVs report.

Structure of this response

Our response focuses on three key themes: the importance of the real estate industry to the wider economy; an explanation of how treaties are commonly used in the real estate industry; and how the current proposals could jeopardise real estate investment and the associated benefits it brings to the real economy. The key themes are elaborated further in the appendices to this letter:

Appendix 1: The role of real estate in the economy

Appendix 2: The role of real estate investment structures

Appendix 3: Specific comments on BEPS action 6 discussion draft

We would welcome the opportunity to discuss the contents of this letter in more detail. We remain at your disposal should you have any questions or require further details.

Yours faithfully

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¹ http://www.oecd.org/tax/treaties/45359261.pdf
Appendix 1: Real estate and the wider economy

Real estate is a physical asset with a tangible economic footprint that contributes significantly to the wider economy. It is fundamental to the functioning of commerce and industry and provides a source of employment across a range of professions and trades.

Commercial real estate in particular is fundamental to the functioning of the economy as it provides high quality, flexible locations from which businesses can operate. The ability to rent rather than own their commercial real estate frees up working capital for businesses to invest and develop. It also provides them with the flexibility to easily expand or relocate to adapt to changing economic conditions.

Because real estate is a physical asset, its investment and maintenance is relatively labour intensive compared to other investment asset classes such as equities or bonds. The construction industry in particular benefits from investment in commercial real estate but there are significant benefits for auxiliary services such as property and facilities management, surveyors, lawyers, accountants and many others.

To illustrate this point, we provide below some recent data on the value of commercial real estate to the UK economy:

- The commercial property industry employed approximately 900,000 people and directly contributed about £42 billion to the UK’s GDP in 2012 (3% of the national total)².
- Property development supports the retention and development of construction expertise, both general and ‘green’, by creating construction industry jobs.
- Most of the capital invested in UK commercial property is used to provide pensions and savings for households around the world.
- UK commercial property is an attractive investment for individuals and institutions around the world, as the following table shows:³

<table>
<thead>
<tr>
<th>Investment in UK commercial property</th>
<th>£bn mid-2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>TOTAL</td>
<td>£364</td>
</tr>
<tr>
<td>Overseas</td>
<td>£88</td>
</tr>
<tr>
<td>UK, of which:</td>
<td>£277</td>
</tr>
<tr>
<td>Collective investment schemes</td>
<td>£59</td>
</tr>
<tr>
<td>REITs &amp; listed property companies</td>
<td>£52</td>
</tr>
<tr>
<td>Private property companies</td>
<td>£50</td>
</tr>
<tr>
<td>Insurance companies (including unit-linked &amp; managed property funds)</td>
<td>£41</td>
</tr>
<tr>
<td>Segregated pension funds</td>
<td>£30</td>
</tr>
<tr>
<td>Rest (traditional estates &amp; charities, private individuals, local govt, tenanted pub owners)</td>
<td>£44</td>
</tr>
</tbody>
</table>

It is important – in the context of the BEPS Action 6 consultation – to note that the largest portion (£59bn) of UK investment in UK commercial real estate is made through collective investment schemes. A significant proportion of overseas investment is also made through collective investment schemes, and institutional investors are increasingly investing collectively rather than owning property directly.

² Property Data Report 2013 (Property Industry Alliance)
³ The Size and Structure of the UK Property Market 2013 (Investment Property Forum)
It is therefore critical that any proposals to curb the practice of treaty shopping do not result in ‘collateral damage’ for collective investment arrangements.
Appendix 2: The role of real estate investment structures

Given the importance of fund structures for collective real estate investment we have provided an illustrative example of a real estate investment structure in appendix 2a and explained how treaties are commonly used in these arrangements. For the purposes of this response the terms collective investment scheme and investment fund are used interchangeably.

Collective (as opposed to individual or direct) investment takes place for a number of reasons; including to achieve economies of scale by pooling resources, to mitigate investment risk and to access professional portfolio management and investment expertise.

Real estate investment funds will often have investors from more than one country and may well have property investments in several countries. It is normal for the structures used to carry out such investment to be truly international and the ability to obtain benefits under tax treaties is therefore very important.

One of the aims of a collective investment structure is to ensure that investors are taxed on their interest in the fund as if they had invested in the underlying assets directly. Investment fund structures are often transparent for tax purposes to allow profits to be distributed to investors, which will pay tax based on their individual tax attributes.

It is important to not confuse tax transparency with tax avoidance. In other words, the mere fact that entities in an investment structure may not pay significant amounts of tax is not necessarily an indicator that abusive tax avoidance is taking place. In fact, income (i.e. rents) from commercial real estate is always taxed by the country in which the asset is located. Capital gains from commercial real estate are also normally taxed by that country (although the UK is a notable exception in that it does not levy capital gains tax on non-resident investors).

In summary, real estate investment structures are not designed to facilitate tax avoidance, but rather to ensure that investors are taxed according to their own individual attributes. Property rental profits and gains are generally taxable in the country in which the asset is located (which is where the economic activity relating to property investment occurs). Any further tax suffered by investors would effectively represent double taxation.

We are concerned that the proposals set out in the OECD’s consultation paper would hinder the tax transparency of real estate funds by removing the ability of entities within the structure to benefit from double tax treaties, and set out our specific concerns in Appendix 3.
Appendix 2a: Illustrative example of a real estate investment structure

**Investors**
Investors invest via a fund to pool resources and achieve economies of scale, to spread risk and to access professional investment and portfolio management services.

**Master Feeder Fund**
This vehicle is usually a transparent entity. Investors like to invest in a transparent vehicle to ensure that they are taxed based on their individual tax attributes.

**Holding Company**
A holding company is required in order to consolidate all of the underlying real estate investments. The administration and financing of the property portfolio may also be carried out by the holding company.

Any double tax treaty claims applied for in respect of WHT suffered on the distributions received from the underlying investments are claimed by the holding company. This is an important function of the Holding company as it is administratively simpler for one company to reclaim the WHT suffered, rather than each individual investor making a treaty claim. Individual investors may not have expertise to submit a treaty claim and it may not even be economically viable to do so on their proportion of profits.

**SPVs and investments**
Individual real estate assets are often directly owned by a special purpose vehicle or holding company, often (but not always) in the same country that the asset is located. This allows flexibility when selling the asset e.g. the ability to sell a proportion of the asset rather than the whole asset. It also allows specific borrowing to be done at the level of the asset if required.
Appendix 3: Specific comments on BEPS Action 6 discussion draft

We have two main concerns regarding the application of the entitlement to benefits clause in a real estate investment context:

- It is unclear how the clause would apply to entities in a real estate fund structure; and
- It could lead to a disparity of tax treatment between different real estate investment structures that ultimately carry on the same activity.

Are entities within a real estate investment fund “qualified persons”?

It is clear that entities in real estate fund structures will generally not meet the tests in clause 2(a) or (b) of the proposed entitlement to benefits article. Most entities will also not meet the test in clause 2(c) (although some will, which could lead to the disparities, set out in more detail below).

However, it is less clear whether clauses 2(d)(ii) and (iii) should apply. Pension funds are significant investors in real estate funds and the question arises as to whether the structures through which they invest could be considered “constituted and operated to invest funds for the[ir] benefit”. We would argue that such is the case, but would this still hold if pension funds invest alongside non-pension fund investors? Again, we would argue that it should.

It is also unclear what is meant by “pension or other similar benefits”. Presumably the intention is for the individuals investing their savings in retail fund products or in products such as life insurance to not suffer any double taxation on the returns generated by those products. Given that the majority of real estate investment is ultimately carried out for the benefit of ordinary savers around the world, it makes sense to interpret ‘similar benefits’ broadly so as to catch as many real estate funds as possible.

In addition, clause 2(d)(ii) requires that more than 50% of the investors with beneficial interest in the entity are residents of one of the two treaty states. This requirement is in our view far too restrictive and ignores the global nature of the investment management industry.

As noted in Appendix 2 above (and recognised in the OECD CIVs report), the economic viability of collective investment depends on tax transparency. It is therefore appropriate that entities in the structures through which such investment is carried out should benefit from treaty relief, and qualified person status. The OECD should make that clear.

Disparity of tax treatment for different vehicles

Restricting qualified person status to real estate investment funds which satisfy certain criteria (such as being listed or part of a listed group) would create an unjustifiable disparity in the tax treatment of businesses which ultimately carry on the same activity.

Apart from being conceptually inequitable it is likely that at a practical level investor choice would suffer as certain investment structures become economically unfeasible. A smaller range of investment options would lead to increased costs for investors and lower returns for ordinary savers everywhere. The OECD should therefore ensure that its treaty abuse proposals do not have undesirable unintended economic consequences for investors.
BUSINESSEUROPE is pleased to provide comments prepared by the members of its Tax Policy Group, chaired by Krister Andersson, on the OECD Discussion Draft entitled “BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, 14 March 2014 – 9 April 2014” (hereinafter referred to as the Draft).

General Comments

BUSINESSEUROPE supports OECD’s work to clarify the purpose of tax treaties. The initial and prime objective with tax treaties is to facilitate cross-border trade through the allocation of taxing rights between countries and to provide for mechanisms to eliminate double-taxation. By doing so, tax treaties provide certainty and eliminate major obstacles to cross border trade.

The introduction to the commentary recognizes the harm of international juridical double taxation:

“Its harmful effects on the exchange of goods and services and movements of capital, technology and persons are so well known that it is scarcely necessary to stress the importance of removing the obstacles that double taxation presents to the development of economic relations between countries.”

In this context however, we believe that the importance of certainty and the harm of double taxation need to be stressed. The proposal at hand aims at preventing the granting of treaty benefits in inappropriate circumstances. Misuse of treaty provisions undermines the integrity of a tax convention and should of course be addressed.

However, preventing tax avoidance and evasion in general, or treaty abuse in particular, should not be a main objective or purpose for entering into a tax treaty. When negotiating a treaty, countries should naturally aim at designing the treaty in a
way that does not open up for unintended non-taxation. However, the need to prevent tax avoidance and evasion does not by itself trigger countries to negotiate a tax treaty. Although the prevention of tax evasion and avoidance may be important purposes of a tax treaty, they do not constitute a prime objective, equal to the prevention of double taxation.

Consequently, BUSINESSEUROPE is concerned about the proposal to insert tax avoidance in the title and also the proposed wording in the preamble without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance.

Before initiating tax treaty negotiations, it is important that countries carefully analyse and study relevant provisions etc. in the other country, in order to identify potential areas that could open up for treaty abuse. BUSINESSEUROPE fully supports the policy consideration proposed in Section C of the Draft. We believe that, if these policy considerations were to be adopted by countries, there would be fewer loopholes to exploit and thus less need for Anti-Abuse rules. This approach would minimize the impact on genuine business activities.

Although the Draft essentially aims at preventing abuse of treaty provisions we believe that further clarification is needed with respect to what is to be considered abuse of treaty benefits.

It is of utmost importance to make a clear distinction between intended and unintended non-taxation. In the Action Plan on Base Erosion and Profit Shifting, it is stated that “no or low taxation is not per se a cause of concern, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it.” The distinction between intended and unintended non-taxation provides meaning to differences between tax efficiency and aggressive tax planning from a business point of view, and normal tax policy and harmful tax practices from a government point of view. Businesses should be allowed to respond to legislative tax initiatives without being accused of aggressive tax planning and Governments need to agree on acceptable forms of tax competition.

The Draft proposes various Anti-Abuse provisions to be inserted into the OECD Model Convention; namely a Limitation-on-Benefits provision (LOB), a Main Purpose Test (MPT) and a number of Specific Anti-Abuse provisions.

While both the LOB provision and the MPT aim at addressing treaty shopping in particular, they take different approaches. Whereas the LOB provision is extremely complex, it is at least to a greater extent than the MPT, based on objective criteria, thus leaving less room for arbitrary assessment. The MPT on the other hand is very unclear and subjective and open for arbitrary assessment.

In general, we believe that perceived inappropriate behaviour is best addressed with specific and targeted Anti-Abuse provisions. This way, abusive practices can be prevented with a minimum impact on bona fide business. It is of utmost importance that
Anti-Abuse rules are designed so that they have a minimum impact on genuine business operations. We believe that both the proposed LOB provision and the MPT fail in this respect since they are too general in nature and not limited to abusive situations. In particular, Anti-Abuse provisions should recognize that holding, financing, licensing and investment activities are normal and legitimate business activities that should not suffer blanket exclusions from Treaty protection.

BUSINESSEUROPE strongly opposes the proposal to insert a LOB provision and a MPT into the OECD Model Convention.

It does not seem to be a proportionate response to insert two very different provisions that aim at addressing the same issue. It is neither reasonable, nor desirable that taxpayers should have to struggle through a very complex LOB provision, only to be confronted with a very subjective MPT, providing little predictability regarding the outcome. Such a scenario would definitely have a negative impact on businesses and discourage investments and employment.

It should be made clear in the Draft that at most one of these two provisions for preventing treaty shopping shall be inserted in the OECD Model Convention.

Specific comments on the LOB provision

It is mentioned in the Draft that a number of countries already include LOB provisions in their tax treaties. The proposed LOB provision is based on the LOB provision found in treaties concluded by the United States. The fact that a number of countries choose to include a LOB provision in their treaties does not by itself justify a LOB provision to be inserted in the OECD Model Convention. Countries have different needs and priorities when negotiating tax treaties. Although a country may accept a certain LOB provision in relation to another country, this does not necessarily mean that it would be willing to have such an LOB in all of its treaties.

As previously stated, BUSINESSEUROPE opposes the LOB provision as currently drafted. The proposed LOB provision is, to say the least, very complex. Furthermore, it denies treaty benefits by default. Only where explicitly stated would a resident enjoy the benefits under the treaty in question. Such language seems to suggest that taxpayers, as a general rule, evade tax and engage in aggressive tax planning. This is clearly not true. Most businesses allocate substantial resources in order to comply with existing tax rules and struggle to overcome obstacles to cross border trade and investment. The OECD Model Tax Convention must reflect the fact that most businesses are engaged in bona fide operations and not tax evasion and circumvention of tax provisions.

We question whether it is proportionate to exclude all holding companies from treaty benefits. The structure of a holding company may vary significantly and there may be a number of reasons as to why a holding company is being used. The LOB provision
should take into account substance and purpose of the holding company, existence of substantive activities such as premises, employees in the holding state etc. Political stability and geographical location are further factors that may warrant a regional holding company, rather than any intent to engage in abusive behaviour.

It would of course not be possible to cover all genuine business situations in a LOB provision. Neither would it be possible to cover all inappropriate circumstances in Specific Anti-Abuse provisions. The answer however is not to deem all situations abusive unless otherwise stated. Instead of allowing treaty benefit only where explicitly stated, the LOB provision should at least be reversed so that treaty benefit is granted by default, and that benefits are only denied in case of treaty abuse. Listed entities and entities controlled by listed entities as well as entities that conduct active trade or business should still be deemed low risk and always be granted treaty benefits. The situations covered by the Derivative Benefits provision in the Draft should also be considered low risk and granted treaty benefits. Because there is no incentive to treaty shopping, the Derivative Benefits provision should be inserted in the OECD Model Convention itself and not as part of the Commentary if a LOB provision is adopted.

Such language would certainly be more reasonable, provide more clarity, maintain the integrity and purpose of the convention, be more fair and at the same time target cases of treaty shopping. It would also limit the scope of the LOB provision to cases of treaty shopping, which is the aim of Action 6 of the BEPS Action Plan.

Another issue that we think needs a thorough analysis is the question whether the proposed LOB could be in violation of EU law. In particular, our concern is with the prohibition of non-resident intermediaries in the ownership test, the local stock exchange requirement in the publicly traded test and the absence of a derivative benefit provision. All these aspects require analysis in light of EU law. Should the conclusion be that such provisions are in violation of EU law, a significant number of OECD members would not be able to adopt the LOB provision as it stands.

Specific comments on the Main Purpose Test

In addition to the LOB provision, the discussion draft also contains a MPT. Whilst both provisions aim at addressing the same issue, they do have significantly different approaches to doing so. As stated above, the proposed LOB provision is technically complex, but leaves less room for subjective and arbitrary assessments. The MPT on the other hand takes the opposite approach. It does not provide much guidance with respect to when the treaty benefits will be granted. Instead, it opens a door for tax administrations to disqualify taxpayers from treaty benefits where that tax administration finds it appropriate. The problem with the MPT is not that it is very complex. Rather, our concern lies with the fact that it is very subjective and leaves significant room for arbitrary assessments.
As mentioned above, BUSINESSEUROPE strongly opposes the proposed MPT. The language is much too vague and subjective. It is difficult for a company to foresee whether the provision is applicable in a particular situation.

It is stated in the Draft that the MPT would merely incorporate principles already recognized in the Commentary on Article 1 of the OECD Model Convention. Here, the Draft seems to be referring to paragraph 9.5 of the commentary on Article 1 which states the following:

“A guiding principle is that the benefits of a double taxation convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions.”

The commentary on Article 1 contains a number of solutions to address improper use of the convention. The MPT is one of many potential solutions. The fact that it is included in the commentary is not in itself a justification to include it in the OECD Model Convention. Such a test may be suitable between some treaty countries, but not necessarily between all.

Furthermore, the proposal in the Draft differs significantly from the language in paragraph 9.5 of the commentary to Article 1. In the Draft, the MPT would be applicable if it is reasonable to conclude that a tax benefit has occurred, if one of the main purposes of the arrangement would be to obtain a tax benefit and the tax benefit is achieved directly or indirectly. Compared to para 9.5 of the commentary to Article 1 the threshold has been lowered considerably.

With respect to the one of the main purposes criteria, The Draft indicates that there could be more than one main purpose. In our view, there could only be one main purpose. Since the Draft seems to suggest otherwise, it should be clarified how many main purposes there can be without any of them falling below the threshold of being considered a “main” purpose.

Similarly to the proposed LOB provision, the MPT imposes a significant burden on the taxpayer. The onus on the tax administration is set low (“reasonable to conclude”, “one of the main purposes”, “directly or indirectly”) while the onus on the taxpayer is significant (“establish that the granting of tax benefit would be in accordance with the object and purpose of provisions in the convention”).

Such a vague, unclear and wide scoped provision in itself is not acceptable. The provision is extremely unpredictable and would likely have a very negative effect for genuine business activities. In particular, holding, financing and investment activities are all normal and genuine business activities that may fall within the scope.

Should the OECD choose to insert a MPT in the OECD Model Convention, it is of utmost importance that it is designed to be applicable only where a structure has been
wholly artificially set up solely to secure a treaty benefit. Tax administration should establish (instead of make it reasonable to conclude) that the main purpose (instead of one of the main purposes) of an arrangement was to obtain the tax benefit. Furthermore, the provision should only be applicable if it is established that granting the benefit would be contrary to the objective of the provisions of the Convention.

Although such redrafting of the provision would not be enough to solve the fact that the MPT is unclear and unpredictable, it would at least increase the threshold for when an arrangement or transaction is considered abusive. In addition, where any dispute arises over the application of the MPT, we suggest provision is made for a binding arbitration process with time limits to provide a quick resolution and to avoid unnecessary costs.

Additionally, the MPT requires analysis in the light of EU law. Given the fact that the language of the MPT in the Draft is so wide in scope, it could be argued that EU Member States would not be able to adopt such a provision.

Furthermore, if the MPT were to be adopted, the interaction between that provision and GAARs and SAARs in the domestic tax laws would need to be clarified. It is established in the commentary on Article 1 of the OECD Model Convention that the domestic Anti-Abuse rules may be applied to address abuse of tax treaties. Domestic tax law may contain Anti-Abuse rules that do not correspond with the proposed MPT. Allowing domestic Anti-Abuse rules in addition to the proposed LOB, MPT and SAARs would definitely cause more uncertainty.

Conclusions

In conclusion, BUSINESSEUROPE considers that, as currently drafted, both the proposed LOB provision and the MPT would be contrary to the purpose of tax treaties and undermine their effect as a tool to facilitate enhanced cross border trade and investments. Instead, we believe that countries should put significantly more effort and focus on the policy considerations proposed in section C of the Draft.

Should the OECD include an Anti-Abuse provision in the OECD Model Convention, we believe that either a redrafted LOB provision or a redrafted MPT should be inserted. It would simply not be reasonable to include both a LOB and a MPT.

From a business perspective, and as an overriding principle, the objective should be to design a targeted provision that does not affect genuine business activities. A vague and unclear General Anti-Abuse provision would certainly be harmful. It would be extremely difficult for businesses to be certain whether treaty benefits will be granted. Likewise, it would be difficult for governments to fully understand the scope of the tax treaty that is being negotiated. Such uncertainty would undermine the very purpose of tax treaties and result in an increasing number of double taxation cases. The effect would be very negative on investment, jobs and growth. This in turn would risk
undermining sustainable tax revenue collection. The lack of an impact assessment on private sector activities, administrative costs and revenue allocation between countries is deplorable and unacceptable. Each proposal should be analysed carefully and its consequences should be presented to policy makers.

Furthermore, we urge the OECD to further analyse potential violations with EU law in the Draft. Otherwise, a significant number of OECD members would not be able to adopt the provisions as they stand.

BUSINESSEUROPE is happy to continue a constructive dialogue with the OECD on this topic.

On behalf of the BUSINESSEUROPE Tax Policy Group

Yours sincerely,

James Watson
Director
Economics Department
9 April 2014

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Dear Sir/Madam

Comments on the Discussion Draft on BEPS Action 6: Preventing The Granting Of Treaty Benefits In Inappropriate Circumstances

This submission is respectfully made in response to your invitation for comments on the Discussion Draft on “BEPS Action 6: Preventing The Granting Of Treaty Benefits In Inappropriate Circumstances” (“the discussion draft”) issued by the OECD on 14 March 2014.

Submission by CMTC

The Capital Markets Tax Committee of Asia (“CMTC”)1 would like to reiterate our support for the OECD’s transparent and inclusive consultation process and acknowledge the importance of preventing treaty abuse as an area of BEPS concern.

In summary, CMTC is concerned that the discussion draft would extend far beyond treaty abuse cases and have a significant impact to cross border flows in genuine commercial situations. In order to address these concerns, we suggest the following:

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1 The Capital Markets Tax Committee of Asia is a financial services industry body consisting of a number of banks, investment banks, securities firms and other diversified financial services institutions operating in Asia who are represented through their regional tax directors.


The main objects of the CMTC, according to its constitution, are “to provide a forum for discussion by corporate tax managers responsible for the tax affairs of investment banks, securities firms, banks and other diversified financial services institutions of topical taxation issues in Asia affecting their capital and securities markets and similar activities; ... to keep members informed of up to date information on taxation matters affecting capital and securities markets, and to exchange views on the technical analysis thereof; [and] to represent the interests of its members through acting as the respected voice of investment banks, securities firms, banks and other diversified financial services institutions, and to participate in liaison or advocacy activities on tax matters either directly or indirectly through representation with other groups or societies concerned with or by fiscal matters”.

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1. The general anti-abuse rule should be omitted and instead left for countries’ domestic law.

2. If the general anti-abuse rule must be included in the treaty, it should be amended to focus on the “dominant purpose” of an arrangement or transaction, rather than merely “one of the main purposes”, and additionally the OECD should consider building in other safeguards to limit aggressive application of this test by tax authorities.

3. The limitation-on-benefits (“LOB”) rule should include a derivative benefits test.

4. The derivative benefits test should be extended to apply to multiple tiers in a corporate group with a listed parent, provided that such ultimate parent has an equivalent or lower rate under its treaty with the source State.

5. The “substantiality test” in paragraph 3(b) of the LOB rule should be amended to refer to de-minimis activity, rather than the proposed comparative test. If the comparative test must be retained, then subparagraph 3(c) should be amended to only attribute activities undertaken by connected persons who are also resident in the taxpayer’s contracting state.

6. The OECD commentary should clarify that notwithstanding the LOB’s genesis in US tax law, the OECD commentary (rather than US guidance) should be the source for interpretation of the LOB provision.

Each of these submissions is discussed further below.

**General anti-abuse rule (submissions 1 and 2)**

CMTC submits that including a general anti-abuse rule in the model treaty is unnecessary and will create considerable uncertainty for taxpayers. In order to take advantage of treaty provisions, taxpayers already need to satisfy multiple tiers of tests and safeguards. For example, in certain Asian jurisdictions, a taxpayer might need to satisfy the following hurdles prior to accessing a reduced treaty rate on interest withholding tax:

- Treaty beneficial ownership provisions
- Treaty LOB provisions (as proposed)
- Domestic law specific anti-abuse rules
- Domestic law general anti-abuse rules
- Domestic law administrative procedures

Adding in an additional layer of general anti-abuse rule unnecessarily adds complexity and uncertainty for taxpayers. This is particularly the case if the treaty rule incorporates a different threshold to local general anti-abuse rules (which are often focused on the “dominant purpose” of an arrangement, rather than merely “one of the main purposes”).

Given the trend towards more countries’ adopting general anti-abuse rules in their domestic law, it is submitted that the OECD treaty should not “double up” and impose an additional general anti-abuse rule, but should instead leave such rules to each country’s domestic regime.

If a general anti-abuse rule must be included in the treaty, it should be amended to reduce potential uncertainty and to limit its applicability in genuine, commercial transactions. First, the subjective threshold should be amended to focus on the “dominant purpose” instead of “one of the main purposes”. Many countries’ domestic law general anti-abuse rules focus on dominant purpose and the treaty need not have a stricter threshold than the source State would seek to apply in its own law. Additionally, identifying numerous “main purposes” appears to be a very imprecise and subjective task. Almost any planning that is cognisant of the tax outcomes will have some form of tax purpose. Limiting situations regarded as abusive to those cases where the tax purpose overrides the commercial purpose (i.e., the tax purpose is the dominant purpose).
ensures that genuine commercial transactions are less likely impacted by the rule, whilst still countering tax-driven abusive arrangements.

Second, if a general anti-abuse rule is to be included, additional “safeguards” should be considered to protect against aggressive application of the rule by tax authorities. The OECD could consider a combination of additions to the commentary, as well as encouraging countries to amend their domestic law items for items such as the following:

- effective advance ruling mechanisms in the source state;
- limitations on time-periods within which tax authorities can challenge arrangements;
- application of any safeguards included within the Source State’s domestic law regarding its own general anti-abuse rule (e.g., referral to expert panels before the tax authority can invoke the general anti-abuse rule); and
- placing the burden of proof with the tax authority, given that the taxpayer must already have satisfied the strict LOB rule and numerous other hurdles to claim treaty benefits.

**Derivative benefits test (submissions 3 and 4)**

The LOB clause, as proposed, is extremely strict and could preclude many non-abusive arrangements and transactions from taking advantage of treaty benefits. A derivative benefits clause should be introduced as it helps reduce this undesirable effect in cases where treaty shopping does not exist (e.g., where the ultimate owner of the income would have been entitled to the same treaty benefits).

The discussion draft calls for comments on an example in paragraphs 15-16. In this regard, CMTC respectfully submits that the example is not a case of treaty shopping. The parent company would have been entitled to a withholding tax exemption had it received the income directly. Interposing a subsidiary in State R (which is also entitled to a withholding tax exemption under its treaty) confers no incremental treaty benefit for the group. CMTC acknowledges that this example might create BEPS concerns, but submits that the appropriate way to deal with such examples is through the OECD’s work on BEPS Action 5: Countering Harmful Tax Practices or for State S to reconsider its bilateral treaty negotiations with State R.

CMTC submits that the proposed derivative benefits test should be extended to apply to multiple tiers in a listed group’s corporate structure, provided that the ultimate parent has an equivalent or lower rate under its treaty with the source State.

Multinational enterprises use corporate structures and holding companies for many non-tax reasons (e.g., aligning corporate structures with regional governance models, accounting consolidation, financial markets regulatory restrictions etc). The derivative benefits test, as currently proposed, inadequately takes this into account because it limits “equivalent beneficiaries” in the corporate context to only listed companies (i.e., those qualifying under paragraph 2(c)(i)). Thus, intermediate holding companies cannot qualify as equivalent beneficiaries even if owned by a listed parent that enjoys an equivalent treaty with the relevant source state. And correspondingly, second tier (and lower) subsidiaries cannot pass the LOB rule under the derivative benefits test.

Given that the intention of the derivative benefits rule is to allow treaty benefits where the ultimate indirect owner of the income (e.g., the listed parent) would have been entitled to equivalent benefits, the status of any intermediate holding companies should be largely irrelevant, provided that the resident taxpayer does not base erode the income it receives.

With regard to potential base erosion payments, rather than focus on payments to the small class of “equivalent beneficiaries” it is submitted that the test should instead only consider whether the recipient of the payment would itself satisfy the “equal or lower rate test” in paragraph 5(e)(i)(B). This is a more commercial approach, considering that multinational groups will often make intra-group payments to entities other than their listed parent for commercial, non-tax reasons, and should not be penalised for doing so.
For reference, we have included in Appendix A a draft amended version of the proposed derivative benefits rule, including mark-ups that might be used to address the issues identified above.

**Substantiality requirement in the LOB active trade or business test (Submission 5)**

Proposed subparagraph 3(b) restricts the operation of the “active trade or business test” in paragraph 3(a) by imposing a requirement that the activity carried out in the state of residence is substantial in relation to the activity in the state of source. CMTC understands that this provision is generally targeted at a narrow case of treaty shopping abuses in which a company attempts to qualify for benefits by engaging in de-minimis connected business activities in the residence country. If so, it is submitted that the wording of the provision should reflect this underlying intention and should expressly refer to de-minimis activity, rather than imposing a comparative test at a significantly tougher threshold (i.e., the proposed substantiality requirement).

If the relative test must be retained, it is submitted that the attribution rule in subparagraph 3(c) should be amended to only attribute activities undertaken by connected persons who are also resident in the taxpayer’s contracting state. Otherwise, the interplay of paragraphs 3(b) and (c) could lead to uncertainty and inconsistent outcomes.

For example, assume a multinational banking group has 5 subsidiaries resident in State R and 5 subsidiaries resident in State S, and it makes an intercompany loan from R1 to S1. In this case, R1 will derive interest income from an associate, so must test the substantiality requirement in paragraph 3(b). However, given that subparagraph 3(c) attributes activities not just to the resident taxpayer (R1), but to persons in general, it also appears to attribute activities to the associate (S1). That is, R1 would be deemed to be carrying on all the R1-5 activities, and S1 would be deemed to be carrying on all the S1-5 activities. Consequently, the group would need to test whether its overall operations in the residence State are substantial compared to its overall operations in the source State. If so, group activities carried out in the residence State in relation to smaller overseas operations might satisfy the substantiality requirement, whereas the exact same activities carried out in relation to a larger overseas operation might not, thus leading to inconsistent outcomes and significant uncertainty.

For reference, we have included in Appendix B a draft amended version of the proposed paragraph 3, including mark-ups that might be used to address the issues identified above.

**Detailed commentary to the LOB rule (submission 6)**

Paragraph 12 of the discussion draft states that a detailed commentary will explain the main features of the LOB rule. It is submitted that this commentary should clarify that notwithstanding the LOB’s genesis in US tax law, the OECD commentary (rather than US guidance) should be the source for interpretation of the LOB provision.

This will ensure that all taxpayers and tax authorities have equal access to relevant guidance, without having to navigate US law, and it will also ensure that international interpretation cannot be amended by domestic law action in the US.

* * * * *
Thank you again for the opportunity to provide our comments in relation to the Discussion Draft. If you would like to discuss anything contained in this submission regarding the Draft, we would appreciate the opportunity to contribute further.

I can be contacted on +852 2252 6083 or jesse.kavanagh@nomura.com if there are matters you wish to discuss.

Yours sincerely

Jesse Kavanagh  
Chairman  
Capital Markets Tax Committee of Asia
Appendix A – marked up derivative benefits rule

Proposed changes appear in **bold italics** for additions and **strike-through** for deletions.

[to be added after paragraph 3]

A company that is a resident of a Contracting State shall also be entitled to the benefits of this Convention if:

a) at least 95 percent of the aggregate voting power and value of its shares (and at least 50 percent of any disproportionate class of shares) is owned, directly or indirectly, by seven or fewer persons that are equivalent beneficiaries, provided that in the case of indirect ownership, each intermediate owner is itself an equivalent beneficiary and

b) less than 50 percent of the company’s gross income, as determined in the company’s State of residence, for the taxable year is paid or accrued, directly or indirectly, to persons who are not equivalent beneficiaries **would not satisfy the conditions in paragraph 5(e)(i)(B) of the definition of “equivalent beneficiary”**, in the form of payments (but not including arm’s length payments in the ordinary course of business for services or tangible property) that are deductible for the purposes of the taxes covered by this Convention in the company’s State of residence.

[to be added to the definitions in paragraph 5]

e) the term “equivalent beneficiary” means a resident of any other State, but only if that resident

i. A) would be entitled to all the benefits of a comprehensive convention for the avoidance of double taxation between that other State and the State from which the benefits of this Convention are claimed under provisions analogous to subparagraph a), b), subdivision i) of subparagraph c), or subparagraph d) of paragraph 2 of this Article, provided that if such convention does not contain a comprehensive limitation on benefits article, the person would be entitled to the benefits of this Convention by reason of subparagraph a), b), subdivision i) of subparagraph c), or subparagraph d) of paragraph 2 of this Article if such person were a resident of one of the States under Article 4 of this Convention; and

B) with respect to income referred to in Articles 10, 11 and 12 of this Convention, would be entitled under such convention to a rate of tax with respect to the particular class of income for which benefits are being claimed under this Convention that is at least as low as the rate applicable under this Convention; or

ii. is a resident of a Contracting State that is entitled to the benefits of this Convention by reason of subparagraph a), b), subdivision i) of subparagraph c) or subparagraph d) of paragraph 2 of this Article.
Appendix B – marked up active business test

Proposed changes appear in **bold italics** for additions and *strikethrough* for deletions.

3.  
   a) A resident of a Contracting State will be entitled to benefits of this Convention with respect to an item of income derived from the other Contracting State, regardless of whether the resident is a qualified person, if the resident is engaged in the active conduct of a trade or business in the first-mentioned Contracting State (other than the business of making or managing investments for the resident’s own account, unless these activities are banking, insurance or securities activities carried on by a bank, insurance company or registered securities dealer respectively), and the income derived from the other Contracting State is derived in connection with, or is incidental to, that trade or business.

   b) If a resident of a Contracting State derives an item of income from a trade or business activity conducted by that resident in the other Contracting State, or derives an item of income arising in the other Contracting State from an associated enterprise, the conditions described in subparagraph a) shall not be considered to be satisfied with respect to such item only if the trade or business activity carried on by the resident in the first-mentioned Contracting State is *merely de-minimis* substantial in relation to the trade or business activity carried on by the resident or associated enterprise in the other Contracting State. Whether a trade or business activity is de-minimis substantial for the purposes of this paragraph will be determined based on all the facts and circumstances.

   c) For purposes of applying this paragraph, a resident person’s activities shall be deemed to include activities conducted by connected persons who are resident in the first mentioned contracting State. Activities conducted by persons connected to a person shall be deemed to be conducted by such person. A person shall be connected to another if one possesses at least 50 percent of the beneficial interest in the other (or, in the case of a company, at least 50 percent of the aggregate vote and value of the company’s shares or of the beneficial equity interest in the company) or another person possesses at least 50 percent of the beneficial interest (or, in the case of a company, at least 50 percent of the aggregate voting power and value of the company’s shares or of the beneficial equity interest in the company) in each person. In any case, a person shall be considered to be connected to another if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same person or persons.
BEPS Action 6: Preventing the Granting of Treaty Benefits in inappropriate circumstances
Response by the Chartered Institute of Taxation

1 Introduction

1.1 We refer to the public discussion document published by the OECD on 14 March 2014 regarding BEPS Action 6: Preventing the granting of treaty benefits in inappropriate circumstances (Discussion Document).

1.2 We welcome the opportunity to comment on this work being done by the OECD as the proper functioning of treaties is absolutely essential to international trade. We are concerned, however, that there is a lack of proportionality in what is being proposed which risks damaging the ability of treaties to facilitate cross border trade.

1.3 We are concerned that the OECD is trying to solve too much of the BEPS agenda with this paper. A step back should be taken. Not every BEPS problem can or should be solved by each action point. Each BEPS action should focus on solving the issues specifically identified by that action. The granting of treaty benefits in inappropriate circumstances principally relates to artificial conduit and similar structures. Prevention of this can largely be achieved with a properly drawn limitation on benefits (LOB) provision. Other actions, such as CFC, Hybrids and the transfer pricing actions can work with this action to support a coherent international tax system.

1.4 As it stands the proposals in the Discussion Document would result in taxpayers having to consider in some detail for almost every cross-border transaction whether they fall within a treaty or not. Such a result would be harmful to international trade, investment and movement of Individuals.

2 Executive summary

2.1 Treaty benefits should not be conferred in abusive situations. However, treaty benefits should be available in all situations in accordance with the terms of the particular treaty and the circumstances in which benefits should be denied on the grounds of
abuse should be clearly stated in the treaty itself in a manner which produces certainty of outcome.

2.2 The policy considerations and aims around the concept of choice of jurisdiction (treaty shopping) and the availability of treaty relief should be clarified.

2.3 The tests relating to residency also need clarification. In places (for example the residence test in the LOB provision and in the tie breaker rule), there appears to be an intention to amalgamate the two currently well-known concepts - central management and control and effective management – which we do not think is helpful.

2.4 If it is properly constructed, an LOB provision would give a degree of certainty for tax authorities and taxpayers. To achieve this, the LOB provision needs to be drafted as clearly as possible and be targeted only at unacceptable access to treaty benefits, without excluding commercial arrangements. The basic principle underpinning double tax treaties, namely, that residents of a contracting state are entitled to benefits should be maintained. For that reason, and to be consistent with the purpose of preventing improper use of treaties, the LOB should identify disqualified residents rather than prescribing a limited list of qualifying residents.

2.5 It is imperative that any LOB provision (on the basis proposed) should include a derivative benefits provision such as that as envisaged in paragraph 13 of the Discussion Document. Not having such a clause would create problems for many groups. Further, as a matter of European law, a derivative benefits provision is required. It is our understanding that an LOB provision without a derivative benefits provision would breach the fundamental freedom of establishment as regards treaties between EU member states.

2.6 We are opposed to the proposed ‘main purpose’ anti-abuse rule. The application of this rule is inherently uncertain and is likely to give rise to disputes not only between tax authorities and taxpayers but between tax authorities with different views as to what is or is not acceptable.

2.7 The preamble suggested in Part B is, by itself, unhelpful. It is no substitute for a clear description of the class of persons who qualify for treaty benefits. The proposed preamble should only be recommended where a substantive LOB article is agreed by the contracting states.

2.8 The paragraphs on Tax policy considerations set out in Part C of the Discussion Document are important. They should emphasise that states should have a clear understanding of the relevant rules of a state with whom they proposed to conclude a treaty. It should make clear that states that conclude treaties must grant the treaty benefits they have agreed, and should recognise the implications of their international obligations. In this respect states should be cautioned that the Model treaty functions as a precedent that must be tailored to specific circumstances.

3 General points

3.1 We support the principle that treaty benefits should not be conferred in abusive situations.

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1 We note that if treaties specify disqualified residents rather than identifying qualifying residents, the LOB provisions can be somewhat differently drawn and the issue of derivative benefits may not arise.
3.2 However, treaty benefits should be available in all situations in accordance with the terms of the particular treaty. The circumstances in which benefits should be denied on the grounds of abuse should be clearly stated in the treaty itself in a manner which produces certainty of outcome. This principle is essential to ensure that international trade is not inhibited by double taxation, or the fear of double taxation. The benefits arising from tax treaties in facilitating international trade and investment should not be forgotten; and facilitating international trade and investment should continue to be a fundamental aim of the work in this area. Nor should the fact that most taxpayers who claim benefits under treaties are not attempting to abuse the terms of those treaties be forgotten.

3.3 We have significant concerns that the current proposals go wider than is necessary to counter treaty abuse; whilst they may reduce treaty abuse they will, in practice, also severely limit access to the benefits of treaties in non-abusive situations, and lead to either increased double taxation or a substantial increase in mutual agreement procedure (MAP) requests, putting great strain on tax authorities, increasing costs for compliant taxpayers and discouraging cross-border activity. We believe that treaty abuse can be tackled without such negative results.

3.4 We note that the Commentary to article 1 of the OECD Model has long contained a menu of possible provisions for inclusion in bilateral treaties in order to prevent improper use of treaties. There is no indication as to whether any of these are somehow inadequate. There is also no analysis of whether greater inclusion of those possible provisions would address the concerns now raised.

3.5 It seems as though the issues identified by the BEPS project are being tackled without proper consideration of the impact for smaller enterprises or mobile workers. There is a real danger that the changes introduced to tackle BEPS will, for these smaller enterprises and individuals, drive up the cost of the compliance burden and the complexity in applying the rules to such an extent that trading internationally is no longer something that smaller businesses can undertake. The BEPS project should not result in driving smaller businesses out of the global market as a result of over regulation which is a disproportionate response to tackle issues presented by some MNCs.

4 Choice of jurisdiction

4.1 Before addressing the specific proposals in the Discussion Document we would like to explore the policy considerations and aims around the concept of choice of jurisdiction (treaty shopping) and the availability of treaty relief that appear throughout the document. These do not seem to be very clear. We refer, for example, to paragraphs 15, 21, 32 and 33 of the Discussion Document.

4.2 Paragraph 32 says: ‘...where an arrangement is inextricably linked to a core commercial activity, and its form has not been driven by considerations of obtaining a benefit, it is unlikely etc...’.

4.3 Example C in paragraph 33 is said to be a situation where the proposed new paragraph 6 to Article X (Entitlement to Benefits) would not apply. However, the example makes it clear that State S is chosen because it is the one where there is a double tax treaty. So, although the arrangement is linked to a core commercial activity, the form is also driven by the availability of the double tax treaty.

4.4 This can be contrasted with the example in paragraph 15 of the Discussion
Document, which deals with the location of intangibles. This situation is said to be one which does give rise to BEPS concerns, because the group chooses to locate the royalties in a treaty jurisdiction and it is suggested this is not acceptable. We question why this should be the case as there is nothing to suggest that the licencing of IP to OPCO 1 for royalty income is not a legitimate commercial activity.

4.5 Considering these two examples, where, we suggest, both arrangements are linked to commercial activities, the distinction made in the Discussion Documents infers a policy intent to favour active income (manufacturing etc.) over passive income (royalties, finance income). Is the intention that benefits of a treaty will not be denied where the choice of jurisdiction is driven, or at least heavily influenced by, the availability of a treaty if the income flow is active income, but will be denied when the income flow is passive income?

4.6 To draw out this concept further, what would the intended outcome be if the companies in Examples A and B of paragraph 33 were raising money for their commercial operations using the dividend stream as security? If the same deal had been offered by a bank in State T as well as the one in State R, the State R bank will win the deal as it can price it more competitively?

4.7 We wonder whether the distinction being made here is in relation to significant people functions. The implication of the examples is that a choice of jurisdiction linked to the placing of functions employing a significant number of people is acceptable, but that one relating to an activity which does not employ a large number is not. We do not think this can be correct. A result of this argument would be that it would not be acceptable to centralise a group’s treasury function, which might require only a small number of people to run it, in a low tax jurisdiction with a wide treaty network. This would be a significant shift of current international tax policy.

4.8 Alternatively, does the distinction between the examples in paragraphs 15 and 33 of the Discussion Document arise as a result of what is perceived to be a ‘core’ activity? Is the implication that licencing of IP (and financing) is not generally considered to be ‘core’?

4.9 If this is what is intended, we would not support such a distinction. Although internal licensing is not a front-line activity of generating turnover by selling goods and services to the outside world, it is an inevitable part of the business infrastructure of a group of any significant size.

4.10 For example, if the relevant IP is a patent, only one company in the group can be the registered owner of the patent, so if other group companies want to use the patent, there have to be licensing arrangements. These could be formal or informal, written or merely customary, but they must exist. Good transfer pricing practice would prompt the group to make these arrangements formal and documented to record what price was to be paid, what expenses the local user was expected to incur, who would litigate if there were infringements etc. (Also from a litigation point of view the group would want both the IP owner and the user to have the right to sue which is another good, non-tax, reason for having documented licensing arrangements.)

4.11 Although it is not necessary to transfer the IP to a low tax jurisdiction before licensing it, in some industry sectors it is regarded as good practice to isolate valuable IP into a special purpose company. If the patent (to continue the previous example) is used to make drugs which result in unforeseen adverse side effects leading to expensive litigation, the group does not want its patent to be vulnerable to judgement creditors. This of course has absolutely nothing to do with tax planning. Where the tax planning comes in is that if a group has decided to have an IP holding company, it would not be
commercial for this company to be located somewhere which involved significant tax leakage, whether by way of taxation in the jurisdiction of residence or by way of withholding taxes on payments made by the licensees. We do not see that the choice of jurisdiction to simply avoid leakage, is objectionable. A group should be able to choose a sensible low tax jurisdiction.

4.12 Thus we do not think that a distinction between ‘front-line’ and ‘infrastructure’ activities should be drawn in the way that is implied by the examples in the Discussion Document. If we continue the drug making group example, the manufacturing, testing and selling of the drugs is obviously essential for earning the profits and may involve a lot of people, but there would be no manufacturing without the business infrastructure of legal rights to the patent, the factory premises, working capital etc. Both types of activity are as ‘normal/necessary/commercial/core’ as each other.

4.13 Businesses are entitled to choose a jurisdiction which has a good treaty network, even if the rates of tax there are low, in which to set up a properly resourced subsidiary operating in a commercial manner, whatever the function of the subsidiary is within the group. Why should a company have to choose a higher tax jurisdiction? If there are concerns that the low tax jurisdictions are offering unfair tax competition, they should be addressed through another BEPS action (harmful tax practices) rather than be introducing treaty provisions which exclude businesses from qualifying for treaty benefits (for example an LOB provision without an adequate derivative benefits provision) or which have uncertain application (for example a broadly drafted ‘main purpose’ anti-abuse rule). In addition, many of these perceived issues will also be addressed through the BEPS (and non-BEPS) work in respect of transfer pricing. Seeking to address and solve them through treaty changes simply adds unnecessary and unhelpful complexity to treaties for no real gain.

4.14 The recent global trend towards transparency of information and mutual exchange of information initiatives should go a long way to alleviate concerns over opportunities for abuse.

4.15 Further, we understand that seeking to enforce such a choice on companies would, in any event, be contrary to EU law and the principles of freedom of establishment and free movement of capital.

5 Part A – 1 Cases where a person tries to circumvent the limitations provided by the treaty itself

Part A. 1. a) Treaty shopping

5.1 The OECD model operates on the fundamental assumption that the treaty applies to persons who are residents of one or both contracting states (Article 1). Where this application is unqualified in the treaty, residents should, in principle, be entitled to the relevant benefits of a treaty. States are free to choose the criteria for determining residence under the domestic law, and free not to enter into treaties with countries who they regard as offering unduly preferential regimes. We think that persons who are resident under the domestic law of a contracting state and are thus liable to tax there should not be viewed as abusing the treaty if they meet with the agreed criteria for qualification for such benefits simply because, for example, they are members of a group which is headquartered in a third country. Indeed, it is a misuse of language to describe persons who fall within the chosen criteria as abusing the treaty. If treaties are concluded with countries that have beneficial domestic regimes, then those treaties should be respected.
5.2 If contracting states wish to limit such benefits only to a limited class of their residents ('qualifying persons' in both the existing and proposed LOB articles) then we regard that as an acceptable way of preventing treaty shopping because it can describe the circumstances in which residents of a third country might be precluded from establishing legal persons with a view to obtaining treaty benefits that they could not obtain directly.

5.3 A properly constructed LOB provision would tackle abusive arrangements whilst at the same time providing adequate certainty for tax authorities and taxpayers. To achieve this, the LOB provision needs to be as clearly drafted as possible and targeted on unacceptable access to treaty benefits.

5.4 However, the basic principle underpinning double tax treaties, namely, that residents of a contracting state are entitled to benefits should be maintained. For that reason, and to be consistent with the purpose of preventing improper use of treaties, the LOB should identify a disqualified residents rather than prescribing a limited list of qualifying residents.

5.5 The LOB provisions as found in many US treaties are not well understood and even the largest multinational groups have difficulties in applying them. We would not wish to see such a complex model being adopted. Although the provision proposed in paragraphs 11 to 17 of the Discussion Document is less complex than found in recent US treaties, it would still create significant practical difficulties if rolled out across many more treaties. Each tax authority would have to grapple with its interpretation from different perspectives, and any small differences in wording arising between different bilateral treaties would give rise to further uncertainty.

5.6 We question whether it is possible to simplify what is a complex provision originally devised by two sophisticated tax jurisdictions (US and Netherlands) into something that subsidiaries and tax authorities in various territories around the world could implement successfully. Therefore, we suggest that some time is spent considering what is required from first principles in order to produce a well drafted LOB provision and with a clear statement as to when residents do not qualify for treaty benefit which provides certainty and ease of administration for taxpayers and tax administrators alike.

5.7 i) **Limitation-on-benefits provision**

5.8 In order to demonstrate our concerns as to the problems of the proposed draft LOB provisions set out in paragraph 11 of the Discussion Document, we set out below some specific comments on the drafting.

5.9 The policy underpinning the requirement for companies to be ‘primarily traded’ in the state of residence is unclear as to precisely what is intended by these words.

5.10 The UK Listing Authority used to distinguish between ‘primary’ and ‘secondary’ listings; although the up to date terminology is ‘premium’ and ‘standard’, the differences being the extent of disclosure obligations on initial listing and continuing obligations and the circumstances in which matters must be put to shareholder votes. That seems an unlikely consideration for double tax treaties and in any event it is about ‘listing’ and the LOB drafting refers to ‘trading’.

5.11 There is no real indication what ‘primarily traded’ might mean and, we understand, that HM Revenue & Customs experienced similar difficulties when designing the exemption from stamp duty for dealings on AIM and other growth markets. We are
concerned as to how it would affect a company which has listings in different jurisdictions. It is possible that for some reason there could be considerably more activity on one exchange than on another. This is something outside the issuer company’s control, but could it lead to it to failing the test through no fault of its own.

5.12 Would it be necessary to think about shares which are represented by depositary receipts (DR) where technically the shares are immobilised in the DR issuer and do not technically trade? Also where a company has (say) sterling shares listed on the London Stock Exchange and dollar shares on NASDAQ (technically different classes), strange results could arise by trying to apply the ‘principal class’ of shares definition in paragraph 5 c) of the proposed Article X – there could be a situations where there is a single ‘principal class’ made up of both classes but only part of which is traded on the relevant exchange.

5.13 These points of detail can be resolved. However, it is first necessary to articulate the underlying policy with sufficient clarity. The location of the listing ought not to matter. There are a lot of companies that come to London, for example, for their listing even though they are not resident here. There is no obvious reason why the OECD should feel the need to deter them from doing so (for example if a Chinese company lists on the London Stock Exchange, but not on a Chinese exchange or its Chinese listing does not lead to significant trading, why should the Chinese company not be able to rely on the fact that it is a listed company on a reputable stock exchange?) or why treaty considerations should influence the decision as to where to list.

5.14 The US LOB provision specifically caters for listed unit trusts. The proposed draft article in the Discussion Document does not. Is this intentional? If not, which category would listed unit trusts fall into? Generally, we cannot see how investment funds would be able to access treaty benefits under the LOB provision as drafted. We think it is important that investment funds should be able to access treaty benefits.

5.15 The test based on ‘primary place of management and control’ is confusing and unnecessarily introduces a new concept. This is unhelpful. Place of effective management is the only rational expression in this context, not least because it is an existing concept.

5.16 Paragraph 2.c) ii) refers to ‘disproportionate class of shares’. We cannot follow what the ‘disproportionate class of shares’ is disproportionate to. Is it that they track the underlying income to manipulate access to underlying credits or that their return is disproportionate to the capital that they represent (or to the price which was paid for them, which is by no means necessarily the same thing)?

5.17 In paragraph 3 b) of the proposed Article, there is no indication what ‘substantial’ might mean. Is it measured by reference to profits? Turnover? Assets? Human capital? What is substantial? 5% 20% 50.01%? The test seems to favour companies which are based in big countries (such as the US). For example a UK parent company may have a UK trade but find that it has much bigger opportunities in the USA (or China or one of the BRICS). This will be a serious point for unquoted companies which cannot get into paragraph 2 c) (as they are not listed and not a consortia of listed companies) or paragraph 2 d) (not for ordinary commercial companies) or paragraph 2 e) (this test will always be difficult for companies with any private equity investment as it will be impossible to be sure that the test has been passed).

5.18 Finally, if the LOB provision is drafted as proposed we suggest there should be a provision giving a no-tax avoidance motive get-out. The current proposal is that
paragraph 4 only applies on a competent authority determination. This seems likely to be particularly onerous for the smaller, unquoted international business that may have problems fitting the other exemptions. This may not be necessary if the LOB provision is drafted as we suggest on the basis of a list of disqualified residents.

5.19 Derivative benefits provision

5.20 In our view it is imperative that any LOB provision as proposed in paragraph 11 should include a derivative benefits provision such as that envisaged in paragraph 13 of the Discussion Draft. Not having such a clause would create problems for many groups.

5.21 Centralisation of certain functions is a business reality, and is generally acknowledged not to be abusive as long as the return to the function follows economic activity.

5.22 A lack of a derivative benefits clause will leave groups relying on active trade or business test or discretionary tests, where functions such as IP management and treasury have been centralised, or regional headquarters companies have been established. Both of these tests are likely to be subjectively applied by tax authorities, leading to cases of potential double taxation, which taxpayers will increasingly seek to resolve through MAP.

5.23 Thus we suggest that a wide derivative benefits provision is required. In relation to the example set out in paragraph 15 of the Discussion Draft, we see no reason why OPCO 2 should not be entitled to treaty benefits for the arm’s length royalties paid by OPCO 1 if OPCO 2 is managing IP and entitled to an intangible related return under OECD transfer pricing guidelines, and not acting as a conduit. If there is a concern about State R’s ‘preferential’ tax regime, this is best addressed through Action 5 (harmful tax practices).

5.24 A group with a common set up such as this should not automatically be prevented from claiming treaty benefits as a result of an LOB provision. Surely the structure is only abusive if the subsidiary is set up in a treaty jurisdiction and is merely a conduit with no real substance? We suggest that to the extent that there is an objection to a structure such as this in certain circumstances, this would be better dealt with by Action 5 or, possibly, by effective exit taxes or controlled foreign company rules. There would be significant collateral damage from not sanctioning a suitable derivative benefits clause in order to seek to prevent a specific type of abuse which would be better tackled under a different BEPS action.

5.25 It is also our understanding that as a matter of European law, a derivative benefits provision is required. An LOB provision without one would breach the fundamental freedom of establishment as regards treaties between EU member states. We refer, in particular, to the Court of Justice of the European Union (CJEU)’s judgement in the 2002 Open Skies cases (C-466/98, C-467/98, C-468/98, C-469/98, C-471/98, C-472/98, C-475/98 and C-476/98) of 5 November 2002, in which the CJEU held that the ‘nationality clauses’ in eight EU member states bilateral international air transport agreements with the US were considered to be in breach of EU Law, that is contrary to the EU’s fundamental freedoms. In particular, the requirement in most of those bilateral agreements for > 50% of the shares in their national airline to be held by nationals of that airline’s home country breached the freedom of establishment of the EC Treaty (now TFEU).

5.26 This is an important point to take into account, because at the moment the OECD is proposing a form of LOB rule which 23 out of the 42 countries participating in the
BEPS project will be unable to adopt.

5.27 Similarly, in our view EU/EEA law, in particular the Papillon case (C-418/07) requires EU/EEA countries to be able to trace bilateral treaty entitlement via any EU/EEA country entity, and not just via the relevant EU/EEA country and its treaty partner entities. Likewise, the proposed paragraph 2c(i)A) requirement for shares to be traded on a local stock exchange should, to be EU/EEA law compliant be expanded to traded on a stock exchange anywhere in the EU/EEA, in particular per the CJEU's RBS case (C-311/97).

5.28 Finally, we would note that if the LOB provision is drafted as we suggest on the basis of a list of disqualified residents, it may be possible to avoid the complexities of derivative benefits, as residents who would be expected to qualify for derivative benefits would not be expected to be disqualified residents.

5.29 **ii) Rules aimed at arrangements one of the main purposes of which is to obtain treaty benefits**

5.30 A sensibly and clearly constructed LOB will achieve the objective of preventing abusive treaty shopping and makes the proposed ‘Entitlement to Benefits’ article in paragraph 18 of the Discussion Draft unnecessary.

5.31 We are especially uncomfortable with the proposed ‘main purpose’ anti-abuse rule. The application of this rule is inherently uncertain and is likely to give rise to disputes not only between tax authorities and taxpayers but between tax authorities with different views as to what is or is not acceptable. This will inevitably give rise to a significant increase in recourse to dispute resolution mechanisms and the MAP workload, and double taxation of the kind which treaties are intended to prevent. OECD statistics on existing MAP workload suggest very uneven success as well as always long delays and attendant cost in resolving disputes. This will, in practice, discourage cross-border investment particularly among smaller groups, by increasing the costs for them in doing so (for example in obtaining advice). It is also important not to forget that states also have an interest in being able to rely on taxing rights allocated to them under bilateral treaties – so uncertainty hurts states as well as taxpayers.

5.32 Although expressed as an anti-treaty shopping measure, the proposal goes far beyond that. Since it is unnecessary to achieve the anti-treaty shopping objective, and introduces an unacceptably high degree of uncertainty into the application of treaties generally, it is disproportionate.

5.33 The existence of a tax treaty or a tax treaty network concluded by a state, who respects its treaty obligations, is a commercially relevant factor in deciding whether to engage with the economy of that state. Thus commercial decisions and the availability of treaty benefits are frequently inextricably linked. This test is incapable of distinguishing purely tax avoidance driven decisions from commercial decisions.

5.34 Despite the helpful comments in paragraph 29 (about not ‘lightly assuming’ that tax avoidance is a motive), our concern is that a ‘main purpose’ anti-abuse rule would lead to many commercial arrangements being denied treaty relief, particularly if the business’s tax advisers (internal or external) have had any input into the decision making process; the commentary at paragraph 32 suggests that relief may be denied merely because the form of a transaction has been ‘driven by considerations of obtaining a treaty benefit’.

5.35 The suggested ‘main purpose’ anti-abuse rule is too wide, particularly because it is
drafted that the rule would apply if obtaining the treaty benefit was ‘*one of the main purposes*’. This provision would lead to a great deal of uncertainty for taxpayers as it would be very likely that different tax authorities would take different views on the same set of facts. The UK experience is that ‘one of the main purposes’ is a low bar and applies to many commercial situations. The UK typically includes additional taxpayer protections, such as in the enactment of the UK’s general anti-abuse rule. At the very least such a provision should be constructed on the basis that it only applies if obtaining the treaty benefit was ‘*the main purpose*’ – better expressed as ‘*the primary purpose*’.

5.36 Whilst it is recognised that the deterrence of taxpayers from the use of abusive avoidance arrangements is one of the desired effects of such a rule, it is contrary to the fundamental principle that taxpayers should be able to arrange their affairs with reasonable certainty of the outcome. It is noted that the inclusion of a ‘main purpose’ anti-abuse rule in the Model Treaty would be accompanied by detailed guidance on the type of arrangements that the rule is intended to catch. However, it is not considered satisfactory for taxpayers having to rely on guidance rather than clear legislative provisions – and there is significant risk that different interpretations would arise in different countries.

5.37 To the extent a general anti-abuse rule is required at all, we suggest that this should be constructed as an objective test – for example focussing on substance requirements - rather than a ‘main purpose’ test. An objective test would be more straightforward for tax authorities and taxpayers to apply, and also seems to better target the perceived abuse of artificially establishing SPVs to claim treaty benefits where none would otherwise be available: if a group makes the conscious decision to invest in appropriate levels of assets and personnel in a jurisdiction (for example, satisfying any substance requirements to qualify for any preferential tax regimes), why should it not be entitled to benefit from that jurisdiction’s tax treaties?

5.38 We would therefore consider that the better (although more onerous) approach would be to introduce targeted anti-abuse rules to combat identified areas of abuse.

5.39 In regard to the example given at paragraph 27 of the Discussion Document, if State R has no withholding tax on interest, then RCo can be seen as a conduit company. However, if State R has a withholding tax on interest then it makes little sense to deny treaty benefits under the R-S treaty.

5.40 In regards to paragraph 28, if a company changes its residence and becomes fully taxable in a new state where it is carrying on economic activities, in our view it should be entitled to treaty benefits.

5.41 In regards to paragraph 29-32, it should be explicitly stated that just because a beneficial tax result arises from a transaction, this does not of itself mean that tax advantage was a main purpose. Tax authorities are prone to assume that any tax benefit – however small – is a main purpose of a transaction, whatever the other commercial benefits that may arise.

5.42 With regard to paragraph 33 of the Discussion Document:

Example A: This is in effect the facts of the *Royal Dutch Shell* case on ‘beneficial ownership’ in the Netherlands Supreme Court. We can see no reason to suggest this judgment was wrong.

Example B: This is in effect the facts of the *Royal Bank of Scotland* case on ‘beneficial ownership’ in the French Supreme Administrative Court. The court
reached its conclusions on abuse on ordinary interpretation of the treaty without the necessity for either provisions proposed in the Discussion Document.

These cases demonstrate that existing treaty provisions are up to the task of preventing improper use and abusive treaty shopping.

5.43 In passing we would note that there are not very many cases of treaty abuse or treaty shopping, particularly in the UK courts. However, in the cases that have arisen, the courts have shown little tolerance for what might be perceived to be abusive arrangements in question without the need for such provisions. The cases Revenue and Customs Commissioners v Smallwood [2007] EWCA Civ 462, Bayfine UK v Revenue and Customs Commissioners [2011] EWCA Civ 304, and R (on the application of Huitson) v Revenue and Customs Commissioners [2011] EWCA Civ 893 are all on facts that arose some years ago. In each of these cases the courts took a robust line, suggesting that the existing treaty provisions work pretty well and do not require a radical overhaul.

6 Part A – 1 Cases where a person tries to circumvent the limitations provided by the treaty itself

Part A. 1. b) Other situations where a person seeks to circumvent treaty limitations

6.1 We suggest that the examples in paragraphs 35-56 of the Discussion Document do not so much reflect ‘abuse’ as indicate areas where it is suggested that the current boundary for source state taxation ought to be moved.

6.2 iv) Dividend transfer transactions

6.3 In respect to paragraph 43 of the Discussion Document, consideration should be given to ensuring the 25% holding requirement takes account of holdings under common ultimate ownership directly or indirectly.

6.4 We suggest that the subparagraph a) suggested for Treaties in paragraph 17 of the Commentary on Article 10 (discussed in paragraph 42 of the Discussion Document) should refer to the ‘primary purpose’ rather than simply the ‘purpose’.

6.5 With regard to the new minimum shareholding period to be included in subparagraph a) of Article 10(2), suggested in paragraph 43 of the Discussion Document, we do not think that this should necessarily include ‘the time of payment of the dividend’ because in circumstances where a company is acquired and joins a group or where there is a completely non-tax (for example local regulatory) reason why a transaction has to be concluded on a certain date, this requirement could lead to a denial of treaty benefits which seems unreasonable. We agree that there should be a lock down on artificial increases of ownership, but this needs to be distinguished carefully from a commercial transaction. One option could be to take account of prospective ownership, as well as prior ownership.

6.6 There is some inconsistency between the preamble in paragraph 16 of the Commentary on Article 10 (as set out in paragraph 42 of the Discussion Document), which refers to the time ‘when the dividends become legally available to the shareholders’ and the proposed new subparagraph a) of Article 10(2) which refers to date of payment. There may be some time between the date on which a dividend become legally available – that is the date on which it is declared – and the date on
which it is paid. We suggest that these provisions and the Commentary should be consistent in identifying which of these dates minimum shareholding periods should be linked to.

6.7 vi) Tie-breaker rule for determining the treaty residence of dual-residence persons

6.8 The proposed approach undermines legal certainty and the rule of law by placing the matter within the hands of the competent authorities without real guidelines or rules for them to apply. The mere assertion that there have been cases involving avoidance is insufficient to displace a legal rule with administrative power. The proposal assumes that the tie-breaker rule ought to be aimed primarily at preventing abuse and not at resolving double taxation. The two should be separated. No actual abuse is identified or explained. The problem should be identified and, if it exists, a solution may be found.

6.9 We think this issue would be best addressed by a recommendation for domestic legislation, such as that used in the UK. The primary rule for a UK-incorporated company is that it is resident for tax purposes in the UK. However, where residence is allocated to another country under a treaty, the company is automatically removed from UK residence. The result is that dual residence is avoided in a more straightforward manner.

6.10 Further, going through a competent authority process tends to be slow and expensive and there is no higher authority to give ‘case directions’ to control the process or to deal with the situation where the competent authorities do not agree with each other (and the more that treaties are expanded by the BEPS process, the more likely different interpretations in different jurisdictions and/or procedural break-downs become). This is principally why we would advocate sufficient and clear criteria in any LOB provision: so that the tie-breaker process is only required as a last resort and is not the primary route to resolve issues.

6.11 A sound principle based approach would involve reverting to the discussion in the 2003 paper on company residence and the communication revolution to consider whether the current single factor test continues to be appropriate in the 21st century.

6.12 Previously we have had a central control and management test which from a corporate point of view maps to things that the board does (or ought to do if its functions are not usurped) and an effective management test which can be regarded as the things you would expect executive management to do. The proposals seem to be heading for something that amalgamates the two as it suggests the need to look at the actions of directors and of executives and governing law. Such an approach would give rise to considerable uncertainty.

6.13 The relationship between these proposals and the proposed saving clause is unsatisfactory because it easily leads to double taxation.

7 Part A – 2 Cases where a person tries to abuse the provisions of domestic tax law using treaties

7.1 Paragraphs 57-70 of the Discussion Document deploy inverted logic (see especially paragraph 59). If the effect of a treaty is to override or modify domestic law then the expected consequence is that override or modification, including an override or modification of any measures in domestic law described as anti-avoidance. If contracting states wish to see a different outcome then the distributive provisions of
the treaty referred to should be modified to reflect the intended outcome. Again the examples appear to reflect a change of policy on where the boundary for source State taxation ought to be drawn.

7.2 It is incorrect to suggest that the use of treaty benefits in the circumstances described is an abuse of domestic law. The examples are simply the normal consequence of the existence of a treaty. The State entering into a treaty intends to confer the benefits set out in the treaty by accepting the modifications the treaty makes to its domestic law.

7.3 The discussion in paragraphs 68-69 of the Discussion Document on entitlement to treaty benefits is flawed. The basic structure of application of the OECD model is that dual residence (if it exists) must first be resolved and then the distributive provisions of the treaty applied. This is not an abuse but the essential way in which the model is constructed. Paragraph 68 is at odds with the decision in Smallwood.

7.4 The introduction of a saving clause frustrates the basic purpose of the treaty, because it subverts the mechanism for resolving one source of double taxation, namely tax as a resident of two states simultaneously. The long list of exceptions proposed illustrates the fundamental flaws in the concept. It will give rise to increased double taxation, particularly in the case of the UK where under the statutory residence test it is possible for an individual (but not a UK company) to be resident in the UK and another state at the same time.

8 Part B Clarification that tax treaties are not intended to be used to generate double non-taxation

8.1 The expression, being the second part of the work mandated by Action 6, that ‘tax treaties are not intended to be used to generate double non-taxation’ carries with it the implication of artifice. However, no attempt is made in the document to distinguish between double non-taxation that may occur as a result of the simple coexistence of national tax systems and the normal operation of tax treaties on the one hand, and transactions involving artifice that are regarded as abusive and which result in unintended double non-taxation on the other.

8.2 Consequently, reference to ‘unintended non-taxation’ or ‘unintended reduced taxation’ in the preamble would be more correct. In some cases, contracting states enter into treaties that seek to achieve double non-taxation and others either allow for it or do not exclude it for sound policy reasons. This does not contradict the object and purpose of double tax treaties. Subject-to-tax in clauses are designed to prevent double non-taxation. However, introducing such a general principle where it is unsupported by the terms of a treaty is only likely to cause confusion and uncertainty, thereby undermining the object and purpose of the treaty. Similarly we do not think that the term ‘treaty shopping’ is appropriate for the preamble to a Model Tax Treaty. While that phrase may be understood at a colloquial level, it is not sufficiently precise to be suitable for a legal document.

8.3 We reiterate our earlier points that this work on treaties cannot solve every perceived BEPS problem; in particular because of the collateral impact on commercial arrangements it should not be used as a substitute for action against tax regimes which are perceived to be unduly preferential. Some areas of perceived abuse would be better tackled through other action points.

8.4 The proposed preamble is, by itself unhelpful. It is no substitute for a clear description of the class of persons who qualify for treaty benefits. In the absence, for example, of an LOB
article such statements are only confusing, since, on its terms, the treaty would apply to any person meeting the residence requirements of Article 4, and subject to any specific limitations set out in the distributive provisions of the treaty. The proposed preamble should only be recommended where substantive general limitations on benefits are agreed by the contracting states.

9 Part C – Tax policy considerations

9.1 This is an important section. It should emphasise that states should have a clear understanding of the relevant rules of a state with whom they proposed to conclude a treaty. It should make clear that states that conclude treaties must grant the treaty benefits they have agreed, and should recognise the implications of their international obligations. In this respect states should be cautioned that the Model treaty functions as a precedent that must be tailored to specific circumstances.

9.2 The Model however also presupposes a comprehensive approach to the subject and proposed paragraph 15.2 should clarify that a comprehensive approach is recommended rather than picking out odd topics.

9.3 Proposed paragraph 15.1 should make clear that these paragraphs drafted in the context of the BEPS project, focus on the concerns of that project and are not intended to be a comprehensive statement on the policy issues on whether to have a treaty with another state and, if so, the terms of that treaty. It is noted that of the six proposed paragraphs, four are devoted to avoidance. It would be helpful to include some recognition of the other, positive, policy reasons to enter into treaties; that is to promote trade etc.

9.4 Proposed paragraph 15.3 should be rephrased to be clear that it is not an encouragement to unilateralism. States should be encouraged to conclude treaties rather than simply relying on unilateral measures. The fact that domestic law measures such as relief for foreign tax coincide with treaty provisions is not a reason for treaties not to exist. Treaties provide a measure of stability and certainty in framing the international tax order and states wishing to adopt different approaches should be encouraged to do so on a consensual, rather than a unilateral, basis.

10 The Chartered Institute of Taxation

10.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT’s work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members’ experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT’s comments and recommendations on tax issues are made in line with our charitable
objectives: we are politically neutral in our work.

The CIOT’s 17,000 members have the practising title of ‘Chartered Tax Adviser’ and the designatory letters ‘CTA’, to represent the leading tax qualification.

The Chartered Institute of Taxation
10 April 2014
Christian Aid Submission

Response to OECD BEPS Project

Public Discussion Draft BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

April 2014
Christian Aid is a Christian organisation that insists the world can and must be swiftly changed to one where everyone can live a full life, free from poverty. We work globally in over 40 countries for profound change that eradicates the causes of poverty, striving to achieve equality, dignity and freedom for all, regardless of faith or nationality. We are part of a wider movement for social justice. We provide urgent, practical and effective assistance where need is great, tackling the effects of poverty as well as its root causes.

Introduction

We welcome this discussion on tax treaties. Christian Aid has been engaged on tax justice for many years now. Ensuring and enabling developing countries are able to raise the revenues they need to be able to fund their own sustainable development is vital for eradicating poverty, as well as creating a long term sustainable global economy. There is significant concern over the role that tax treaties play in developing countries; there is a lack of evidence on the positive impact of tax treaties\(^1\), while evidence is mounting on the negative impact of treaties\(^2\).

The challenges that developing countries face as regards tax treaties are several, and go beyond the narrower framing of the discussion draft. As we feel that it is necessary to put the issue of tax treaties and developing countries into its fuller context we have therefore sought to address a wider set of issues than those identified in the discussion draft. In this response we have therefore decided to focus on the main issues that we have identified as regards tax treaties and developing countries:

- Treaty shopping/abuse
- Source and Residence issues
- The power disparities between developed and developing countries in negotiating treaties

Treaty Shopping

The impact of treaty shopping can be significant on developing countries; the apparent impact of treaty shopping by one multinational group in Zambia was some $17.8m in lost revenue over 5 years\(^3\). The cost to 28 developing countries of tax treaties with the Netherlands is estimated to be €771 on lost dividend and interest revenue alone\(^4\).

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\(^1\) See for example [http://www2.warwick.ac.uk/fac/soc/economics/news_events/conferences/peuk12/paul_l__baker_dtts_on_fdi_23_may_2012.pdf](http://www2.warwick.ac.uk/fac/soc/economics/news_events/conferences/peuk12/paul_l__baker_dtts_on_fdi_23_may_2012.pdf) - which argues that DTAs have no impact on FDI, and [http://personal.lse.ac.uk/barthel/docs/dtt_fdi.pdf](http://personal.lse.ac.uk/barthel/docs/dtt_fdi.pdf) which claims that they do.


\(^3\) [http://www.actionaid.org/publications/sweet-nothings](http://www.actionaid.org/publications/sweet-nothings)

The problem of round tripping is also significant, with India for example estimating that they lose up to US$600m per year in lost revenue due to round tripping with Mauritius.

While improvements in anti-abuse measures would hopefully provide some improvements in reducing treaty shopping, there are concerns over how easy it will be to enforce anti-abuse measures, especially for capacity constrained developing countries. Therefore as is Christian Aid’s recommendation on all BEPS actions, part of the criteria for assessing proposals in this area is how effective the proposals would be in developing countries, and to assess if there are alternatives that may be more effective. Furthermore it is also clear that anti-abuse measures alone would not solve all the problems faced by developing countries as regards treaties.

**Source and Residence Issues**

Many developing countries face challenges with high value functions being offshored, for example intellectual property and intra-company services. The challenge can come both through mispricing of transactions, but also through the limited source taxation of such functions. Treaties reduce further, and more permanently, developing countries abilities to impose taxes on these functions – e.g. through the reduction of withholding taxes on royalties, interests and dividends.

Capital gains tax appears to be a further area of concern, some treaties contain articles reserving all capital gains taxation to the residence state of the investor, these can then combine with rules in a contracting state exempting capital gains.

Greater source taxation, for example through withholding taxes and retaining rights to tax capital gains, would appear to be a relatively simple and potentially high solution for many developing countries seeking to tackle base-erosion and profit shifting.

As many countries have moved (or are moving) towards territorial taxation it would appear that the tension between source and residence taxation, and the potential for double taxation, is being progressively reduced, making it an appropriate time to review the appropriateness of current approaches to source and residence taxation and the most appropriate mechanisms to reduce the risks of double taxation.

**Power disparities**

Section C of the discussion draft appears to implicitly acknowledge this question on the appropriate mechanisms to reduce double taxation, by recommending policy considerations before deciding to enter tax treaties with other countries. What this section fails to do is to also acknowledge the disparities that can exist between the negotiating parties, and the duty of the more powerful party not to seek to abuse that power.

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5 http://uk.reuters.com/article/2011/08/09/column-dcjohnston-gateways-idUKN1E77726R20110809
7 See for example Alliance Sud’s research on Switzerland’s double tax treaties and their increasing focus on reducing withholding taxes.
8 For example Mauritius-Kenya and Mauritius-Nigeria treaties signed in 2012
Developed countries are often both more politically and economically powerful than developing countries, as well as better resourced to research, support and conduct a negotiation. Recent research on Switzerland’s tax treaties identified that Switzerland appears to be obtaining especially favourable treaties with developing countries, as a result of their increased bargaining power over developing countries.

There are increasing calls for the renegotiation of double tax treaties with developing countries, and it is welcome that some countries have agreed to offer renegotiation. However without addressing the issue of power disparity there are concerns that developing countries may not be able to realise the maximum benefits from such renegotiations.

The OECD appears to at least implicitly accept a need to address power disparities as it is noted in the discussion on mutual agreement proceedings that in such proceedings for developed countries ‘the question of an appreciation of the constraints on the developing country [...] will arise’. The OECD, IMF, UN and WB also addressed this issue in their joint report to the G20, noting that ‘[I]t is important that G20 countries recognise in their negotiations that reductions in a developing country’s taxing jurisdiction may significantly erode its tax base’. What is needed is to go beyond a mere ‘appreciation’ or ‘recognition’ to a clear acknowledgement and an agreed process to seek to minimise the impact of the imbalances in negotiation.

Recommendations

The discussion draft does not adequately address the needs of developing countries as regards tax treaties. While there may be some potential gains in tackling treaty shopping/abuse, it should be clear from the discussion above that more is needed to enable developing countries to be able to utilise tax treaties more effectively, as well as be better placed to explore alternatives to treaties.

We would therefore make the following recommendations:

- Ensure that new anti-abuse provisions are accessible to developing countries (both through ease of introducing to new/existing treaties and in enforcing the provisions easily)
- Enable reviews of the balance of source and residence taxation
  - This could be integrated with discussions elsewhere on how to implement transfer pricing and/or alternatives in developing countries.
  - This should take into account how moves towards territorial taxation may have changed previous assumptions on source/residence allocations and the incidence of double taxation.

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9 See [http://www.alliancesud.ch/de/ep/steuerpolitik/DBA-Studie%20bei%20WTI.pdf](http://www.alliancesud.ch/de/ep/steuerpolitik/DBA-Studie%20bei%20WTI.pdf) (especially page 2 and 22-23)

10 See [http://www.ft.com/cms/s/0/1560d626-16bf-11e3-bced-00144feabdc0.html#axzz2yJFNh3G1](http://www.ft.com/cms/s/0/1560d626-16bf-11e3-bced-00144feabdc0.html#axzz2yJFNh3G1) on the Netherlands agreement to renegotiate DTA with least developed countries


- This could include for example provisions for developing countries to increase withholding taxes.

- Create guidelines for OECD countries to follow when negotiating tax treaties with developing countries, especially low income countries, that seek to accommodate the differing powers and capacities of developing countries. These should include:
  - Requirements for independent analysis of the impact on tax base and revenues of the developing country.
  - Requirement that developing countries requests for renegotiation on development grounds be accepted promptly.
  - A process that reduces the opportunity for power imbalances to influence outcomes.
To: Tax Treaties, Transfer Pricing and Financial Transactions Division
OECD/CTPA
taxtreaties@oecd.org

9 April 2014

Dear Sirs,

Comments to Discussion Draft on the Abuse of Tax Treaties

Clifford Chance welcomes the opportunity to comment on the OECD Discussion Draft “Preventing the granting of treaty benefits in inappropriate circumstances” published on 14 March 2014.

Comments on the proposed limitation-on-benefits provision

1. In the field of application of anti-abuse rules and principles, the business and professional communities advocate the importance of certainty, which requires as an essential prerequisite the maximum possible clarity of the applicable provisions.

2. This is even more important in the international tax domain, where domestic tax systems, with their own laws, principles and interpretations, overlap, creating asymmetries and inconsistencies. Asymmetries and inconsistencies increase the risk of double taxation, whose avoidance should be the main purpose of double tax treaties. They also, of course, create an environment in which taxpayers will structure their affairs to either take advantage of the asymmetries or reduce their exposure to them; the kind of distortive behaviour that the BEPS Project was in large part created to counter.

3. We would also note that, in the current climate, some jurisdictions may consider the tightening of their approach towards the tax affairs of persons engaged in cross-border transactions as a useful revenue raising opportunity, thus further increasing the risk of asymmetries and inconsistencies in the application of the rules under consideration.

4. The need for clarity and consistency requires to the maximum extent possible provisions that may be applied mechanically, leaving the subjective judgement of tax
administrations to a minimum. LOB clauses such as the one proposed in the Discussion Draft (paragraphs 1 to 5) are a laudable step in this direction.  

5. Conversely, the proposed paragraph 6 would go in the opposite direction and should be reconsidered. Expressions like “it is reasonable to conclude” introduce a significant degree of subjective judgement and the associated ambiguity. What is reasonable for one person may not be reasonable for another. Most importantly, what is reasonable in the general tax environment of one contracting State may not be reasonable in the other contracting State.  

6. Similarly, the identification of whether a certain tax benefit was “one of the main purposes of any person concerned with an arrangement or transaction”, is largely subjective. Whilst a test of this nature may be appropriate in a domestic context (and is, for example, widely used in UK tax legislation) it is more difficult in a tax treaty context. A multinational business will have multiple ways of organising its affairs and, in choosing how to (for example) finance its subsidiaries, the availability of tax treaties will inevitably (and perfectly properly) be a key factor to be considered. Accordingly we would query whether a "main purpose" test has any objective meaning in this context. [There is a long-standing "main purpose" test in the UK, which I suspect has inspired this wording, so I think we need to make the point specific to tax treaties]  

7. To mitigate the risk and consequences of a mismatch in the interpretation between the contracting States, it might be advisable to make the disallowance of treaty benefits under anti-abuse rules and principles that are solely dependent on the interpretation by one of the contracting States subject to the mutual agreement procedure. Alternatively, it could be stated clearly that, before disallowing treaty benefit that have been bilaterally agreed with the other contracting State, the burden to prove that a given arrangement or transaction was motivated mainly by tax considerations should lie with the contracting State that intends to disallow the benefit.  

Comments on granting derivative benefits  

8. The granting of derivative benefits appears fully consistent with the approach that favours the maximisation of consistency in the international tax domain and is fully consistent with the increased significance of supranational aggregations of States (such as the European Union). The planning example provided to argue against the granting of derivative benefits has little to do with the abuse of tax treaties and is the direct consequence of a specific regime made available under the domestic legislation of a specific State. Should such regime be regarded as unwelcome, it should be addressed within the work in harmful tax practices.  

Comments on the examples  

9. The example in paragraph 31 lends itself to ambiguity and it may be used to argue that any tax benefit deriving from international mobility may be regarded as inappropriate. This conclusion would be against the very purpose and spirit of double tax treaties, which is to facilitate trade and investments between countries. If a person
decides to move residence and defers the sale of a property because the sale as a resident of the jurisdiction of destination would be subject to a more favourable tax regime, would this be an inappropriate use of tax treaties? This may be the case if the move is short-term in nature, or indeed if the taxpayer moves abroad, crystallises the gain, and then returns. But it should not be the case where there is a substantive long term change of residence. This is, however, not a distinction made by the example in paragraph 31.

10. The examples in paragraph 33 are somewhat simplified and, as such, unhelpful. For example, as to Example A, the arrangement may be part of a wider transaction under which the shares have been given to RCo as collateral on a financing transaction. And the cost of such financing may be influenced by the general tax regime of RCo, including the availability of treaty benefits. Businesses price their products and services aiming at maximising their after tax return; the availability of more favourable tax regimes might contribute to the determination of businesses to price more aggressively. Hence, it might be inappropriate in such circumstances to conclude that one of the main purposes of the arrangement was the obtaining of the benefits under the treaty.

11. In providing examples, careful wording should be introduced to clarify beyond doubt that those are just examples and are not to be considered as per se abusive transactions.

12. It may be appropriate to introduce wording to clarify that transactions between unrelated parties should be considered more benignly.

**Comments on policy consideration of entering into tax treaties**

13. It should be acknowledged that entering into double tax treaties is, for several jurisdictions, an important policy tool to improve the attractiveness of the jurisdictions with foreign investors. Hence, it should be considered that the existence of a tax treaty network may be one of the reasons why economic activities have been implanted within a given jurisdiction. Hence, when judging whether a given “arrangement or transaction” has been implemented chiefly to achieve a given benefit under a specific double tax treaty, due consideration should be given also to the possibility that a certain arrangement has been implemented to access a wider treaty network, which is normally exactly the reason why a certain State enters into double tax treaties. Other contracting states that believe that developing a wider treaty network to attract foreign investments is no longer an acceptable policy should refrain from entering into double tax treaties which such jurisdictions (or terminate the existing treaties) rather than leveraging on uncertainties to challenge taxpayers’ arrangements.

Yours Sincerely,

Carlo Galli – Head of BEPS Project

**Clifford Chance**
Response of the Commercial Real Estate Finance Council Europe to the OECD’s Public Discussion Draft BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

By email: taxtreaties@oecd.org
FAO: Tax Treaties, Transfer Pricing and Financial Transactions Division OECD/CTPA

9 April 2014

Dear Sir/Madam

BEPS Action 6: Preventing the granting of treaty benefits in inappropriate circumstances

We are grateful for the opportunity to comment on this important aspect of the OECD’s work.

CREFC Europe is the voice of the commercial real estate (CRE) finance industry in Europe, representing banks, insurers, fund managers and others providing or intermediating the provision of debt to real estate businesses, as well as advisers, consultants and others with a stake in this sector. It is our role to promote transparency and liquidity in CRE finance markets by developing and disseminating best practice and engaging with regulators and policymakers, so that our industry can flourish while playing its part in supporting the real estate sector and the wider economy.

Executive summary

In broad terms, we support the objectives of the OECD’s work in the area of BEPS and specifically to prevent the granting of treaty benefits in inappropriate circumstances. However, we believe that the specific proposals for taking forward this work are inconsistent with the report on The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles which was adopted by the OECD Committee on Fiscal Affairs on 23 April 2010 (the OECD CIVs report).

We believe that the current effort to limit the inappropriate use of tax treaties should recognise that for the most part, reliance on tax treaties by collective investment vehicles (CIVs) is not inappropriate. The current proposals should accordingly be modified so as to respect the approach reflected in the OECD CIVs report.

To that end, we support the submissions and recommendations of INREV\(^1\) and the BPF\(^2\) for amending the proposals contained in the public discussion draft so as to avoid needlessly undermining the valuable contribution that CIVs can make.

Background and reasoning

CRE is a central part of the built environment, representing a large proportion of the capital stock of developed economies and making a significant contribution to employment and economic growth. It forms a critical part of an economy’s business infrastructure, as well as providing space for citizens to work, shop and relax in, and diversified returns for investors. A sophisticated, diverse and

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\(^1\) INREV is the European Association for Investors in Non-listed Real Estate Vehicles.
\(^2\) The BPF is the British Property Federation.
professional commercial property investment industry allows our built environment to be managed on a smart, long-term and strategic basis, while also making it possible for ordinary businesses large and small to occupy premises flexibly according to their changing needs.

CRE is a fundamentally long-term, heterogeneous, illiquid and capital intensive asset class. It is also inevitably cyclical. Debt, as well as equity, capital is an essential input for the CRE sector to function effectively. The resilience of the sector, and the threat its cyclicality can pose to financial stability, is greatly affected by the extent to which its funding sources and management structures are diverse. For example, a market dominated by one source of debt and by property investors with a similar perspective and time horizon is likely to be more vulnerable to shocks than one in which different kinds of equity and debt investor are structurally well-represented. A less diverse market is less able to meet the needs of the economy across business and credit cycles, and can also pose significant risks to financial stability.

CIVs have an important role to play in supporting both CRE investment activity, and improved market and financial system diversification and resilience. They are often naturally international in nature, as both the sources of investment capital and the CRE in which that capital is invested may be international. As the OECD CIVs report recognises, their reliance on tax treaties is hardly inappropriate. We are concerned, however, that the proposals contained in the public discussion draft on preventing the granting of treaty benefits in inappropriate circumstances risks limiting the access of CIVs to treaty benefits. We believe that would be damaging not only for CIVs and their investors, but for the broader policy objectives discussed above.

CREFC Europe’s most direct interest is in encouraging the participation of CRE debt funds in the CRE finance market, not least to reduce Europe’s traditionally great (and risky) reliance on banks for financing CRE. However, our views are closely aligned with those of industry organisations primarily concerned with ensuring that CIVs investing directly in CRE can flourish. For that reason, and because of the limited time and resource we have had at our disposal to respond to the public discussion draft, we lend our support to the submissions made by INREV and the BPF.

Yours faithfully

Peter Cosmetatos
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Opinion Statement FC 5/2014 of the CFE

on the OECD Discussion Draft: Preventing the granting of treaty benefits in inappropriate circumstances (BEPS Action 6)

Prepared by the CFE Fiscal Committee

Submitted to the OECD

in April 2014
CFE (Confédération Fiscale Européenne) is the umbrella organisation representing the tax profession in Europe. Our members are 32 professional organisations from 25 European countries (21 EU member states) with 180,000 individual members. Our functions are to safeguard the professional interests of tax advisers, to assure the quality of tax services provided by tax advisers, to exchange information about national tax laws and professional law and to contribute to the coordination of tax law in Europe.

CFE is registered in the EU Transparency Register (no. 3543183647-05).

We will be pleased to answer any questions you may have concerning CFE’s comments outlined below. For further information, please contact Mr. Piergiorgio Valente, Chairman of the CFE Fiscal Committee, or Rudolf Reibel, Fiscal and Professional Affairs Officer of the CFE, at brusselsoffice@cfe-eutax.org.

Sincerely yours,

Confédération Fiscale Européenne

1. We are concerned that Action 6 seems to mix, and assimilate, many different issues: the existing rules for the allocation of taxing rights under domestic laws (apparently aimed to restore source taxation as if tax in the country of residence were tantamount to abuse), treaty abuse and double non taxation. Such confusion does not help to make the content of this discussion draft easy to follow.

2. If OECD is concerned that the existing rules on allocation of taxing powers are no longer adequate, it should consider a more fundamental reform of the Treaty Model rather than attempt to change the existing principles through restrictions on the use of the treaty.

3. The three areas, A B and C, identified by Action 6 do not correspond to the issues mentioned above. On the one hand, treaty provisions aimed at preventing treaty abuse should be dealt with separately from recommendations regarding the design of domestic rules. On the other hand, to clarify that tax treaties are not intended to be used to generate double non-taxation should also reflect the fact that double non-taxation is sometimes sought by the two contracting states in order to make investments more attractive. And lastly, the draft suggests that some countries may have been signing double tax treaties without a proper understanding of the tax consequences.

4. While CFE understands the wish to prevent treaty abuse, it is nevertheless concerned that too much effort may be being put on restricting the entitlement to the benefits of double tax treaties instead of addressing the many cases of double taxation that still arise. Many of the cases of alleged treaty abuse described in paragraphs 57-70 are no more than the consequence of the existence of an applicable treaty.
5. CFE believes that Limitation Of Benefit (LOB) provisions based on the US Model are exceedingly complex and very difficult to administer which should be avoided in a tax treaty. We would like to recall the principles set out by the OECD Committee of Fiscal Affairs in the Electronic Commerce study of 1998, principles that should also apply to the tax treaty rules: neutrality, efficiency, certainty and simplicity, effectiveness and fairness and flexibility.

6. The proposed LOB is inspired by the US model, which reflects a specific legal framework. It is doubtful that it would be useful in negotiations between countries whose legal systems do not resemble those of the US.

7. While LOB clauses ensure that treaty benefits are granted only to listed categories of residents (“qualifying persons”), they might deny benefits where non-qualifying persons are engaged in wholly commercial transactions. For example, LOB provisions could result in situations which are per se not abusive and might make the treaty inapplicable in situations involving Pension Funds.

8. CFE is of the view that taxpayers should be able to enjoy the benefits of tax treaties when they perform ‘genuine economic activities’ in the relevant Contracting State(s).

9. Consequently, CFE favours a purpose based approach that provides a more flexible approach to treaty abuse than LOB clauses.

10. It is also our belief that it is redundant to have at the same time a LOB provision and an anti-abuse general rule. A very well drafted anti-abuse general rule should encompass practically all situations that would be covered by the LOB provision.

11. In order to prevent treaty shopping one could consider the introduction of a ‘most favored nation’ clause in the OECD Model. Thus allowing residents of one contracting state to obtain benefits granted by the other contracting state to residents of third states. As a consequence, residents of a contracting state would not be inclined to establish e.g. intermediary structures in another state solely because this state has a more beneficial tax treaty with the other contracting state.

12. We would like to stress that EU member states are obliged to render full effectiveness to the Treaty on the Functioning of the European Union and its fundamental freedoms as interpreted by the European Court of Justice, in particular the freedom of establishment (Art.49). As a result of this, any recommendation contrary to the principles of EU law may not be followed by EU member states (21 of 34 OECD countries), with regard to intra-community dealings. We have doubts as to the compatibility of the proposed LOB clause with EU law and are concerned that EU member states will lose sight of their citizens’ and businesses’ fundamental freedoms, in search of a coherent implementation of any proposed OECD solutions.
13. Whatever the solutions adopted by the OECD, it will be crucial, in the CFE’s view, that they are adopted simultaneously by all OECD Member States, to avoid the competitive disadvantages that arise when countries operate incompatible provisions.
CBI RESPONSE TO THE OECD DISCUSSION DRAFT ON ACTION 6 (PREVENT TREATY ABUSE) OF THE BEPS ACTION PLAN

The CBI is pleased to comment on the OECD’s discussion draft on Action 6 (Prevent Treaty Abuse) of the BEPS Action Plan (‘the discussion draft’) published on 14 March 2014.

As the UK’s leading business organisation, the CBI speaks for some 240,000 businesses that together employ around a third of the private sector workforce, covering the full spectrum of business interests both by sector and by size.

Our comments

The CBI notes that our members have contributed to the BIAC comments on the discussion draft and fully endorse them. In addition, below we make some points of emphasis on matters which are of particular concern to businesses active in the UK. These are as follows:

• The discussion draft recommends the inclusion in tax treaties of a specific anti-abuse rule based on existing Limitation on benefits provision (‘LoB’) provisions. However, there is no ‘derivative benefits’ provision currently included. We would wish to see that included, especially as it is a feature of US treaties on which the LOB wordings are based.

• We are also concerned about little experience by tax authorities in applying LOB clauses and the degree of uncertainty this would introduce to business. This seriously undermines the desired objective of a consistent approach to the application of LoB clauses under this action point. It would therefore be helpful to have guidelines on the proper application of such clauses.

• To address forms of treaty abuse that would not be covered by the LOB provision, the discussion draft recommends adding to tax treaties a more general anti-abuse rule (‘GAAR’). We understand that the intention of such rule is to supplement the LOB provision. We note that many countries, including the UK, already have a GAAR. Further, such domestic law may have a ‘dominant purpose’ test, whereas the proposed rule simply has a ‘one of the main purposes’ test. This means there would be three levels of test (treaty LOB, treaty main purpose rule, domestic main purpose rule) all of which would need to be addressed, raising clear potential for conflicts of interpretation and application. While the CBI recognises that there are reasons to support either having an LOB article or a GAAR within the treaty, we do not support the inclusion of both.

• Finally, we note that the OECD’s BEPS Action Plan includes 15 distinct actions. Four of those actions will be completed by September 2014, three will be partially complete, and eight will be completed by September 2015. Each one of those 15 actions will interact with each other in ways that cannot be envisaged until all of the OECD’s proposals are finalised. We welcome the OECD’s work under action 15 on the development of a multilateral tool to implement the BEPS actions, however, there is a real risk that this tool alone will not be enough to guard against unilateral and inconsistent adoption of various BEPS Actions, which could be damaging for cross-border trade and investment.
Business is concerned that as the September 2014 actions are concluded, a number of countries may move quickly to adopt the OECD’s proposals on a unilateral basis without considering the potential interactions with future BEPS actions. We understand that other countries may not consider immediate action, instead choosing to wait for the outcome of the September 2015 actions, and to implement a selection of the proposals to target specific BEPS issues, but that minimises the potentially negative impact for cross-border trade.

These two opposing approaches will result in a potentially fragmented international tax system that will increase uncertainty, dispute, and the potential for double taxation. Therefore, the CBI encourages the OECD to establish a clear framework under which the OECD’s proposals, when finalised, should be considered and discussed by governments. Such a framework will provide the best chance of achieving a multilateral adoption of a clear, targeted set of proposals that best deals with the issues whilst safeguarding investment.
BEPS: Action 6 – Prevent Treaty Abuse – Concerns and Recommendation

A REPRESENTATION

April 2014
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BEPS: Action 6 – Prevent Treaty Abuse – Concerns and Recommendation

Background

On March 14, 2014 the Organization for Economic Co-operation and Development (‘OECD’) issued a discussion draft on ‘Preventing the granting of Treaty Benefits in Inappropriate Circumstances’ for public consultation. The discussion draft includes proposals for BEPS Action 6 (Prevent Treaty Abuse) for countering perceived abuse of tax treaties. This is one of the 15 action plans recognized by OECD for addressing the issue of Base Erosion and Profit Shifting (‘BEPS’) practices adopted by Multinational Enterprises (MNEs). The concern regarding BEPS was first highlighted by G20 lead of nations in 2011 and India being a part of G20 nations supports the OECD work on BEPS.

The discussion draft suggests amendments to the OECD Model Treaty and the Commentary. The proposals are primarily aimed at preventing abusive treaty practices. The amendments proposed are that tax treaties should contain a specific anti-abuse rule similar to the limitation on benefits provision found in U.S. India and Japan treaties. The treaties should also contain a main purpose test, a minimum shareholding period and other requirements to qualify for reduced source-country taxation. The discussion draft notes that a number of other additional treaty abuse provisions are being dealt with through other BEPS action plans. These include measures to ensure that treaties do not prevent the application of domestic anti-abuse provisions such as thin capitalization and provisions against hybrid transactions. The discussion draft also proposes changes to the title and preamble to Model Treaty to make clear that treaties are not intended to generate double non-taxation and to emphasize that they include the prevention of tax evasion and avoidance.

We recognize the efforts of G20 along with the OECD towards addressing the issues of treaty abuse. However, in view of the existing Indian tax system and the legal and economic environment in India, we foresee certain practical challenges with regard to the cross border transactions and implementation in the present form for companies operating in India. Accordingly, we wish to bring to notice the following challenges and recommendation for your kind consideration.

General anti-avoidance regulations

Concerns

The discussion draft proposes that the LOB provisions would be accompanied, by general anti-abuse rules (Treaty GAAR), intended to address perceived treaty abuse that are not otherwise addressed by the LOB provision. The Treaty GAAR would deny treaty benefits where “one of the main purposes” of an
arrangement or transaction is to secure such benefit, unless allowing the benefit in such case is “in accordance with the object and purpose” of the relevant treaty provision.

In the Indian context, under the domestic GAAR, an arrangement or transaction would fall under the ambit of domestic GAAR where “the main purpose” is to avoid tax. Accordingly, the provisions proposed in the Treaty GAAR containing the clause “one of the main purposes” vis-à-vis the domestic GAAR containing the clause “main purpose”, raises various uncertainties regarding their applicability.

Further, the domestic GAAR covers those cases where the main purpose of a step in, or a part of the arrangement is to obtain tax benefit, notwithstanding the fact that the main purpose of the whole arrangement is not to obtain such benefit. In contrast to this, in the case of Treaty GAAR, one of the main purposes of the arrangement in entirety needs to be evaluated. Therefore, uncertainty exists regarding which of the above terms would be considered to be wider.

One of the pertinent issues is the requirement of clarity on whether the LOB clause in Treaty GAAR would override domestic GAAR under all circumstances. As per India’s domestic law i.e. section 90(2A) of the Income-tax Act, 1961, GAAR would override treaty under all circumstances. The Shome Committee in India on GAAR has recommended that where treaty contains LOB clause, domestic GAAR should not override LOB clause. This recommendation is still under consideration and has not been incorporated into the main law.

The ambiguity and subjectivity around “legitimate business transaction” vs “tax avoidance transaction” would continue to prevail. More clarity is required on the transactions that would be considered as tax avoidance and transactions regarded as undertaken for legitimate tax benefit.

Recommendations

a) There is a need to realign “one of the main purposes” specified in LOB with “main purpose” specified under domestic GAAR. A provision could be drafted to specify that domestic law provisions should be re-aligned with the LOB provision, so that none of the domestic GAAR provisions are wider than GAAR.

b) The LOB clause should override domestic GAAR under all circumstances. As per the current regime, transactions where GAAR does not apply are granted treaty benefit. Similarly, for the transactions that would fall within the domain of GAAR, the wider anti-abuse provisions under treaty (as opposed to the domestic law) should apply.

c) Prior to the enforcement of Action 6 on prevention of treaty abuse, the domestic laws through a notification, should cite various examples to clarify as to what would fall within the ambit of tax avoidance and legitimate business transactions. These would serve as yardstick for the taxpayers to understand the law with greater level of clarity.
d) A mechanism should be established whereby taxpayers can approach the Competent Authorities in advance to get clarity on whether the proposed arrangement or transaction would be covered under LOB or not.

Absence of grandfathering provisions

Concerns

The discussion draft does not provide for grandfathering provisions for investments made prior to the insertion of LOB clause, which would have an adverse impact on existing international trade practices, structures and cross border transactions. On account of this, there are apprehensions prevailing over the applicability of LOB provisions. Specific to the Indian context, with reference to GAAR, the Shome Committee had recommended that all investments (though not arrangements) made by a resident or non-resident and existing as on the date of commencement of the GAAR, should be grandfathered so that on exit (sale of such investments) on or after this date, GAAR provisions are not invoked for examination or denial of tax benefit.

The absence of grandfathering provisions, similar to the ones specified above, would lead to uncertainty for investors.

Recommendations

(a) LOB provisions to necessarily contain grandfathering provisions that would clearly specify the effective date of their applicability.

(b) Investments and structures prior to the applicability of LOB should not be covered by such provisions, as these would cause significant hardship to taxpayers.

Dual-residency - Adjudication by Competent Authority

Concerns

The discussion draft prescribes in case a person, other than an individual, is a resident of both Contracting States, the Competent Authorities of the respective States would determine by mutual agreement, the Contracting State of which such person would be considered as the resident for the purpose of availing treaty benefits. The residence test would be determined on the basis of the place of effective management, place of incorporation and other relevant factors. Where such agreement could not be arrived at, such person may not be entitled to tax treaty benefits, except to the extent agreed by the Competent Authorities.
The determination of residency by Competent Authorities could be a time consuming exercise, considering in the Indian context, the authorities could be approached post issue of the assessment order by the initial level tax officer. The residency test is to be evaluated on a year-on-year basis. Approaching the authorities every year for this purpose would involve significant time and resources. The issue of whether collection of tax demand would remain suspended during the period the application remains with Competent Authorities needs to be addressed. Most of the tax treaties entered into by India does not contain provisions relating to suspension of demand collection. Therefore, there could be a possible requirement to re-negotiate tax treaty laws to provide for the same; else the revenue officers may not refrain from demand collection. The denial of treaty benefits to a person in case the authorities do not arrive at a conclusion is against the purpose for which tax treaties are entered into – to prevent double taxation for taxpayers.

We would like to invite your attention to a situation where the Indian holding company has a subsidiary in another contracting state, and the directors of such foreign subsidiary are tax residents of India. In such a scenario, the Indian income-tax authorities, based on the test prescribed in the discussion draft, are likely to hold that the place of effective management of the foreign subsidiary is in India. Accordingly, the treaty benefit to the foreign subsidiary is denied solely on the basis of the residency of its directors.

Recommendations

(a) There should be a mechanism to grant treaty benefit to taxpayers, even where the Competent Authorities do not arrive at a consensus. Legitimate tax treaty benefit should not be denied to a taxpayer.

(b) The time period of three years to approach the authorities after the receipt of the first notification from the income tax authorities (i.e. assessment order in the Indian context) could lead to significant delay in the decision making process of the authorities. This period should be reduced.

(c) There should be a time limit specified by which the authorities would be required to provide their resolution.

(d) A mechanism could be established whereby the taxpayers having uncertainty over their residency could approach the Competent Authorities in advance for determination of their residency in respect of a particular tax year.

(e) The provision for suspension of demand during the pendency of application with Competent Authorities should be made mandatory, so as to prevent aggressive measures for demand collection.
Limitation on benefits - Implementation

Concerns

The discussion draft recommends that treaties should include an objective LOB provision similar to that included in most US treaties (including India-US convention). The LOB provision is intended to address treaty shopping situations based on the legal nature, ownership in, and general activities, carried out by treaty residents. The provision generally restricts treaty benefits to treaty residents who are “qualified persons”.

The insertion of a combination of specific plus general anti-avoidance rules would lead to the possibility of litigation on account of aggressive positions adopted by revenue officers. Also, competent officers who are well equipped with the applicability of LOB provisions would be required.

The implementation of these provisions seem to be a big challenge in terms of re-negotiation of treaties (with or without LOB clause) already entered into by India and to bring the timelines of applicability of LOB provisions at par with other countries.

Recommendations

(a) A threshold limit may be prescribed for invoking LOB provisions, so as to put a check on those transactions where significant stake or profit shifting is involved.

(b) The LOB provision should specify that these provisions could be invoked only after seeking approval from higher level officers.

(c) The implementation of LOB provisions should necessarily be addressed by Action 15 (Develop a multilateral instrument), which should specify the procedure for execution by various countries and the timelines to be adopted.

Limitation in benefits for holding companies

Concerns

The draft report mentions that a resident of a Contracting State shall not be entitled to treaty benefits, unless such resident is a “qualified person” as per the definition specified. The exception to this relates to a situation where such resident is engaged in the active conduct of a trade or business, other than the business of making or managing investments for such resident’s own account. Further, the exception to this clause is available to a bank, insurance company or registered securities dealers.
The exception provided to banking, insurance companies etc. do not cover cases involving pure holding / investing companies carrying on the legitimate business of managing and enhancing the group’s investments. Denial of treaty benefit to such companies would be against the basic premise for which tax treaties are entered into.

Recommendations

a) Treaty benefit should not be denied on a blanket basis to holding / investment companies – this would deny treaty benefit even to legitimate structures.

b) The allowability of tax treaty benefit should be left to the tax authorities to determine on a case-by-case basis.

Derivative Benefits

Concerns

The provision intends to deny tax treaty benefit under circumstances where the benefit of a lower rate of taxation is proposed to be availed by moving the ownership of intangible property belonging to a parent company, to a subsidiary set-up in a jurisdiction having lower taxation regime. In the example specified in the Discussion Draft at Page 9, the taxation is presumed to happen in the State of residence and not in the Source State (State S).

In the event, the incidence of tax happens in Source State, then State S should be in a position to provide treaty benefit in respect of the income since there is no base erosion happening from State S perspective.

Recommendation

The derivative benefits should not be made applicable to situations where the income is taxed only in the State of residence, considering the base erosion is likely to happen in a situation where the profits are diverted from source State to State of residence.
The Confederation of Indian Industry (CII) works to create and sustain an environment conducive to the development of India, partnering industry, Government, and civil society, through advisory and consultative processes.

CII is a non-government, not-for-profit, industry led and industry managed organization, playing a proactive role in India's development process. Founded over 118 years ago, India's premier business association has over 7100 member organizations, from the private as well as public sectors, including SMEs and MNCs, and an indirect membership of over 90,000 companies from around 257 national and regional sectoral associations.

CII charts change by working closely with Government on policy issues, interfacing with thought leaders, and enhancing efficiency, competitiveness and business opportunities for industry through a range of specialised services and global linkages. It also provides a platform for consensus-building and networking on diverse issues.

Extending its agenda beyond business, CII assists industry to identify and execute corporate citizenship programmes. Partnerships with over 120 NGOs across the country carry forward our initiatives for integrated and inclusive development, in affirmative action, healthcare, education, livelihood, diversity management, skill development, empowerment of women, and water, to name a few.

The CII Theme for 2013-14 is Accelerating Economic Growth through Innovation, Transformation, Inclusion and Governance. Towards this, CII advocacy will accord top priority to stepping up the growth trajectory of the nation, while retaining a strong focus on accountability, transparency and measurement in both the corporate and social eco-system, building a knowledge economy, and broad-basing development to help deliver the fruits of progress to many.

With 63 offices including 10 Centres of Excellence in India, and 7 overseas offices in Australia, China, France, Singapore, South Africa, UK, and USA, as well as institutional partnerships with 224 counterpart organizations in 90 countries, CII serves as a reference point for Indian industry and the international business community.
Dear Mr. Saint-Amans,

The Confederation of Netherlands Industry and Employers VNO-NCW is happy to provide comments on the OECD Discussion Draft on preventing the granting of treaty benefits in inappropriate circumstances that was published on 14 March.

The comments are included in the annex. The main points that we would like to make are:

1. The principle purpose of tax treaties is to foster cross-border trade and investment by eliminating double taxation and creating certainty for taxpayers. VNO-NCW supports the principle that treaties should not create unintended opportunities for double non-taxation and treaty benefits should not be available in case of clearly defined abuse of treaties.

2. Tax competition has to be preserved. The contents of tax treaties are the prerogative of the contracting states. The OECD should not impede on this prerogative of contracting states, unless there is a question of harmful tax practices.

3. The Discussion Draft does not reflect on the purpose of tax treaties and the need to safeguard this purpose. Also, it does not define abuse of tax treaties. In addition, it does not offer an assessment of whether such abuse should be addressed domestically or through a (new) provision in the Model Convention. We feel these points should be explicitly addressed.
4. Tax treaties need to achieve a careful balance between eliminating double taxation and avoiding abuse of treaties. Giving the certainty to business that is required to make investment decisions and avoiding unnecessary compliance burdens, the rules for treaty application should be objective, clear and predictable and actions should be aimed at addressing clearly defined abuse and be proportionate.

5. We are concerned that the layering of multiple anti-abuse measures does not meet the conditions as set out above (under 4.) and therefore may not lead to strengthening of the international tax system, but rather result in more obstacles that could hamper cross border trade and investment and ultimately have a negative effect on global economic development, prosperity, growth and job-creation.

6. VNO-NCW thus is of the opinion that layering of anti-abuse provisions in tax treaties should be avoided. The Model Convention should be clear that either a Limitations on Benefits (LOB), or a General Anti-Abuse Rule (GAAR) approach should be adopted.

7. As currently drafted, VNO-NCW objects to both the proposed LOB provision and the Main Purpose Test as they would be contrary to the purpose of tax treaties and undermine their effect as a tool to facilitate enhanced cross border trade and investment.

   a. The proposed LOB provision is too complex and restricts application of the treaty where there is no treaty shopping or abuse. Furthermore, it is essential that an LOB contains a derivative benefits provision as well as a provision that gives treaty access to intermediate companies that are used for legitimate commercial reasons and have genuine economic substance, such as (regional) holding and treasury companies.

   b. It is imperative that a GAAR is well constructed and appropriately narrowly targeted against artificial structures and should even then be applied sparingly and with extreme care. The proposed wording is far too wide. It would cause unacceptable uncertainty for business and lead to a denial of treaty protection in cases where there is no abuse.

8. Additionally, both the proposed LOB provision and the proposed GAAR may be at odds with EU law. Further analysis on potential violations with EU law is needed.

9. Specific anti-abuse measures may be better suited to be implemented in domestic legislation than being included in tax treaties, specifically in situations where the application of the treaty yields a result that would defy the purpose of the domestic legislation.

10. Both states and taxpayers have to be able to rely on the fact that existing situations
are not subjected to abrupt changes to applicable tax rules as recommendations are implemented.

11. In order to resolve conflicts effectively, a more streamlined dispute resolution process is required with, ultimately, a mandatory binding arbitration mechanism.

We hope you will take our comments into consideration in further developing this action point. Of course, we are available to elaborate on these comments should this be helpful and we look forward to the public consultation on this important issue.

Yours sincerely,

Jeroen Lammers
Manager Fiscal Affairs
VNO-NCW comments on the Discussion Draft regarding BEPS Action Point 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances published on 14 March 2014

VNO-NCW welcomes the opportunity to provide comments to the Discussion Draft regarding BEPS Action Point 6 on preventing treaty abuse (hereinafter: Discussion Draft). VNO-NCW would like to make a few general remarks regarding the BEPS process, followed by general remarks concerning this Discussion Draft and concluding with more specific remarks regarding the recommendations in the Discussion Draft.

General Remarks concerning the BEPS process
The manner in which this Discussion Draft and the Discussion Draft on Action Point 13 dealing with Transfer Pricing Documentation and Country-by-Country Reporting are structured, give rise to some concern regarding the entire BEPS process. This concern mainly stems from the fact that the Discussion Drafts offer a stocktaking of possible ways to combat BEPS issues, rather than a targeted and proportional approach.

Even though it is understandable that it is very difficult to reach full consensus in the given timeframe and that the very nature of Discussion Drafts is to offer guidance to the discussion what is to be the best way to deal with BEPS issues, we feel that this approach might lead to either a situation where different states adopt different approaches and/or where states might want to adopt all proposed measures and thus create layering of different anti-abuse measures that will effectively create a lot of uncertainty and cumbersome administrative burdens for international business and cross border investment and trade. This would result in an obstacle for cross border business activity, because too far reaching measures to combat BEPS issues threaten to make competing on foreign markets difficult and thus incentivizes multinational corporations to withdraw to their domestic markets. The negative impact of these effects on prosperity, growth and job-creation will be specifically harsh for smaller economies, but ultimately they will have a negative effect on global economic development. VNO-NCW feels that this must be avoided.

We therefore would advocate that in the second phase of each BEPS action it is made clear that countries should make a choice between the different anti-abuse measures rather than implement a layer of multiple anti-abuse measures to ensure that the end result of the BEPS process does not create a disincentive for international business and cross border trade. It seems to VNO-NCW that this should also be perfectly aligned with the objectives and core values of the OECD.

General remarks on the Discussion Draft
The principle purpose of treaties is to foster trade and investment by eliminating double taxation and creating certainty for taxpayers. The purpose is not to eliminate taxation altogether or to eliminate double taxation for others than qualifying residents of the treaty countries. Any suggestion should take these principles into account as well as the subsidiarity principle: treaties should not attempt address issues that can better be addressed in domestic legislation. The current commentary to Article 1 of the OECD Model Convention already gives very sensible suggestions in paragraphs 7-25 and any work in this area should build on the existing commentary. The Discussion Draft in its current form fails
to follow these principles.

VNO-NCW feels that the Discussion Draft fails to reflect upon the purpose of treaties and it does not define abuse of tax treaties. In addition, the Discussion Draft does not offer an assessment of whether such abuse should be addressed domestically or through a (new) provision in the Model Convention.

Layering various and at times ambiguous anti-abuse measures on top of each other based on a number of possibly anecdotal and/or highly stylized examples instead of a proper definition of the abuse that should be addressed will make the Model Convention and its Commentary not only very complicated, but will make tax treaties as a whole very unpredictable and thus making it impossible to deliver on their principle purpose of fostering trade and investment by eliminating double taxation and providing certainty to taxpayers. In fact, the opposite will be achieved.

Additionally, it remains to be seen also whether all the countries whose tax base should be protected by the proposed changes will be able make effective use of these layered measures. The quoted Limitations on Benefits (LOB) article for example is so complicated that many tax administrations will struggle to apply it in practice.

Addressing abuse should start by defining which abuse should be targeted and identifying the possible sources of abuse, based on actual data. Secondly these need to be sorted based on whether they need to be addressed through the treaty or domestically. For those types of abuse that can be dealt with through the treaty and the commentary sensible approaches – as suggested in the current commentary – should be further developed by the OECD. All others need to be addressed domestically. The current Commentary also offers guidance there through a range of potential solutions, such as anti-conduit legislation in paragraphs 13-15 of the Commentary.

As far as solutions are to be delivered through the treaty, these solutions should be effective and proportionate in combating abuse as well as being clear and predictable enough to offer certainty especially to the taxpayers not involved in treaty shopping. Layering various instruments on top of each other will fail to meet these two requirements. Using broad ranging language that can be interpreted in multiple ways such as the suggested ‘one of the main purposes’ test, or overly complicated LOB clauses will also fail to deliver these. To achieve the objectives set out without leaving business with significant administrative burdens on top of great uncertainty, it is essential that tax treaties of contracting states include both objective criteria that give access to the treaty and adequate, objective, clear, predictable and proportionate measures to combat possible abuse. VNO-NCW feels the discussion draft does not deliver on these points yet.

**The purpose of tax treaties needs to be safeguarded**

As stated in the Commentary on Article 1, paragraph 7: “The principal purpose of double taxation conventions is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons. It is also a purpose of tax conventions to prevent tax avoidance and evasion”. Preserving this purpose should be
paramount. Research by CPB Netherlands Bureau for Economic Policy Analysis\(^1\) proves that tax treaties increase foreign direct investments significantly. The study shows that the increase is about 16 percent; for new treaties this is even 21 percent. Moreover, the EU parent subsidiary directive doubles bilateral foreign direct investment stocks. And as a result of these foreign direct investment there is more economic growth. This means that tax treaties are a vital part of the international investment climate and contribute significantly and positively to the development of national economies and growth.

Therefore it is of the utmost importance that the instrument can work as efficiently and productively as possible. This also means that if abuse of tax treaties occurs that this has to be dealt with in a proportionate manner. The OECD has done a lot of work on combatting treaty abuse. The Discussion Draft describes in broad strokes the actions taken since 1977 until present day.

Making sure that the treaty benefits are reserved for and limited to the parties intended is also warranted. It is in the interest of both the contracting states and business to restrict access to tax treaty benefits to companies or individuals for which these were intended, and exclude these benefits for instance if they represent no economic activity and presence in the relevant territories.

At the same time, legal certainty is paramount for business to make investment decisions. This means that access to treaty benefits has to be able to be established before making the investment decision. This in turn can only be achieved if the criteria for treaty application are objectively defined in the treaty. Otherwise, the investment simply will not take place.

**Definition of abuse is needed for targeted and proportional approach**

As mentioned in the Commentary to Article 1, paragraph 7, in addition to the principal purpose of eliminating double taxation it is also a purpose of tax conventions to avoid tax avoidance and tax evasion. Tax conventions need to achieve a careful balance between these two goals, and the Commentary to the model treaty provides a number of suggestions as to how both purposes can be achieved at the same time. The Discussion Draft however does not address this balance and instead offers a layering of various provision which eventually will make the tax convention ineffective; either because it is overly complicated, or because the terms used are vague to an extent that any transaction is captured. This means that instead of clear and predictable rules, the Discussion Draft will lead to more uncertainty.

VNO-NCW feels the Discussion Draft does not address the importance of finding the right balance between enabling investments, providing certainty, avoiding both double taxation and tax avoidance / evasion and preventing abuse. There is a need for a targeted and proportional approach. With the current approach the Discussion Draft unfortunately creates an overly complex tax situation for all international business, while a specific focused approach on treaty shopping is required.

As stated above, to be able to target only the abuse a clear definition of what constitutes

abuse is indispensable. For this purpose the remark in paragraph 29 of the Discussion Draft should be considered that “it should not be lightly assumed that obtaining a benefit under a tax treaty was one of the main purposes of an arrangement”. VNO-NCW feels that a comprehensive definition should be added to the Discussion Draft. We would propose to use the definition suggested by Van Weeghel. This means that there would be abuse of tax treaties in those situations where the particular use of a tax treaty $i$ has the sole intention to avoid the tax of either or both of the contracting states, and $ii$ defeats fundamental and enduring expectations and policy objectives shared by both states and therefore the purpose of the treaty in a broad sense.

According to van Weeghel, the term treaty shopping connotes a situation in which a person who is not entitled to the benefits of a tax treaty makes use – in the widest meaning of the word – of an individual or legal person in order to obtain those treaty benefits that would not be available to him directly. In our view this relates to wholly artificial situations designed to gain access to a certain tax treaty where the taxpayer would not have access without it. Consequently, in determining whether or not the taxpayer would be entitled to the benefits of the tax treaty concerned and therefore if the use of the treaty should be regarded as abusive, the purpose, expectations and policy objectives of the contracting states that concluded the tax treaty cannot be ignored. Of course, if the contracting states modelled their treaty after the OECD Model Convention it is to be expected that the policy intentions are in line with that provided in the Commentary, insofar contracting states have not made exceptions to the Commentary of the OECD Model Convention or the treaty concerned.

The Discussion Draft therefore does not directly address the question whether the policy decisions of contracting states could negate the claim that there is abuse of tax treaties. In fact, the Discussion Draft appears to largely ignore this possibility, outside the recommendation under 4. that a statement is to be included in the preamble of tax treaties that the treaty is not intended for creating opportunities for tax evasion and tax avoidance. Later on this recommendation will be examined further.

**Tax competition needs to be preserved**

For all BEPS Action Points international consensus on the actions and their interpretation is key. Otherwise it will lead to more BEPS related issues. However, the contracting states are first and foremost responsible for the content of their tax treaties. This means that the content of a treaty and the conditions under which the benefits of a treaty are granted, are a form of (benign) tax competition. And as such VNO-NCW feels that the content of the tax treaty should be the prerogative of the contracting states. The OECD should not impede on this prerogative of contracting states, unless there is a question of harmful tax practices.

For that reason VNO-NCW recommends that – rather than trying to put a double or even triple lock on the door in tax treaties and denying tax benefits to companies making use of treaties in a way that stays well inside the intentions of the contracting states – the issue of treaty abuse is dealt with under Action Point 5 in the sense that failing to include an

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3 *Id*, p 119.
adequate anti-abuse provision in tax treaties should be deemed harmful tax competition. In doing so, the responsibility to prevent treaty abuse is put at the appropriate level, namely the contracting states, rather than putting companies at fault for responding to express policy intentions. What should be considered an adequate anti-abuse provision should be left up to the contracting states, so the provision can be bespoke to their specific needs. Of course, the OECD can offer very helpful guidance in designing the appropriate anti-abuse provision. Furthermore, positioning the absence of an adequate anti-abuse provision in tax treaties under Action Point 5 rather than Action Point 6 increases the chances that all treaties (both in effect and still to be concluded) would apply the same template and thus actually strengthens the integrity of the tax system and furthers a global level playing field, rather than impose more sanctions and double taxation on business.

In any event, VNO-NCW is of the opinion that layering of anti-abuse provisions in tax treaties should be avoided as this will most certainly lead to overkill in the sense that access to treaty benefits will (have to) be denied in situations that do not constitute abuse and thus ultimately defeat the purpose of the treaty. The Model Convention should be clear that either an LOB, or a General Anti-Abuse Rule (GAAR) approach should be adopted. If they are well constructed and appropriately narrowly targeted against artificial structures, then they should in principle address the same scenarios, whilst not denying treaty benefits for genuine commercial arrangements.

Specific remarks on the recommendations in the Discussion Draft
The Discussion Draft recommends:
1. to include a series of instruments in tax treaties to counter tax treaty abuse, in particular treaty shopping, which consist of:
   a. a limitation-on-benefits provision, such as included by the US in its tax treaties;
   b. a general anti-abuse rule in the form of a ‘main purpose test’; and
   c. other anti-abuse provisions for certain specific situations, such as for dual-resident entities and for low taxed permanent establishments in a third state (triangular cases);
2. to ensure that treaties do not prevent the application of specific anti-abuse provisions in domestic laws;
3. to include in the OECD model tax treaty a clear statement that tax treaties are intended to eliminate double taxation without creating opportunities for tax evasion and tax avoidance; and
4. to amend the introduction to the OECD model tax treaty to provide for a clearer articulation of the tax policy considerations that are relevant to the decision of whether to enter into a tax treaty or amend an existing tax treaty.

Below, the separate recommendations will be discussed in more detail.

Measures aimed at preventing treaty shopping
VNO-NCW feels that all measures to combat unintended double non-taxation should remain within the arm’s length principle. Where it is clear that a transaction is upheld by a proper analysis of functions carried out, risks taken and assets used and adequate substance is present, it should be clear that there is no question of abusive behaviour, or trying to gain
access to a tax treaty where this access would not be available directly. Business must be able to organise their affairs in a way that is commercially optimal and concentrate their activities in their global value chain as they see fit, as long as adequate substance is attributed to these activities and the accompanying transactions are according to the at arm’s length standards. This is vital to achieving to improving the international tax system, strengthening the integrity of the tax system and furthering a global level playing field and at the same time improving certainty for international business to foster cross border investments and trade.

**Limitations on Benefits provision**

VNO-NCW objects to the LOB provision as it is currently drafted. The proposed LOB provision is, to say the least, very complex. An LOB clause has to be simple and targeted, such that it can actually be applied by tax revenue services around the world.

Furthermore, it is essential that an LOB clause contains a provision that gives treaty access to intermediate companies that are used for legitimate commercial reasons and have genuine economic substance, such as (regional) holding and treasury companies. The draft proposed will unnecessarily restrict the application of a treaty where there is no treaty shopping or abuse. VNO-NCW is of the opinion this is insupportable.

Another improvement that could be made still is an effective procedure to get upfront clarity on whether the provision applies or not. In paragraph 4 of the proposed LOB clause is a statement that “the competent authority of the other Contracting State shall nevertheless treat that resident as being entitled to the benefits of this Convention, or benefits with respect to a specific item of income, if such competent authority determines that the establishment, acquisition or maintenance of such person and the conduct of its operations did not have as one of its principle purposes the obtaining of benefits under this Convention”. The words “one of its principal purposes” are virtually the same as the words “one of the main purposes” in the proposed paragraph 6. These words are far too wide and as a result genuine commercial arrangements could be caught by it. For that reason, the provision needs to be far more focussed in order to retain clarity and certainty for the majority of taxpayers. We would point to the criteria in the ECJ case Cadbury Schweppes where the test was one of whether a structure was “wholly artificial”. This is also the criterion that must be applied between EU Member States.

Also, this procedure would be considerably more effective if such assessment would be made by the resident state. After all this is the state where it needs to be established that the “establishment, acquisition or maintenance of such person and the conduct of its operations” was not wholly artificial. Alternatively, the assessment could be left to either competent authority. Finally, it could be established that such assessment can also be requested if there is a doubt as to whether paragraph 2 of the LOB article applies.

It is important that the LOB is interpreted in a consistent, uniform way by the Contracting States and should provide certainty in order to avoid double taxation. The mutual agreement procedure, together with the possibility for Contracting States of moving to arbitration (paragraph 81-15.5) should be seen as a last resort.
Derivative benefits provision
VNO-NCW stresses the need to include a derivative benefits provision in the LOB. Inclusion of a derivative benefits provision is crucial to show that the existing situation does not have treaty shopping as its purpose. In addition, the derivative benefits provision should not be too strict on comparability to avoid exclusion of treaty benefits in situations where treaty shopping is not the purpose.

Main purpose test
As noted above, we feel that both a GAAR and an LOB approach will lead to increased complexity, uncertainty, and administrative costs. In the interest of clarity and certainty one or the other should be adopted in the treaty.

In the Discussion Draft the main purpose test is essentially set up as a GAAR. This means that it functions as a catchall measure and as a result treaty benefits can be denied because a transaction – although qualifying under the rules of the treaty – is deemed to “be contrary to the object and purpose of the relevant treaty.

A main purpose test should be applied sparingly and with extreme care to avoid running the risk of inadvertently, but effectively annulling the actual purpose of the tax treaty and thus throwing away the baby with the bath water. For that reason it is imperative that a GAAR is well constructed and appropriately narrowly targeted against artificial structures.

We feel that the GAAR as proposed in the Discussion Draft fails to meet this requirement. The wording is far too wide and as a result genuine commercial arrangements could be caught by it. For that reason, the provision needs to be far more focussed in order to retain clarity and certainty for the majority of taxpayers. We would point to the criteria in the ECJ case Cadbury Schweppes where the test was one of whether a structure was ‘wholly artificial’. This is also the criterion that needs to be applied between EU Member States.

Tax costs always play a role in investment decisions. This in itself cannot be enough to deny treaty benefits as a result of the main purpose test. This notion seems to be affirmed in paragraph 29 and 30 of the Discussion Draft. However, in paragraph 31 of the Discussion Draft so much room is left to discard other purposes for the transaction, that it remains unclear how much weight can be allotted to other purposes outside obtaining the treaty benefits. The examples in the Discussion Draft also do not offer much in the form of comfort, because these situations would hardly occur in every day practice due to their highly stylized nature. Because of this they seem clear at first glance, but in fact rather lead to confusion than offer clarity.

Concerning the examples given:
Example A and B: In these examples it is not clear why there could be no doubt as to whether it would be contrary to the object and purpose of any and all tax conventions concluded. The purposes and intentions of the contracting states are ignored as is the question whether there is a genuine transfer of risks, rewards and beneficial ownership of flows. OECD seems only to state here that it should be contrary to the object and purpose.

Example C - It seems very arbitrary that it seems acceptable to cite lower manufacturing
costs as a valid reason to decide on an investment in a certain territory, but citing lower tax
costs cannot be. The main deciding factor here however seems to be that economic
activities in State R will be an expansion of the original activities of RCo instead of
financial services. This however is a distinction that will proof impossible to maintain in
practice. There is no compelling reason why one business activity should be regarded
differently from another, just because the latter appears to be more intangible than the
former.

The Discussion Draft creates a situation where there is no legal certainty as to the tax
treatment of genuine commercial investments with the risk that those investments do not
take place at all, so that the economic development of the territories in question may suffer.

Additionally, the main purpose test warrants analysis in the light of EU law. Given the fact
that the language in the Discussion Draft is so wide, it could be argued that EU Member
States would not be able to adopt such a wide provision within the EU and therefore would
not be able to adopt the provision in these instances.

Anti-abuse provisions for situations where a person seeks to circumvent treaty
limitations
Paragraph 34 of the Discussion Draft states that having a general anti-abuse rule to
determine that it is inappropriate to grant the relevant treaty benefits, leads to uncertainty in
the application of the treaty, whereas specific treaty abuse rules provide greater certainty for
both taxpayers as tax authorities. Specific anti-abuse rules are therefore preferable over
general anti-abuse rules. However, specific anti-abuse measures also might be better suited
to be implemented in domestic legislation, rather than being included in tax treaties. In the
view of VNO-NCW a distinction should be made between situations where treaty
limitations are being circumvented and situations where the application of the treaty yields a
result that would defy the purpose of the domestic legislation.

The examples mentioned in the Discussion Draft are all fairly specific situations that are
very fact dependant. As such they could be much better dealt with under domestic
legislation as dealing with these in the treaty could even give unwanted results.

For instance, regarding specifically the proposed changes on tie-breaker rule for
determining the treaty residence of dual-resident persons other than individuals the effect
could be that if competent authorities agree to disagree the relevant tax treaty would not
apply at all. This is far from the purpose of the concluded tax treaty by the contracting
states.

Therefore we propose to keep the current “place of effective management” in order to
realize a uniform approach. This should also serve to increase certainty and minimize the
number of disputes. As a result, the mutual agreement procedure, together with the
compulsory arbitration would only be needed in specific circumstances. For these
circumstances, the OECD should provide a set of clear procedural rules to ensure timely
and binding outcomes that provide upfront clarity for the taxpayers involved. The OECD
should not leave this to the individual countries without further guidance.
With respect to paragraph 43 regarding dividends the aim must be primarily to remove double taxation, whilst protecting against abusive behaviour. We therefore recommend to the minimum holding period should not apply to bona fide circumstances, e.g. following acquisitions from third parties. In other situations we would propose to have a 3 month holding period.

Additionally, we would recommend reducing the minimum shareholding from 25% to 10% in line with the EU parent-subsidiary directive. In any event, even if a minimum holding period is not met this does not necessarily mean there is an abusive situation. The taxpayer should therefore be able to submit evidence that the application of treaty benefits would in that case be justified.

Measures that prevent domestic anti-abuse rules to be circumvented
Both the Commentaries on Article 1 of the OECD Model Convention and the UN Model Convention address the interaction between tax treaties and domestic anti-abuse provisions. From these Commentaries follows that certain domestic anti-abuse rule can be applied insofar a transaction constitutes an abuse of the tax treaty. Also, from the OECD Commentary on Article 1, paragraph 9.2 follows that, as a general rule, there will be no conflict between domestic anti-abuse rules and the application of the tax treaty. Therefore it is not precisely clear which problem the Discussion Draft is aiming to solve.

The Discussion Draft recommends including a provision that has the same effect as the ‘saving clause’ that the US includes in their tax treaties. This added clause confirms the principle that the tax treaty does not restrict a contracting state’s right to tax its own residents except where this is intended.

This clause sanctions treaty override where a transaction constitutes an abuse of the tax treaty. In and of itself this might not be a big problem. However, as stated above the recommendations to introduce an LOB clause in combination with a main purpose test makes that it is possible that more and more situations could be (inappropriately) judged as abusive. As a consequence the function of tax treaties would be inadequate and business investments would thus be exposed to the undue risk of double taxation.

Recommendations to clarify that tax treaties are not intended to be used to generate double non-taxation
The practical implications seem limited of including a statement in the preamble that contracting states that enter into a tax treaty intend to eliminate double taxation without creating opportunities for tax evasion and tax avoidance. This certainly already was the case as far as tax evasion is concerned. Implicitly this also already should be the case for tax avoidance, as one could argue that tax avoidance resulting from the use of a tax treaty is contrary to its object and purpose. The claim made in paragraph 76 that the statement in the preamble will be relevant to the interpretation and application of the provisions of that treaty is fairly relative.

VNO-NCW supports the notion that the object and purpose of a tax treaty should be to eliminate double taxation and prevent tax evasion and tax avoidance. Including this statement in the preamble however gives very little guidance as to the expectations and
policy intentions of the contracting states. In any event, a statement that the purpose of a treaty is to prevent tax avoidance is meaningless if it is not clear what it is that should be prevented. This underlines the need formulated above to come to a comprehensive definition of abuse of tax treaties.

For the expectations and policy intentions to be clear it is important that these expectations and policy intentions are also explicitly included in the preamble, or at the least it should be made explicit that the policy intentions of the contracting states are in line with the Commentary to the OECD Model Convention, insofar contracting states have not made exceptions to the Commentary of the OECD Model treaty or the treaty concerned. This would truly be very helpful in the interpretation and application of the provisions of that treaty.

In that sense, VNO-NCW can support the recommendations made under paragraph 81. of the Discussion Draft.

**Implementation of new provisions must not be effective retroactively**

In the interest of clarity and certainty we feel that it is crucial that it is made clear from the outset that measures – both in the Model Convention and domestic legislation – to be taken aimed at preventing abuse of tax treaties cannot be enforced retroactively. In addition, business must be able to rely on the fact that commercial arrangements that are not deemed abusive and where the taxpayer has no reason to expect otherwise, that changes to the Model Convention do not automatically result in denial of treaty benefits.

This means that insofar proposed measures would lead to changes in the Commentary, but not in the actual provisions of the Model Convention, a certain period is recommended for the effectuation of these changes. That would provide clarity between States and taxpayers and ensures stability for the short to medium term so that taxpayers are not subjected to abrupt changes to applicable tax rules.

The Confederation of Swedish Enterprise is pleased to provide comments on the OECD Discussion Draft entitled “BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances” 14 March 2014 – 9 April 2014 (hereinafter referred to as the Draft).

General Comments

Action 6 on Treaty Abuse reads as follows:

“Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. Work will also be done to clarify that tax treaties are not intended to be used to generate double non-taxation and to identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country. The work will be coordinated with the work on hybrids.”

The following three areas are identified in Action 6:

A. Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances.

B. Clarify that tax treaties are not intended to be used to generate double non-taxation.

C. Identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country.

The Confederation of Swedish Enterprise supports the OECD’s work to clarify the purpose of tax treaties. The initial and prime objective with tax treaties is and should continue to be to facilitate cross-border trade through the allocation of taxing rights
between countries and to provide for mechanisms to eliminate double-taxation. By doing so, tax treaties provide certainty and eliminate major obstacles to cross border trade.

The introduction to the commentary recognizes the harm of international juridical double taxation:

“its harmful effects on the exchange of goods and series and movements of capital, technology and persons are so well known that it is scarcely necessary to stress the importance of removing the obstacles that double taxation presents to the development of economic relations between countries”.

In light of what is stated in Action 6 however, we believe that the importance of certainty and the harm of double taxation need to be stressed. The proposal at hand aims at preventing the granting of treaty benefits in inappropriate circumstances. Misuse of treaty provisions undermines the integrity of a tax convention and should of course be addressed.

However, preventing tax avoidance and evasion in general, or treaty abuse in particular, should not be a main objective for entering into a tax treaty. When negotiating a treaty, countries should naturally aim at designing the treaty in a way that does not open up for unintended non-taxation. However, the need to prevent tax avoidance and evasion does not by itself trigger countries to negotiate a tax treaty. Although the prevention of tax evasion and avoidance may be important purposes of a tax treaty, they do not constitute a prime objective, equal to the prevention of double taxation.

Before initiating tax treaty negotiations, it is important that countries carefully analyse and study relevant provisions etc. in the other country, in order to identify potential areas that could open up for treaty abuse. Consequently, the Confederation of Swedish Enterprise fully supports the policy consideration proposed in Section C of The Draft. We believe that, if these policy considerations were to be adopted by countries, there would be fewer loopholes to exploit and thus less need for Anti-Abuse rules. This approach would minimize the impact on genuine business activities.

Although the Draft essentially aim at preventing abuse of treaty provisions we believe that further clarification is needed with respect to what is to be considered abuse of treaty benefits.

It is important to make a clear distinction between intended and un-intended non-taxation. In the Action Plan on Base Erosion and Profit Shifting, it is stated that “no or low taxation is not per se a cause of concern, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it.” The distinction between intended and unintended non-taxation provides meaning to differences between tax efficiency and aggressive tax planning.
from a business point of view, and normal tax policy and harmful tax practices from a government point of view. Businesses should be allowed to respond to legislative tax initiatives without being accused of aggressive tax planning and Governments need to agree on acceptable forms of tax competition.

The Draft proposes various Anti-Abuse provisions to be inserted into the OECD Model Convention; namely a Limitation-on-Benefits provision (LOB), a Main Purpose Test (MPT) and a number of Specific Anti-Abuse provisions.

While both the LOB provision and the MPT are more general in nature and aim at addressing treaty shopping in particular, they take different approaches. Whereas the LOB provision is extremely complex, it is at least based on objective criteria, thus leaving little room for arbitrary assessment. The MPT on the other hand is very unclear and subjective and opens for arbitrary assessment.

In general, we believe that perceived inappropriate behaviour is best addressed with specific and targeted Anti-Abuse provisions. This way, abusive practices can be prevented with a minimum impact on bona fide business. It is of utmost importance that Anti-Abuse rules are designed so that they have a minimum impact on genuine business operations. We believe that both the proposed LOB provision and the MPT fail in this respect, since they are too general in nature and not limited to abusive situations. In particular, Anti-Abuse provisions should recognize that holding, financing and investment activities are normal and legitimate business activities that should not suffer blanket exclusions from Treaty protection.

Consequently, The Confederation of Swedish Enterprise opposes both the LOB provision and the MPT as they are currently drafted.

Anyhow, it does not seem to be a proportionate response to insert two very different provisions that aim at addressing the same issue. It is neither reasonable, nor desirable that taxpayers should have to struggle through a very complex LOB provision, only to be confronted with a very subjective MPT, providing little predictability as to the outcome. Such a scenario would definitely have a negative impact on businesses and would discourage investments and employment.

Consequently, it should be made clear in The Draft that at most one of these two provisions for preventing treaty shopping shall be inserted in the OECD Model Convention.

From a business perspective, and as an overriding principle, the choice between an objective and targeted (LOB) provision is naturally preferable to a subjective and vague (MPT) provision. The MPT would definitely cause most concern for bona fide businesses. If such a vague provision is inserted in the OECD Model Convention, the clarity and certainty of a tax treaty would be undermined. It would be extremely difficult for businesses to be certain whether treaty benefits will be granted. Likewise, it would be difficult for governments to fully understand the scope of the
tax treaty that is being negotiated. Such uncertainty would undermine the very purpose of tax treaties and is likely to result in an increasing number of double taxation cases.

Specific comments

A. TREATY PROVISIONS AND/OR DOMESTIC RULES TO PREVENT THE GRANTING OF TREATY BENEFITS IN INAPPROPRIATE CIRCUMSTANCES

1. Cases where a person tries to circumvent limitations provided by the treaty itself

*Treaty Shopping*

The Draft recommends a three-pronged approach to address treaty shopping situations:

- Clarify in the title and the preamble of tax treaties that the Contracting States intend to avoid creating opportunities for treaty shopping
- Include in tax treaties a limitation-on-benefits provisions based on the one found in the US model
- Include in tax treaties a more general Anti-Abuse rule (main purpose provision)

*Limitation-on-Benefits provision*

The purpose of the proposed LOB provision is to prevent treaty shopping. If appropriately designed, a LOB provision can be an effective tool to target abuse. However, in order to prevent treaty abuse without causing uncertainty, it is important that the LOB provision only targets the abusive cases.

It is mentioned in The Draft that a number of countries already include LOB provisions in their tax treaties. The proposed LOB provision is based on the LOB provision found in treaties concluded by the United States. The fact that a number of countries choose to include a LOB provision in their treaties does not by itself justify a LOB provision to be inserted in the OECD Model Convention. Countries have different needs and priorities when negotiating tax treaties. Although a country may accept a certain LOB provision in relation to another country does not necessarily mean that it would be willing to have such an LOB in all of its treaties.

As previously stated, The Confederation of Swedish Enterprise opposes the proposed LOB provision. It is, to say the least, very complex. However, our main concern with the proposed LOB provision is not the complexity. A detailed and potentially complex provision leaves less room for arbitrary assessments, which is important for a Model Convention that is used on a global basis. Our concern is that
the proposed LOB provision is not limited to the abusive situations. The proposed LOB provision denies treaty benefits by default. Only where explicitly stated would a resident enjoy the benefits under the treaty in question. Such language seems to suggest that taxpayers, as a general rule, evade tax and engage in aggressive tax planning. This is clearly not true. Most businesses allocate substantial resources in order to comply with existing tax rules and struggle to overcome obstacles to cross border trade and investment. The OECD Model Tax Convention must reflect the fact that most businesses are engaged in bona fide operations and not tax evasion and circumvention of tax provisions.

We support the risk based approach, where listed entities and entities controlled by listed entities are deemed entitled to treaty benefits. Entities that conduct active trade or business are also deemed low risk for the purpose of the LOB provision, and, if qualified, granted treaty benefit. The current language in the proposed LOB provision is however not limited to treaty shopping, since it will also have an impact on genuine business activities.

We question, e.g. whether it is reasonable to exclude all holding companies from treaty benefits. The structure of a holding company may vary significantly and there may be a number of reasons as to why a holding company is being used. The LOB provision should take into account substance and purpose of the holding company, existence of substantive activities such as premises, employees in the holding state etc. Political stability and geographical location are further factors that may warrant a regional holding company, rather than any intent to engage in abusive behaviour.

Another example of bona fide situations that may fall within the scope of the LOB provision is the Swedish group contribution system. In Sweden consolidated balance sheets for groups (consolidated tax returns) are not recognized for tax purposes. However, in order to obtain a tax situation for the group equal to that of a single company, the law allows shifting of income through group contributions between entities in the group. In the case of a qualifying group contribution, the company paying such contribution is entitled to deduct the amount from its taxable income and the recipient company must include such contribution in its taxable income. This means, inter alia, that losses of one company may be set off against profits of another company in the same group.

In accordance with EU law, the deduction is granted as long as the receiver is subject to corporate income tax in Sweden. Thus, the group contribution provisions in Sweden also allow contributions from a Swedish company to a Swedish PE of a foreign group company. According to the base erosion test in subparagraph 2.e) II of article X, treaty benefits would only be granted where less than 50 % of a person’s gross income is paid to a person that does not qualify for benefits under the treaty in the form of payments that are deductible (other than some arm’s length’s payments). Since the foreign company of the Swedish PE would not qualify for benefits under the treaty, the Swedish company making the payment to the PE
would be disqualified for treaty benefits despite the fact that such a payment would not be part of a tax treaty abuse scheme.

It would of course not be possible to cover all genuine business situations in a LOB provision. Neither would it be possible to cover all inappropriate circumstances in Specific Anti-Abuse provisions. The answer however is not to deem all situations abusive unless otherwise stated. Instead of allowing treaty benefit only where explicitly stated, the LOB provision should be reverse so that treaty benefit is granted by default, and that benefits only are denied in case of treaty abuse. This could be achieved by opening the LOB provision with a paragraph that states the following.

*Treaty benefit shall be granted unless the competent authority establishes that the establishment, acquisition or maintenance of such person and the conduct of its operations did have as its principle purpose the obtaining of benefits under the convention. Treaty benefits shall however always be granted in the situations mentions in subparagraphs 2 and 3 of article X.*

Such language would certainly be more reasonable, provide more clarity, maintain the integrity and purpose of the convention, be more fair and at the same time target cases of treaty shopping. It would also limit the scope of the LOB provision to cases of treaty shopping, which is the aim of action 6 of the BEPS Action Plan.

Another issue that needs a thorough analysis is the question whether the proposed LOB could be in violation of EU law. In particular, our concern is with the prohibition of non-resident intermediaries in the ownership test, the local stock exchange requirement in the publicly traded test and the absence of a derivative benefit provision. All these aspects require analysis in light of EU law. Should the conclusion be that such provisions are in violation of EU law, a significant number of OECD members would not be able to adopt the LOB provision as it stands.

*Derivative benefits provision*

As stated above, we support the risk based approach where listed entities and entities controlled by listed entities are deemed qualified for benefits under the treaty. Entities that conduct active trade or business are also deemed low risk for the purpose of the LOB provision, and, if qualified, granted treaty benefit. In the Discussion Draft, a *Derivative Benefits provision* is also considered in the LOB provision. The Derivate Benefits provision would extend the granting of treaty benefits to entities that are controlled by entities that are resident of a third country and that would enjoy the same treaty benefits with the contracting state in question. In such situations, there is no incentive for treaty shopping.

Consequently, if an LOB were to be included in the OECD Model Convention, the Confederation of Swedish Enterprise requests that also the Derivative Benefits
provision be inserted in the OECD Model Convention itself and not as part of the Commentary.

Main purpose test

In addition to the LOB provision, the discussion draft also contains a MPT. The provision reads as follows:

6. Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the main purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.

Both the LOB provision and the MPT are aimed at addressing treaty shopping. Whilst both provisions aim at addressing the same issue, they do have significantly different approaches to doing so.

As stated above, the proposed LOB provision is technically complex, but leaves less room for subjective and arbitrary assessments. This makes the provision very difficult, but at the same time it is at least somewhat predictable. The MPT on the other hand takes the opposite approach. It does not provide much guidance with respect to when the treaty benefits will be granted. Instead, it opens a door for tax administrations to disqualify taxpayers from treaty benefits where that tax administration finds it appropriate. The problem with the MPT is not its complexity. Rather, our concern lies with the fact that it is very subjective and leaves significant room for arbitrary assessments.

As previously stated, The Confederation of Swedish Enterprise strongly opposes the proposed MPT. The language is much too vague and subjective. It is difficult for a company to predict whether the provision is applicable in a particular situation.

It is stated in the Draft that the MPT would merely incorporate principles already recognized in the Commentary on Article 1 of the Model Convention. Here, the Discussion Draft seems to be referring to paragraph 9.5 of the commentary on Article 1, which states the following:

“A guiding principle is that the benefits of a double taxation convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions.”
The commentary on Article 1 contains a number of solutions to address improper use of the convention. The MPT is one of many potential solutions. The fact that an MPT is included in the commentary is not in itself a justification to include one in the OECD Model Convention. Such a test may be suitable between some treaty countries, but not necessarily between all.

Furthermore, the proposal in The Draft differs significantly from the language in paragraph 9.5 of the commentary to Article 1. In The Draft, the MPT would be applicable if it is reasonable to conclude that a tax benefit has occurred, if one of the main purposes of the arrangement would be to obtain a tax benefit and the tax benefit is achieved directly or indirectly. Compared to para 9.5 of the commentary to article 1 the threshold has been lowered considerably.

With respect to the one of the main purposes criterion, the Draft indicates that there could be more than one main purpose. In our view, there could only be one main purpose. Since The Draft seems to suggest otherwise, it should be clarified how many main purposes there can be without any of them falling below the threshold of being considered a “main” purpose.

Similarly to the proposed LOB provision, the MPT imposes a significant burden on the taxpayer. The onus on the tax administration is set low (“reasonable to conclude”, “one of the main purposes”, “directly or indirectly”) while the onus on the taxpayer is significant (“establish that the granting of tax benefit would be in accordance with the object and purpose of provisions in the convention”).

Such a vague, unclear and wide scoped provision in itself is not acceptable. The provision is extremely unpredictable and would likely have a very negative effect for genuine business activities. In particular, holding, financing and investment activities are all normal and genuine business activities that may fall within the scope.

Adding the fact that a LOB provision and a number of SAAR provisions are proposed as well, the OECD Model Convention’s function as a tool to facilitate cross-border trade could be undermined. As the proposal stands, it would mean that taxpayers would first have to struggle through the paragraphs in the very complex proposed LOB provision. In addition, if benefit is granted under that provision, the taxpayers can still not rely on being granted treaty benefits. Instead, they will have to assess whether they may fall within the scope of the proposed MPT. Bona fide business would be negatively affected due to the imposition of a very complex and significant threshold to qualify for the reliefs provided in the convention.

As a general standpoint, if having to choose between an LOB and a MPT, the Confederation of Swedish Enterprise would recommend the former. As previously mentioned a more limited LOB clause than the one proposed, targeted only on abusive situations could be an effective tool. Under any circumstance, we strongly
urge the OECD at least not to include both types of provisions in the Model Convention.

Should the OECD choose to insert a MPT in the Model Convention, it is of utmost importance that it is designed to be applicable only where a structure has been wholly artificially set up solely to secure a treaty benefit. Tax administration must establish (instead of make it reasonable to conclude) that the main purpose (instead of one of the main purposes) of an arrangement was to obtain the tax benefit. Furthermore, the provision should only be applicable if it is established that granting the benefit would be contrary to the objective of the provisions if the Convention.

Although such redrafting of the provision would not make the provision clear, since a MPT by its very nature is unclear and unpredictable. It would, however, at least increase the threshold for when an arrangement or transaction is considered abusive.

Additionally, the MPT requires analysis in the light of EU law. Given the fact that the language of the MPT in the Draft is so wide in scope, it could be argued that EU Member States would not be able to adopt such a provision.

Furthermore, if the MPT were to be adopted, the interaction between that provision and GAARs and SAARs in the domestic tax laws would need to be clarified. It is established in the commentary on Article 1 of the Model Convention that the domestic Anti-Abuse rules may be applied to address abuse of tax treaties. Domestic tax law may contain Anti-Abuse rules that do not correspond with the proposed MPT. Allowing domestic Anti-Abuse rules in addition to the proposed LOB, MPT and SAARs would definitely cause more uncertainty.

**Other situations where a person seeks to circumvent treaty limitations**

Our view is that specific rules for specific issues are preferable to GAARs, since a GAAR is more likely to also affect genuine businesses. We would like to make some remarks to the specific rules proposed in the Discussion Draft.

**Dividend transfer transactions**

As previously stated, we believe that Anti-Abuse provisions should be targeted towards situations that are likely to be abusive. That would not be the case where a treaty provides for source country taxation. To introduce a minimum shareholding period in Article 10.2 of Model, while at the same time retaining the right for source country taxation is not proportionate and would have a negative impact for genuine businesses.

Country practices vary on this issue and some countries provide in their domestic legislation for a minimum shareholding period. We believe that this is an issue to be
decided on a bilateral basis for those countries that consider these transactions a problem. We recommend that an alternative provision is included in the Commentary, for those countries that wish to address this issue, with a minimum shareholding period not exceeding 12-month and the possibility to meet the holding requirement after the payment.

Tie-breaker rule for determining the treaty residence of dual-resident persons other than individuals

We support the change from place of effective management to settlement by the competent authorities. However, we propose to delete the last sentence in the new paragraph 4.3 since we believe this does not facilitate agreement between the competent authorities.

Anti-Abuse rule for PEs situated in third States

With respect to the proposed Article 1 paragraph 4, we question the necessity of a provision like this in the Model Treaty. It may be of interest in relation to some countries but those situations could be solved bilaterally. Furthermore, we are concerned that the provision may be in incompatible with EU Law. The potential incompatibility with EU law can be illustrated by the following example.

CS1 is an EU member and enters into a tax treaty with CS2 that could be either a non-EU or a EU member. The tax treaty prevents CS2 to levy withholding tax on income to a company that is a resident of CS1. However, the treaty would not prevent CS2 to levy withholding tax on income to the same company in CS1 if that income is attributable to a PE in a third country. If that third country is an EU member, the tax treaty would allow a better treatment if the income stays in CS1 compared to if it is attributed to a PE in another EU member state. In our opinion, it should be analysed whether this may constitute an infringement on the free movement of capital or the freedom of establishment.

Should there be an infringement of EU law, it would mean that a large number of OECDs members would not be able to use the provision. In order to avoid such issues with EU law, we recommend that the provision is included as an alternative provision in the Commentary on Article 1 of the Model Convention instead of including it in the Model Convention itself. That way, the provision could be used by contracting states that are not members of the EU and that find the use of such a provision appropriate.
2. Cases where a person tries to circumvent the provisions of domestic tax law using treaty benefits

The Confederation of Swedish Enterprise believes that these issues are sufficiently addressed already in the Commentary and that no further amendment is needed in the OECD Model Convention.

B. CLARIFICATION THAT TAX TREATIES ARE NOT INTENDED TO BE USED TO GENERATE DOUBLE NON-TAXATION

The initial and prime objective with tax treaties is and should continue to be to facilitate cross-border trade through the allocation of taxing right between countries and to provide for mechanisms to eliminate double-taxation.

When negotiating a treaty, countries should naturally aim at designing the treaty in a way that it does not open up for unintended non-taxation. However, the need to prevent tax avoidance and evasion does not by itself trigger countries to negotiate a tax treaty. Although the prevention of tax evasion and avoidance may be important purposes of a tax treaty, they are not equally important to the purpose of avoiding double taxation.

The Confederation of Swedish Enterprise is concerned about the proposal to insert tax avoidance in the title and also the proposed wording in the preamble “…without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance...”.

In our view, this wording is contrary to the principle behind the BEPS project. In the Action Plan on Base Erosion and Profit Shifting, it is stated that “no or low taxation is not per se a cause of concern, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it.”

As previously mentioned, we believe that it is of utmost importance to make a clear distinction between intended and un-intended non-taxation. Such a distinction provides meaning to differences between tax efficiency and aggressive tax planning from a business point of view, and normal tax policy and harmful tax practices from a government point of view. Businesses should be allowed to respond to legislative tax initiatives such as accelerated depreciation or patent box regimes without being accused of aggressive tax planning.

Governments need to agree on acceptable forms of tax competition. In return, businesses should adhere to rules and principles agreed upon by and between countries.
We believe that the proposal in the title and preamble could be used by tax authorities to compensate “deficiencies” in national legislation and lead to increased uncertainty for business. If, in a bilateral situation, a domestic rule in country A opens up for unintended non-taxation vis-à-vis country B, country A should amend its legislation. Alternatively, country B will have to request renegotiation of the treaty.

It would be an improvement if the wording in the preamble would read “…without creating opportunities for unintended non-taxation through tax evasion or avoidance…”

C. TAX POLICY CONSIDERATIONS THAT, IN GENERAL, COUNTRIES SHOULD CONSIDER BEFORE DECIDING TO ENTER INTO A TAX TREATY WITH ANOTHER COUNTRY

The Confederation of Swedish Enterprise fully supports the policy consideration in the proposed new Section C in the Introduction to the OECD Model Convention. We believe that, if these policy considerations was adopted by countries, there would be fewer loopholes to exploit and thus less need for Anti-Abuse rules. This approach would minimise the impact on genuine business activities.

Concluding remarks

Introducing provisions like the proposed LOB and MPT would undoubtedly make treaty application extremely difficult. Although, a number of countries have an LOB in their treaty with the United States, similar to the one proposed in The Draft, it is an entirely different thing to insert such a provision into the OECD Model to be used on a global basis.

To add, on top of the LOB, a subjective and highly unpredictable provision like the MPT would undoubtedly open up for divergence in interpretation. This would not only increase the number of double taxation cases but would also be an effective trade barrier and thus diminish the primary objective of a tax treaty.

Due to the complexity and vagueness of the provisions, it is difficult to foresee the full consequences of the proposed amendments. Consequently, The Confederation of Swedish Enterprise opposes both the LOB provision and the MPT as currently drafted. The Confederation of Swedish Enterprise would recommend the OECD to consider a more targeted LOB that would be limited to truly abusive situations.

Considering the fact that a large number of OECD countries are also members of the EU, the Draft needs to address the potential violation of EU law. Should these proposals be incorporated, as they currently stand, it is not difficult to foresee that the impact these changes would have on business would not be positive and would
also lead to a dramatic increase of double taxation cases. The effect would be very negative on investments, jobs and growth. This in turn, would also risk undermining sustainable tax revenue collection.

Consequently, we urge the OECD to reconsider its proposal in this respect.

On behalf of the Confederation of Swedish Enterprise

April 8, 2014

[Signature]

Krister Andersson
Head of the Tax Policy Department
Dear Sirs

COMMENTS ON DISCUSSION DRAFT ON ACTION 6 (PREVENT TREATY ABUSE) OF THE BEPS ACTION PLAN

We refer to the above titled document. It is highly unsatisfactory that such a short timeframe be allowed for analysis and comment on a document of this complexity with such potentially far-reaching consequences. We are therefore limiting our comments on this occasion to one key observation.

Proposal on Limitation of Benefits

Paragraph A.1.a.i) contains a proposal on Limitation of Benefits. Were this proposal to be generally adopted, it would place considerable constraints on the location of ownership of companies attempting to benefit from tax treaty provisions. The practical impact would be to limit such treaty benefits to companies owned within countries with major economies. This is
because many companies indigenous to smaller countries, once they have grown to a certain size, must cast further afield than their country of tax residence for capital investment.

The document notes at paragraph 11 that the proposal is based "on provisions already found in a number of tax treaties, including treaties concluded by the United States but also in some treaties concluded by Japan and India". We suggest that such a limitation is only tolerable in the context of major economies such as the United States, Japan and India.

It is surely beyond the remit of the BEPS Project to prejudice commercial activities within smaller countries in comparison to their counterparts in larger economies. This proposal is unacceptable.

You may wish to note that this response is from a representative body. The Consultative Committee of Accountancy Bodies – Ireland is the representative committee for the main accountancy bodies in Ireland. It comprises Chartered Accountants Ireland, the Association of Chartered Certified Accountants, the Institute of Certified Public Accountants in Ireland, and the Chartered Institute of Management Accountants, which represent a combined membership of some 40,000 accountants. Brian Keegan, Director of Taxation at Chartered Accountants Ireland (brian.keegan@charteredaccountants.ie, +353 1 6377 347) may be contacted if any further details in relation to this letter are required.

Yours faithfully

Paul Dillon, Chairman, CCAB-I Tax Committee
Comments on the BEPS Action 6 Draft of 14 March 2014 (treaty abuse)

By Gaetano Pizzitola, Crowe Horwath Italy - Partner in charge of Cross-Border Tax Services

Dear Sirs,

We are pleased for the opportunity to submit our comments on the subject matter (the “Draft”).

The proposed amendments and additions to the OECD Model Treaty and Commentary reflect the current political climate targeting challenging any form of aggressive tax planning by abusing of the *bona fide* underlying principles of double tax treaties.

Abuse of tax treaties is widely perceived as one of the main causes of shortfall in the tax collections of high tax jurisdictions and the proposed measures will discourage any abusive behaviour.

Our observations stem from the perspective of professional experience on cases of abuse of domestic and treaty provisions. Our comments focus on **three key areas** that we believe the Draft should also address to minimize the negative effects of the uprising uncertainty inevitably created by soft concepts such as abuse of law and abuse of treaties:

- mandatory arbitration procedure to managing cases of LOB or treaty abuse claims;
- freezing interim collection of taxes claimed under LOB or treaty abuse rules before an arbitration panel or a tax court has done an independent review of the claim;
- application of the equivalent beneficiary treaty rates on dividends, interest and royalties if the qualifying test is not met under the main LOB clauses.

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1 Comments are sent as partner in charge of Cross-border Tax Services of SASPI - Studio Associato Servizi Professionali Integrati, Italian member firm of Crowe Horwath International providing tax and legal services in Italy, and on behalf of the latter firm. The author wish to thank his colleagues Gabriella Sasso and Rubina Fagioli for their contribution to the preparation of our comments.
Challenges of abuse of tax laws and treaties are very complex for various reasons and require business, financial, accounting, managerial skills that tax professionals and auditors may have to deal with through a retrospective analysis on transactions implemented years ahead that may not be easy to analyse and document thoroughly as a matter of fact.

If not balanced by procedural measures ensuring an upfront judicial or otherwise independent review by third parties, the proposed LOB and business purpose tests recommended by the Draft may lead to an increased level of uncertainty and controversy lasting decades, contrary to the spirit of the OECD pursuit and the treaties themselves.

Treaties are negotiated to facilitate cross-border investments. The burden of proof on taxpayers about their business objectives as deriving from the proposed measures will significantly increase the compliance costs to multinationals, particularly the ones in a start-up or developing stage, which may have primary commercial objectives of gaining market recognition in any foreign jurisdiction where they were not actively present earlier. Any foreign expansion will necessarily have to be documented from a business perspective with a tax mentality in a effective way (which may be paper-addictive at times when transactions are more and more dematerialized) that should be able to convince tax inspectors from multiple jurisdictions years later when, for example, the companies involved have changed control because of acquisitions by third parties, which often lead to a change of management and key resources that had implemented transactions in the past that the newcomers may not have full insight about. The above example is more common in real life than anyone may expect by looking at transactions in the vacuum of an ex post analysis of the paperwork of implemented steps from the narrower tax perspective years later.

Clearly, the campaign to stop abuses under the BEPS policy will not step back at this point and, therefore, actions such as the measures included in the Draft will likely be implemented in the practices of all or most jurisdictions, whether or not included in specific tax treaty provisions. The Draft, in fact, contains a wealth of cases and arguments that will inevitably be exploited by local authorities to raise bills based on abuse of law doctrines.

In our view, the Draft should address the risk of abuses-of-treaty-abuse-doctrine claims. The Draft states that the measures require caution and “reasonableness”. However, even the most reasonable inspector may face difficulties to assessing whether a transaction is abusive or not and, in such a case, it is reasonable to expect that any inspector will anyhow raise the claim to be on the safe side vis-à-vis their internal audit teams.

The risk is such to compel an analysis of the measures that must counterbalance the discretionary authority that will be granted to any tax inspector in the field auditing multinationals in their daily work. The level of technical skills beyond the pure knowledge of tax rules required to any tax inspector will inevitably create uncertainty by leading to challenges of abuses in cases where an abuse is actually questionable.

As tax authorities will be strengthened to fight against abuses by taxpayers, the latter must be protected from the risk of abuses by tax inspectors, whatever the nature of such abuses. Abuses do not necessarily imply deliberate wrongdoing by tax inspectors, which may be
counteracted by domestic criminal law legislation or other sanctions against major illegal behaviour by public authorities. Abuses may also arise bona fide from different interpretations of the same facts.

Applying tax rules may be a relatively easy task for tax practitioners and tax authorities. Assessing business purposes of transactions is very subjective and the same fact can be looked at in very different ways. Any transaction may have industrial, commercial, financial, accounting, shareholders’ value creation and all sorts of other business reasons. Transactions may have all those attributes or some of them and tax may be one of the various facets leading to a given choice.

As tax specialists, we always focus on what we know best, which are the tax details. This is true for all tax practitioners, whether in a consulting, industry, or tax authority’s role. Any tax professional, however, may miss the true business reason behind bona fide commercial transactions and experience shows that it is those cases that are often questioned as tax abuses where they are not.

For instance, the Draft outlines an example of potential treaty abuse under paragraph 27 where the case of a change of ownership of a foreign subsidiary is described that may lead to lose treaty protection on a financing arrangement. The example outlined there identifies a transaction that is deemed as abusive by allowing the same tax treatment that the initial loan had, based on the jurisdiction of the initial lender. The example does not take into account the financial perspective of both parties in the transaction. That is, the initial loan was negotiated with a 4% interest rate in a scenario whereby the lender was not subject to withholding tax. The 25% withholding tax that the new owner of the subsidiary would incur in the outlined example may affect the investment return either because the withholding tax may not be creditable, wholly or partially, by the new interest income beneficiary or even just because of the detrimental adverse cash flow impact that any withholding tax will have. The above factors may put the new owner, which may have received the funds for the acquisitions from banks, in the difficult position of being unable to secure the same level of cash flow required by the funding banks. The above circumstances may imply an increase of the cost of borrowing for the new owner.

We wonder how an abuse of law claim in those circumstances should be handled with. Is really the protection of the new owner vis-à-vis the funding banks an abuse that should be challenged as a matter of fact? Someone will certainly say yes. However, would a gross-up clause added to the old contract to ensure the same return to the lender subject to withholding tax be deemed as acceptable from a tax and transfer pricing standpoint or would this lead to further challenges because, for example, the initial loan contract had no gross-up clause?

The above is just one simple example of all complex cases that may arise in the daily commercial and financial activity that we are sceptical about being manageable in the course of a tax audit. Audits have their own limitations from several standpoints, eg, time constraints putting pressure to finalize audits within a given deadline, thorough analyses needed to assess all facts and circumstances without sufficient resources, and the like.

Any abuse of law doctrine creates uncertainty and the ordinary domestic rules designed to protect taxpayers from violations of tax law rules by tax inspectors may not address properly cases of abuse
of law as they were conceived to assess cases of tax evasion where evidence is most of all objective. Assessing objectively the subjective reasons behind transactions is quite a challenge and highly discretionary, up to a level that may fall into intended or even unintended arbitrary behaviour.

For all the above, we believe that the Draft should include recommendations and even specific measures to minimize the risk of abuse of the doctrine of abuse of treaties and domestic tax rules such as a mandatory arbitration clause for all challenges based on the doctrine of abuse of law and abuse of treaties.

The introduction of LOB provisions and general anti-abuse principles such as the ones proposed under the Draft must be counterbalanced by mandatory arbitration clauses such as the one recommended under paragraph 25(5) of the OECD Model Treaty. However, currently the mandatory arbitration clause has been implemented only in specific circumstances and is not accepted as a standard clause. Without a mandatory arbitration clause the new LOB and abuse of law proposed measures will put taxpayers acting bona fide at the will of any tax inspector working for its own Country benefit and the risk of double or multiple taxation arising from any attempt to avoid non-taxation would be a too high price for any cross-border investment.

The narrow focus on cases of abuses without counterbalancing measures will generate abuses on the other side. It may sound cynical but experience shows that abuses may take place, voluntarily or even accidentally and bona fide from all parties. Any pursuit to stop or prevent abuses by taxpayers and tax advisors must also prevent the risk of abuses by tax inspectors.

A mandatory arbitration clause will be a remedy that may allow taxpayers to rely on a competent review of complex cases by an independent and qualified body on cross-border tax matters by minimizing the risk of double taxation that taxpayers may end up with by defending their positions before local tax courts.

We therefore strongly encourage the expansion of the Draft to include a chapter about mandatory arbitration clauses for all cases in which tax authorities may deny treaty benefits on the basis of the proposed LOB and general abuse of treaty measures.

Besides, LOB and abuse of law clauses raise further procedural legitimate concerns from the perspective of taxpayers and tax advisors. We refer to any interim collection authority to raise taxes on the basis of mere claims by tax inspectors.

Although any national legislation may have specific measures to prevent interim payments of taxes claimed under LOBs or treaty abuse rules in all cases of appeal or specific circumstances, such as preliminary court review on the merit of the appeal and/or temporary financial distress exceptions, experience shows that those measure put taxpayers at the mercy of tax inspectors. There is a wide inner danger with that. Although this is a matter of domestic tax rules ordinarily, we believe that the introduction of specific LOB and treaty abuse rules must also include specific procedural measures ancillary to the implementation of the mainstream anti-abuse rules.

Thus, we hope that the Draft will also include rules and comments about balancing LOB and abuse
of treaty claims with specific countermeasures that will suspend any collection of taxes based on those claims at least until any arbitration panel or any external local tax court has issued its own independent ruling on the appeal by taxpayers. Italy has a similar measure currently applicable under Article 37-bis of Presidential Decree No. 600 of 29 September 1973, which includes an anti-abuse rule subjecting various transactions to business purpose test, although experience shows that even the application of such a reasonable provision may lead to cases of abuses of tax law because of the uncertainty created by a very subtle distinction between transactions challenged under Article 37-bis and transaction challenged under the Italian jurisprudence on the doctrine of abuse of tax laws (which confirms that the risk of abuses is on all parties).

Concerns about risk of default by taxpayers for suspension of payments may be dealt with guarantees or similar default risk measures such as a specific monitoring of high risk cases that will not increase compliance costs by taxpayers. Indeed, it goes without saying that the tax authorities should bear the upfront cost of guarantees or similar measures necessary to ensure that taxes are collected if their claim under LOB or abuse of treaty be confirmed by an arbitration panel or a tax court, subject perhaps to final recharge to taxpayers in such a case.

Finally, as third point on the Draft we wish to comment at this stage, we believe that the derivative benefit clause under the LOB provisions currently leads to unfair and unintended results in some circumstances, which should be addressed by the Draft.

We refer to the specific treatment of dividends, interest and royalties under the proposed letter B) of paragraph 13 of the Draft. The proposal extends treaty benefits on those items of income to taxpayers that are not qualified persons under the ordinary LOB rules if they would be able to claim tax rates “at least as low as the rate applicable” under the denied treaty benefit.

There are circumstances whereby the denied treaty provides for exclusive taxation in the Country of residence, but the otherwise applicable treaty under the derivative clause provides for reduced tax rates. For example, the equivalent beneficiary treaty may provide for a 10% tax on interest while the direct treaty may provide for exemption in the source Country. In that scenario, the current LOB clause may trigger, say, the domestic 30% withholding tax on interest default because the equivalent beneficiary treaty rate is not as low as the direct one. Although the reduced 10% rate may perhaps be achieved with an application under the competent authority discretionary clause under paragraph 4 of the proposed LOB clause under the Draft, we believe that an automatic recognition of the 10% equivalent beneficiary treaty rate would facilitate cross-border relationships by reducing compliance costs to multinationals.

In such circumstances, in fact, no risk of abuse of treaties may be envisaged and, therefore, the derivative benefit clause should ensure at least the “worst” treaty tax treatment by default rather than excluding altogether any treaty benefit by allowing application of the domestic rules.

In conclusion, the BEPS policy is somehow shifting application of treaties from a trustful to a sceptical approach vis-à-vis multinationals by based on the assumption of wrongdoing unless otherwise proven. Relationships should be based on a common field even between tax authorities
and taxpayers as indeed legislation on Taxpayers’ Bill of Rights in various Countries strive for. Either one party should trust the other or both have ground to be reciprocally sceptical and, thus \textit{reasonableness} should lead to design rules to protect all parties from wrongdoing. Trust that neither the competent tax authorities engaged in the hard and great work done to release timely the Draft nor any tax inspector in the filed of tax audits will take our comments personally as they are inspired by underlying principles of fair treatment and risk management prevention.

Any tax treaty practice development must protect taxpayers engaging in \textit{bona fide} commercial transactions internationally. We believe that our proposals would enhance their protection without adversely impacting on any action against abuses by taxpayers and, therefore, we trust that the Tax Unit will endeavour to take them into consideration in that perspective.

Thank you for the opportunity to contribute on these very controversial topics and for the work pursued to facilitate cross-border business by clarifying the related tax aspects.

\textit{SASPI – Studio Associato Servizi Professionali Integrati}
Italian member firm of Crowe Horwath International
Tax and Legal Services

Gaetano Pizzitola

Partner in charge of Cross-Border Tax Services
Dear Sirs

Discussion Draft on BEPS Action 6: Preventing the granting of treaty benefits in inappropriate circumstances

Thank you for the opportunity to comment on the Discussion Draft – ‘Preventing the granting of treaty benefits in inappropriate circumstances’ released on 14 March 2014 (the ‘Discussion Draft’). Our comments are made from the perspective of the UK.

Our principal comments are set out below. Our detailed comments are set out in the attached appendix.

1. Treaties are designed to promote cross-border trade and investment by protecting against the risk of double taxation and to provide certainty of tax treatment. We support the position that treaty relief should not be available where the treaty conditions are only met through abuse. However, the proposals put forward in the Discussion Draft are too wide-ranging and in some areas go further than is needed to prevent treaty abuse. Domestic law should be the primary route to tackling such wider tax avoidance and this is reflected in some of the other Actions (for example, Action 2, hybrids).

2. The Discussion Draft sets out a number of different approaches to tackling treaty abuse - a Limitations of Benefit Article (LOB), a general anti-abuse rule (purpose test) and specific anti-avoidance provisions (for example, to cover abuse under triangulation). We recognise that different countries are likely to prefer different approaches, based on their legislative and treaty history – but we do not believe that it would be sensible to include both an LOB clause and a widely-drafted general anti-abuse clause. Either an effectively drafted LOB or a purpose test would meet the required objective.

3. Overall, we would suggest that an LOB would be the most appropriate approach, as it offers greater certainty to taxpayers and to tax authorities. However, we do not think that the LOB provision included in the Discussion Draft is suitable for worldwide use.

4. It is important that the majority of taxpayers can apply this Article without recourse to the competent authorities.
We believe it is essential that an effective LOB should:

- Include a derivative benefits provision;
- The active trade or business test is a US test. Such a test needs to be adapted for worldwide use and should be extended to include all holding companies which have sufficient substance;
- Allow ownership/income/public quotation tests to be met by reference to economic markets (for example, the European Union) rather than individual states;
- Allow override by competent authorities where a mechanical test is failed but there is no abuse.
- Whilst we acknowledge the concern that a company should not be resident in form alone, prescriptive rules about the locations of management decisions do not suit modern business, which may operate in a divisionalised, decentralised manner.
- Consideration needs to be given to the position of investment funds to make sure that they are not excluded from treaty benefits. Many funds are now marketed internationally (for example, funds which comply with the Undertakings for Collective Investment in Transferable Securities ('UCITS') Directives can now operate freely throughout Europe).

5. In addition to recourse to the competent authorities, domestic law should allow for unilateral relief where this is not abusive. If this is not the case, receipts from treaty partners where the LOB is failed could be treated in a less favourable manner than those from a country which has no treaty.

6. Where countries choose to include a purpose test rather than an LOB, we would suggest that a clearance mechanism be provided. Examples in the Commentary are also desirable.

7. The removal of the effective management test for determining corporate residence would significantly increase uncertainty and put greater pressure on competent authorities. Tax abuse through dual-residence can be tackled through domestic laws. For example, the UK treats a UK-incorporated company as not UK tax resident if it is resident somewhere else by virtue of the tax treaty. We would therefore recommend that the effective management test is retained. If it is removed, a form of grandfathering should be considered to remove the requirement for all existing companies to confirm their residence position with the competent authorities.

8. We are concerned that the accelerated timetable for completion of this Action will not give adequate time for drafting and consultation on new drafting. We think it would be preferable for the G20 to consider and approve an outline approach at their meeting on 20-21 September but allow more time for drafting. Given that changes to existing treaties will not take place until completion of Action 15, we would suggest that there is adequate time in the context of the whole Action Plan to allow for this.

If you wish to discuss any of the points raised in this letter, please do not hesitate to contact either me (bdodwell@deloitte.co.uk), or Simon Cooper (sjcooper@deloitte.co.uk).

Yours faithfully

W J I Dodwell
Deloitte LLP
Appendix 1

A. Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances

(1) Cases where a person tries to circumvent limitations provided by the treaty itself

1. The Discussion Draft proposes changes to treaties with a three pronged approach; amendment to the title and preamble; inclusion of a specific anti-abuse rule based on the limitation-on-benefits provision and thirdly; a purpose test. The Discussion Draft also includes further anti-avoidance provisions to tackle specific transactions or scenarios.

2. The inclusion of both a LOB and a purpose test should be unnecessary. Layering complex provisions simply increases uncertainty and the administrative burden of applying the rules for both taxpayers and tax authorities. We would suggest that only one of these two approaches should be taken forward, and that is the LOB.

3. (a)(i) Limitation-on-benefits clause

3.1 A specific anti-abuse rule is proposed based on the LOB provision already included in many US treaties. This clause has been designed by the United States to suit its own legislative approach to treaties. In our view, significant modification is needed to make such a rule more broadly applicable. The rule operates based on the legal nature, ownership in, and general activities of, residents of a treaty country. One of the matters discussed is whether the rule should include a ‘derivative benefits’ clause to allow a treaty country to look through to the shareholders where they would also be entitled to benefits under a treaty.

3.2 There have been mixed experience in relation to the LOBs in existing US treaties due to the uncertainty surrounding its application. It would be helpful to use this knowledge to modify the drafting and also to add additional Commentary to reduce uncertainty.

3.3 Absent a need to refer the matter to the competent authorities, a LOB can be clear and easy to apply subject to Commentary on how the terms should be applied (for example income derived in connection with or incidental to that trade or business). Its potential drawback is that its mechanical nature can result in treaty relief being unavailable in unintended circumstances. This could be resolved by referral to the competent activities but this should be as a last resort. In order to keep competent authorities referrals to a minimum, we would recommend that the proposed LOB is extended/ modified as follows:

3.3.1 There is an equivalent beneficiary test. Without this there are a number of commercial structures (for example, tiered holding companies) where reference would need to be made to the competent authorities and this could be avoided.

3.3.2 The active trade or business test is extended to include any holding companies that have substance in a contracting state and not just companies that make or manage investments in their capacity as a bank, insurance company or registered securities dealer. Many groups use regional holding companies which have a significant presence in a state. These companies should be able to access the benefits of a treaty in a straightforward manner without the need for a referral to the competent authorities. The inclusion of holding
companies could be achieved by removing the exclusion in Article X, paragraph 3a for making or managing investments and changing the test of substance in paragraph 3b (we comment more generally on this point in 3.3.4). It would seem that Paragraph 3b could be amended to consider the substance of the resident in the recipient contracting state alone without the need to compare it with the substance of the payer in its resident state.

3.3.3 The proposed LOB clause may adversely affect industries where collective rights management is common, for example the music industry, publishing industry and television distribution. For these industries, it will be important that the guidance makes it clear that rights managements could meet the active trade or business test where the entity has substance and carries out significant activities in order to collect the royalties.

3.3.4 A company is a qualified person if its shares are listed on a recognised stock exchange; in the Contracting State of residence, or elsewhere but its primary place of management and control is within the contracting state. This requirement seems to be a narrow view of how international business is conducted. Listings and the primary place of management are often not in the same place, and the management test which could alleviate this problem is currently too narrowly drafted. In particular, the primary place of management is defined within Article X, paragraph 5(d) and includes the requirement that executive officers and senior management employees exercise day-to-day responsibility within the contracting state. The fact that this looks at activities in the Contracting State rather than a particular company is helpful. For example, many Japanese trading houses have a number of key managers in the UK but they are not necessarily employed by the same UK company. However, in many large international groups, day-to-day management may be carried out from another company, in another state and it is the central management that is carried out in the state in which the group is listed. We would therefore suggest that the test is by reference to central management rather than day-to-day management.

3.3.5 It is unclear as to when a trade or business is ‘substantial’. Indeed, the proposed substantial test may be an unsuitable test of abuse (for example, an active resident company is acquired by an unrelated, much larger company of a third party). We would therefore suggest that the test should be further refined. In particular, and as set out at 3.3.2, we would recommend that this test be modified to allow holding companies to qualify for treaty benefits based on their presence in their home state alone without the need to compare their position with that of the payer.

3.3.6 Some of the LOB tests are by reference to a particular state, which does not reflect the expansion of many markets; in particular, the European Union. A good example of this is the collective investment vehicle (‘CIV’) market which, following the provisions in the latest UCITS Directives, operates in a truly pan-European manner. For some CIVs, in order to determine whether said CIV is a qualified person, Article X, paragraph 2(e) will need to be considered. A CIV may be denied the benefits of a treaty due to the proposed LOB if more than 50% of gross income for the taxable year is paid or accrued, directly or indirectly, to persons who are not resident in either Contracting State. This is regardless of whether the remaining investors would have been entitled to equivalent benefits under their home jurisdiction treaty.

3.3.7 There are an increasing number of European CIVs that now have a diverse range of investors, which are not limited to residents in the state in which the CIV is established or in
the state in which the investments are made. It is important that the LOB reflects these wider-geographical markets through providing a derivative benefits provision which ensures that widely held CIVs are not inadvertently denied access to tax treaties. If CIVs are not entitled to treaty benefits, this could have a dramatic effect on some CIVs which, in extreme cases, could result in them being no longer able to effectively trade. It should be noted that some of the largest investors in UK and European funds are pension schemes, and that any fall in the value of these funds could result in the beneficiaries’ pension income being reduced. The LOB should take account of this wider market and we would ask that the OECD considers the extent of this potential impact and considers the findings of the 2010 OECD report: *The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles (‘the CIV Report’)*. The CIV Report considered how use of CIVs as treaty shopping tools could be prevented in addition to recognising the need to ensure neutrality of investment held indirectly via CIVs in relation a direct holding in the underlying asset(s).

3.3.8 It is also our understanding that as a matter of European Union law, a derivative benefits provision is required. An LOB provision without one would breach the fundamental freedom of establishment as regards treaties between EU member states. We refer to the Court of Justice of the European Union judgement in the 2002 Open Skies cases (C-466/98, C-467/98, C-468/98, C-469/98, C-471/98, C-472/98, C-475/98 and C-476/98) of 5 November 2002, in which the Court held that the ‘nationality clauses’ in eight EU member states’ bilateral international air transport agreements with the US were considered to be in breach of EU Law, that is contrary to the EU’s fundamental freedoms. In particular, the requirement in most of those bilateral agreements for more than 50% of the shares in their national airline to be held by nationals of that airline’s home country breached the freedom of establishment of the EC Treaty (now TFEU).

3.3.9 We would also draw attention to the *Papillon* case (C-418/07), which requires EU/EEA countries to be able to trace bilateral treaty entitlement via any EU/EEA country entity, and not just via the relevant EU/EEA country and its treaty partner entities. Likewise, the proposed paragraph 2c)i)A) requirement for shares to be traded on a local stock exchange should, to be EU/EEA law compliant be expanded to cover shares traded on a stock exchange anywhere in the EU/EEA (see the CJEU’s *RBS* case (C-311/97)).

3.4 Treaty benefits are not denied if, under Article X, paragraph 4, a competent authority determines that the establishment, acquisition or maintenance and conduct of operations did not have as one of its principal purposes the obtaining of benefits under the convention. Our primary reason for suggesting that a LOB provides the better means of preventing treaty abuse is that it is not as subjective as a purpose test, which could be interpreted in different ways by different states. If an LOB is effectively drafted, reference to the competent authorities should be rare.

The LOB should focus on addressing treaty abuse and should allow for commercial transactions. The example illustrated at paragraph 15 is not an example of abuse of treaty benefits. If there is base erosion or profit shifting in such a case, it should be addressed within national law by other actions of the BEPS Action Plan (harmful tax practices, intangible fixed assets and value creation and controlled foreign companies).

Finally, it is important that there is an effective dispute resolution process and, ideally, a mandatory binding arbitration mechanism.
4. (a)(ii) Rules aimed at arrangements one of the main purposes of which is to obtain treaty benefits

4.1 In addition to the LOB, the Discussion Draft proposes a broadly drafted general purpose rule aimed at removing treaty benefits where one of the main purposes of the arrangements or transaction was to obtain treaty benefits. For the reasons set out above, which primarily relate to uncertainty of application, we believe that a LOB would meet the required objectives, and that multiple anti-avoidance provisions are undesirable and not required. However, we have provided some comments below on a purpose test in case certain countries regard a ‘purpose’ test as more aligned to their legislation.

4.2 Article X, paragraph 6, proposes a treaty benefit shall not be granted ‘….if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining the benefit was one of the main purposes of any arrangement or transaction that resulted directly or indirectly in that benefit….’ This is an unreasonably low threshold. Experience in relation to UK anti-avoidance provisions highlight that it is possible to have predominantly commercial purpose but still fall foul of such a test. The ‘one of the main purposes’ test is used as an entry threshold for the UK’s general anti-abuse rule but there are additional taxpayer protections.

In our view, a general anti-abuse test should only be triggered where avoidance of tax is the primary purpose of the relevant transactions.

4.3 A purpose test is subjective and requires tax authorities (and ultimately courts) to assess the purposes of another party (i.e. the taxpayer). In cases of flagrant avoidance, this assessment may not be troublesome. However, in others, taxpayers may struggle to provide tax authorities with the evidence that they require to form an opinion. We would suggest that any purpose test should not be triggered for third-party transactions unless arrangements have been entered into to convert a connected party transaction into a third party transaction.

4.4 It will be important to include a number of examples in the Commentary of when the purpose test under Article X, paragraph 4 (or the general anti-abuse rule) would/would not apply. The conclusion in examples in the Discussion Draft are not always clear and further work needs to be undertaken in this area.

4.5 The term ‘benefit’ is currently not defined within the current OECD Model Tax Convention and the Discussion Draft does not propose to include a definition. Paragraph 26 states the term ‘benefit’ includes all limitations on taxation imposed on the State of source under Articles 6 through 22 of the Convention, the relief from double taxation provided by Article 23, and the protection afforded to residents and nationals of a Contracting State under Article 24 or any other similar limitations.

Although not currently proposed, clarification should be included within the Model Convention that the denial of benefits does not restrict access to mutual agreement procedures and competent authorities. In addition, it would be important to clarify that, if treaty benefits are denied under the proposed purpose test, the benefits are only denied for the specific transaction to which one of the main purposes was to obtain the benefit and not to the company or group companies in the Contracting State.
4.6 As mentioned above, the proposals could place a large amount of pressure on competent authorities’ procedures and without sufficient resourcing to deal with this; many scenarios may not be concluded for a number of years which could severely hamper international trade.

5. (b)(i-vii) Other situations where a person seeks to circumvent treaty limitations

5.1 Several specific anti-avoidance provisions and proposals for changes are included within the Discussion Draft for consideration. We support the inclusion of well-targeted specific anti-avoidance provisions.

5.2 In respect to the specific provisions to address dividend transfer transactions, a number of jurisdictions include holding period requirements in their dividend exemption rules and an extension to the dividend article of a treaty is therefore in keeping with this approach. We do not believe the minimum holding period should be any longer than 12 months – and allowing a prospective holding period (with recapture of the benefit should this not be met).

5.3 The removal of a residency tie-breaker clause for companies in the State in which effective management is situated will significantly increase uncertainty and put immense pressure on competent authorities. We would therefore recommend that it is not removed. As noted above, any possible abuse is best dealt with under national law.

5.4 A new clause is proposed to restrict relief from withholding taxes on payments to a permanent establishment, to apply where the combined rate of tax paid by the recipient in the permanent establishment and residence countries is less than 60% of the tax rate of the residence country. We believe that this is a matter which is best dealt with through domestic anti-avoidance rules. A state’s tax rate and rules regarding the taxation of international transactions is something that other states should assess before entering into a treaty (although we appreciate that tax rules can move) and should be not something that is covered by a treaty in an overly-mechanical matter. As set out in the Action Plan on Base Erosion and Profit Shifting, OECD, 19 July 2013, “No or low taxation is not per se a cause of concern, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it.”

(2) Cases where a person tries to abuse the provisions of domestic tax law using treaty benefits

1. Anti-avoidance provisions should be dealt with in domestic law. Treaties should only counteract avoidance in relation to the treaty benefits. Many of the proposed points can be, and are dealt with under existing domestic law/ are being considered as separate Action Plan points.

B. Clarification that tax treaties are not intended to be used to generate double non-taxation

We note that this may be controversial for some countries, although UK jurisprudence already makes it clear that the purpose of a treaty is not to facilitate tax avoidance.

C. Tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country

We suspect greater support is needed by some countries than this currently provides.
By e-mail to taxtreaties@oecd.org

April 9, 2014

Mr. Pascal Saint-Amans
Director
OECD/Centre for Tax Policy and Administration (CTPA)

Ms. Marlies de Ruiter
Head of the Tax Treaty, Transfer Pricing and Financial Transactions Division
OECD/CTPA

Subject: BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances
(Public Discussion Draft)

Dear Mr. Saint-Amans and Ms. de Ruiter:

We are pleased to submit comments on behalf of Deloitte Tax LLP, a U.S. member firm of Deloitte Touche Tohmatsu Limited (“DTTL”)1 regarding the Public Discussion Draft, “BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances” (the “Discussion Draft”). We appreciate this opportunity to share our views on the Discussion Draft and hope you find our comments useful as you continue to analyze these important tax treaty issues.

Introduction and Overview

We strongly support the willingness of governments to reduce double taxation via treaties, and we understand the importance of anti-treaty shopping provisions in encouraging governments to do so. However, such measures are a two-edged sword; when not constructed properly, they can also deprive legitimate businesses of treaty protection. Thus, we support the adoption of anti-treaty shopping measures that are appropriately targeted to prevent treaty shopping without undermining the primary purpose of income tax treaties to prevent double taxation and provide taxpayers with a stable cross-border investment environment. As discussed more fully below, we believe that the treaty shopping proposals in the Discussion Draft do not strike the right balance and thus are in need of revision.

Our comments fall into three main categories. In our view:

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i. The Discussion draft’s “more general anti-abuse rule” (the “Main Purpose Test”) should not be incorporated into the OECD Model Tax Convention;

ii. Any “specific anti-abuse rule”\(^2\) (a “Limitation on Benefits” or “LOB” provision) incorporated into the OECD Model should include a derivative benefits rule, and more closely follow the provisions already set forth in paragraph 20 of the current Commentary on Article 1 of the OECD Model; and

iii. The new title of and preamble to the OECD Model proposed by the Discussion Draft should be modified and explained further in the accompanying Commentary to prevent improper inferences being drawn from them.

**The Main Purpose Test**

The Main Purpose Test proposed in the Discussion Draft would deny a treaty benefit in respect of an item of income if it is reasonable to conclude, under the relevant facts and circumstances, that obtaining the treaty benefit was one of the main purposes of any arrangement or transaction, unless the taxpayer is able to establish that granting the benefit would be in accordance with the object and purpose of the relevant treaty provisions.

This standard would inject a subjective element into every aspect of determining whether treaty benefits are available. The virtue of an objective LOB test is that, as demonstrated by experience with U.S. income tax treaties, it generally fosters the ultimate goals of income tax treaties in an administrable way that provides certainty in application to tax administrators and taxpayers. The Main Purpose Test, on the other hand, will defeat the certainty and administrability provided by such an LOB provision.

The uncertainty created by the Main Purpose Test stems from its internally contradictory message: treaty benefits are available to qualifying taxpayers, unless taxpayers intend to avail themselves of those benefits. However, another question is relevant: can the tax-motivated behavior be shown to be consistent with the object and purpose of the relevant treaty provisions? If so, the treaty benefit will be granted. Deciding when tax-motivated behavior is consistent with the “object and purpose” of the relevant treaty provisions will be difficult for both taxpayers and their advisors to apply in practice.

The subjective nature of the Main Purpose Test is bound to cause several types of problems for taxpayers and their advisors. The Main Purpose Test would make it difficult for companies to assess their ultimate liability for tax, which in turn would affect their ability to, among other things: make investment decisions based on projected after-tax returns; prepare accurate financial statement provisions for income taxes; prepare tax returns accurately stating tax liability; and accurately reserve

\(^2\) The quotation is to paragraph 9 of the Discussion Draft: the “specific anti-abuse rule based on the limitation-on-benefits provisions included in treaties concluded by the United States and a few other countries.” Such provisions are generally aimed at preventing “treaty shopping” where persons who are not residents of either contracting state seek the benefits of a treaty through the use of an entity that would otherwise qualify as a resident of one these states. See Paragraph 20 of the Commentary on Article 1 of the OECD Model Tax Convention.
for potential disputes with tax authorities. Without a sufficiently clear and predictable objective test, tax administration based on self-assessment would be significantly hindered.

By the same token, the Main Purpose Test would increase the complexity and cost of auditing companies’ financial statement provisions for income taxes. Uncertainty would likely cause withholding agents to overwithhold on payments, imposing on taxpayers and tax authorities the burden of administering treaty benefits through disputed refund claims for overwithheld taxes. Uncertainty would weaken the incentive to even agree on treaty-based reductions in taxes: approaches to the Main Purpose Test adopted by each government are likely to vary in practice such that governments would be uncertain they would get the benefit of their bargain (i.e., the reduction of a state’s tax on nonresidents in exchange for the reduction of tax in the other state on the residents of the first state). Thus, treaties with the Main Purpose Test are less likely to provide for concessions on a bilateral basis. Ultimately, taking all of the above into account, the Main Purpose Test is likely to increase double taxation, thereby undermining the purpose tax treaties are designed to accomplish.

Finally, if the Main Purpose Test were adopted, then, in order to counteract the adverse effects listed above, governments would need to permit any taxpayer proposing to enter into a transaction or arrangement with treaty implications to receive an advance ruling as to whether or not the Main Purpose Test precludes the application of treaty benefits to such transaction or arrangement. Such a procedure would impose an enormous burden on tax administrators.

For these reasons, we believe that the Main Purpose Test should not be incorporated into the OECD Model. Treaty shopping is much better addressed, in our view, by an objective LOB provision, albeit not in the precise form set forth in the Discussion Draft, as we will discuss below.

**LOB Provision**

The LOB provision proposed in the Discussion Draft is nearly identical to the LOB provision in the 2006 U.S. Model Income Tax Convention. This model contains several provisions which can be overly restrictive in their application. Such provisions can often result in a denial of treaty benefits where there is no treaty shopping concern. We are aware of only one U.S. tax treaty LOB article that essentially matches the LOB article of the 2006 U.S. Model but has no derivative benefits provision: the U.S.-New Zealand treaty. Of the small minority of other U.S. tax treaties that contain all the provisions of this model, all have derivative benefits provisions. Because a minority of the U.S. treaties now in force include all the provisions of this model, taxpayers and tax authorities have limited experience in applying these provisions and judging their workability as a whole. Given that some of these provisions are relatively recent additions to the U.S. Model, and their track record is limited, we would strongly urge the OECD to commit to further study any provisions which go beyond the model LOB included in paragraph 20 of the current Commentary on Article 1 before incorporating them into the OECD Model Tax Convention. If LOB provisions have the effect of precluding treaty benefits with respect to common business structures where no treaty shopping abuse is present, they may do more harm than good and should not be included in the Model unless they are redesigned with appropriate consideration and consultation.

For example, one provision in the Discussion Draft which is overly restrictive is the same-country owner requirement in the “ownership/base erosion test” (subparagraph 2.e) i) of the LOB provision). In the
case of a multinational group of companies, this test can generally only be satisfied if the ultimate parent company of the company being tested for treaty benefits (“tested company”) is publicly traded and is also a resident of the same country as the tested company. No same-country residence test for ultimate owners is included in the corresponding provision in paragraph 20 of the current Commentary on Article 1. It is not clear what treaty abuse the same-country owner requirement is intended to address. Yet the rule would have the unintended result of denying treaty benefits in many common business structures. For example, if a U.S. company and a non-U.S. company formed a joint venture company in the non-U.S. company’s country of residence, the joint venture company would fail the ownership/base erosion test if the U.S. company held a majority interest.

Examples of other LOB provisions which could be viewed as overly restrictive, and are only included in a small percentage of U.S. tax treaties now in force, include:

1. **Intermediate owner requirement in ownership/base erosion test:** The ownership base/erosion test also requires that any “intermediate owner” (i.e., an entity in the ownership chain between the tested company and its ultimate owner) be a resident of the same country as the tested company. For example, where the ultimate parent has a subsidiary that is a resident of another country which acts as a regional holding company, this requirement would preclude a third-country subsidiary of that holding company from claiming benefits under the treaty between its residence country and its ultimate parent’s residence country.

2. **Non-base eroding payments limited to payments to certain qualified persons:** The base erosion prong of the ownership base erosion test generally treats any payments that are not made to certain types of qualified persons as base eroding payments (unless they are “arm’s length payments in the ordinary course of business for services or tangible property” (“ordinary course exception”)). In the case of a multinational group whose members are not governmental entities, charities or pension funds, this rule could cause payments to any person other than the publicly traded parent of the group to be base eroding payments, even if the recipient of the payment is itself a qualified person.³ This could cause ordinary business transactions to shut off legitimate businesses’ access to treaty benefits.

**Derivative Benefits Provision**

We believe that it is appropriate to include in an LOB provision a derivative benefits test. Derivative benefits provisions serve as a needed backstop to the other LOB provisions, making treaty benefits available (without recourse to the discretionary benefits provision) in situations that involve no treaty shopping, but that nevertheless do not satisfy the objective tests in those other provisions.

However, we see no reason for distinguishing between “base eroding payments” and other payments for derivative benefits purposes, as suggested by paragraphs 14-16 of the Discussion Draft. Paragraph 15 poses a situation in which a company resident in State S (“OPCO 1”) pays royalties to a company resident in State R (“OPCO 2”), where OPCO 1 and OPCO 2 are both subsidiaries of Parent, a resident

³ A payment to a company that satisfies the “subsidiary of a publicly traded company test” (subparagraph 2.c) ii) of the LOB provision) would be still be considered a base eroding payment unless the ordinary course exception applies.
of State T. Where State S has negotiated the same royalty rate with each of State R and State T, it would be inappropriate to deny treaty benefits with respect to the royalty payments from OPCO 1 to OPCO 2. If the two treaties limit source-country tax on royalties to the same extent, denial of benefits to OPCO 2 would be entirely arbitrary, assuming that a derivative benefits test is otherwise deemed to be appropriate tax treaty policy, which we certainly believe it is.

The example of a derivative benefits provision included paragraph 13 includes an “intermediate owner” requirement that corresponds to the intermediate owner requirement in the Discussion Draft’s ownership/base erosion test discussed above. We believe such a requirement is unnecessary and would deny treaty benefits in many non-treaty-shopping situations. To our knowledge, no derivative benefits provision in a U.S. treaty now in force contains such a restriction. We believe that the proposed 2013 protocol to the 1990 U.S.-Spain treaty would represent the first intermediate owner requirement in a U.S. treaty’s derivative benefits test. Unlike the Discussion Draft’s provision, however, that protocol would not require intermediate owners to be “equivalent beneficiaries.”

4 We urge the OECD not to adopt an intermediate owner requirement in its model derivative benefits provision.

Title and Preamble

The Discussion Draft proposes that the title to the OECD Model be replaced with the following: “Convention . . . for the elimination of double taxation with respect to taxes on income and on capital and the prevention of tax evasion and avoidance” (emphasis added). The proposed preamble states that the parties intend that the Convention eliminate double taxation “without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance” (emphasis added).

We fear that the proposed title, if adopted, could be cited in the future as a basis for undercutting unambiguous treaty provisions and/or imposing additional enforcement authority not otherwise imposed under domestic law. To the extent those fears were well-founded, it would call into question otherwise unambiguous treaty terms. In addition, the proposed title could be interpreted to undermine the fundamental principle that a treaty should only relieve, and not increase, the taxation imposed under the domestic laws of the two Contracting States. If the title and preamble language could be used to inform the interpretation of all treaty provisions, including unambiguous ones, the effect may be at least as detrimental as if the Main Purpose Test were incorporated into the treaty.

The proposed Commentary stops short of making it clear that the title and preamble changes will not have such effect. To negate these potential inferences, we make two recommendations for your consideration if the title of and preamble to the OECD Model are to be amended. First, the revised title should read more like the revised preamble proposed by the Discussion Draft; it should make clear that the treaty is intended to eliminate double taxation “without creating opportunities for” non- or reduced taxation through tax avoidance, rather than indicating that the treaty is intended to “prevent tax

4 The proposed 2013 protocol would require ultimate owners to be residents of either a member state of the European Union or a party to the North American Free Trade Agreement. This requirement, however, merely represents the limited scope of derivative benefits provisions in U.S. treaties generally, in that, as a general matter, no such provision treats a third-country owner or payment recipient as a “good” owner or recipient unless that person is, among other things, a resident of an EU member state or a party to the NAFTA.
avoidance.” Second, the Commentary on such revised title and preamble should make clear that they are only relevant for interpreting terms of a treaty that are ambiguous.

* * *

In summary, we urge that the Main Purpose Test not be incorporated into the OECD Model Tax Convention; that the OECD eliminate inappropriate limitations on treaty benefits that would result from certain portions of the LOB provisions in the 2006 U.S. Model Income Tax Convention; that any LOB provision incorporated into the OECD Model include a derivative benefits rule; and that the OECD clarify that any revised title of and preamble to the OECD Model cannot be used as a basis for denying treaty benefits unambiguously provided for in the treaty, or increasing the tax imposed under internal law. We appreciate your consideration of our comments.

Sincerely,

Gretchen Sierra  
Principal  
Deloitte Tax LLP

Harrison Cohen  
Director  
Deloitte Tax LLP
RE: reaction NOB to OECD discussion draft ‘Treaty Abuse’

The Dutch Association of Tax Advisers (NOB) is pleased to submit its comments to the Discussion Draft regarding BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, as published on 14 March 2014. For ease of reference we have organized our comments according to the numbers in the Discussion Draft. We start with an executive summary, followed by a number of technical comments on each of the proposed provisions.

Executive summary
1. NOB understands the wish to prevent treaty abuse, but is of the opinion that the method proposed to achieve that objective ignores the main purpose of tax treaties, which is to eliminate double taxation because double taxation is a barrier to trade. The guiding principle in designing anti-abuse provisions should therefore be that taxpayers who conduct ‘genuine economic activities’ should be able to enjoy the benefits of tax treaties without cumbersome compliance obligations. The current proposal, however, is an accumulation of anti-abuse rules that – if implemented on a worldwide basis - will create substantial legal uncertainty for almost all companies operating in more than one jurisdiction and will lead to double taxation for many. It appears to have as its guiding principle that the application of tax treaties is abusive and that only in very limited circumstances access to tax treaties should be available. This would seriously undermine the main purpose of tax treaties and be tantamount to turning the clock more than 50 years back.

2. NOB is of the opinion that anti-abuse provisions should be focused on specific cases of abuse rather than casting a net over all taxpayers and burdening them with the task of exonerating themselves before they are entitled to treaty protection. NOB therefore strongly prefers specific measures to general measures. Consequently, NOB is opposed to the vague “main purposes” test. The proposed LOB-provision is certainly more specific. But it contains too many vague terms that cause legal uncertainty in many situations where abuse is not at issue at all and it likewise casts a net over all group companies – ‘good’ and ‘bad’ – if they have foreign shareholders and are not themselves listed on a stock exchange.
3. A foreign-owned Dutch operating company – i.e. a company with ‘genuine economic activities’ – that provides a loan to a third party borrower in another treaty country would not be certain that the interest income it will receive will be eligible for treaty protection in the source state and in its country of residence, because it is unclear whether that interest income is “derived in connection with its trade or business”. The same uncertainty arises if the group companies lend to each other as participants in a group cash pool.

4. The “in connection with”-criterion also plays an important role for head quarter companies. This is illustrated with the following example. A US MNC has its European headquarters in the Netherlands. All European operating companies are held by the group’s Dutch holding company. Even if the Dutch holding company employs dozens of employees, it would be unclear whether dividends and interest income received from these operating companies would satisfy the “in connection with” criterion. The above examples demonstrate the need for a broad interpretation of the “in connection with”-criterion. The approach we propose in paragraph 9 of this letter would deal with this issue more effectively, because it would make paragraph 3 of Article X\(^1\) redundant.

5. NOB stresses that taxpayers should be able to enjoy the benefits of tax treaties if they perform ‘genuine economic activities’ in the relevant Contracting State(s) and notes that small-size activities can easily mature towards large-size activities and that therefore the threshold for ‘genuine economic activities’ should not be high.

6. In the view of NOB the proposed provisions are especially detrimental to smaller States with open economies, such as the Netherlands. A Dutch company with predominantly foreign shareholders that receives income from a third state will be confronted with a disproportionate burden of proof in order to obtain treaty protection or will face double taxation. Consequently, these proposed provisions – if implemented – will constitute a barrier to cross-border trade. Competing in foreign markets will thus be discouraged. For existing MNCs resident in smaller States this is a serious threat to their existence. They will no longer be on the short list for businesses starting-up or as a location for a joint venture company.

7. Pursuant to settled EU case-law (e.g. Saint-Gobain), Member States are free to allocate their taxing powers, provided they comply with EU law when they exercise those taxing powers. There are good arguments to support the claim that the proposed anti-abuse provisions are outside the ‘free’ sphere of allocation of taxing powers. This means that the implementation of the provisions would conflict with EU law, particularly the free movement provisions and the principle of proportionality. The proposed LOB-provision is problematic in the light of the free movement provisions because it discriminates on the basis of ownership. The proposed “main purpose” test may fall foul of the principle of proportionality, for it seeks to prevent abuse only through a subjective test (i.e., is obtaining a tax treaty benefit “one of the main purposes”?) and lacks an objective test (i.e., is the structure ‘wholly artificial’?) This means that EU member states would violate EU law if they were to sign-up to the LOB provision as currently proposed.

\(^1\) On page 5 of the Discussion Draft, the article number of the proposed LOB-provision is “X”. 
8. Whatever the solutions adopted by the OECD, it would be crucial, in NOB's view, that they be adopted simultaneously by all OECD member States, to avert the competitive disadvantages that would arise when countries would operate on several speeds.

9. NOB is of the opinion that the main objective of tax treaties is the elimination of double taxation in order to promote economic growth and development and this objective, in conjunction with the need to comply with EU law, requires that taxpayers who conduct “economic activities that are not wholly artificial” should enjoy treaty protection without cumbersome, disproportionate compliance obligations. On this basic premise, taxpayers who are engaged in these activities should get treaty protection, unless they have entered into a transaction that has been identified as a case of abuse in the text of the treaty.

10. Notwithstanding the above, it would be possible to rework the OECD draft in a way that meets the majority of NOB’s objections and EU law constraints as follows.

- To Article X paragraph 2 subparagraph (d) would be added: [A resident of a contracting state shall be a qualified person if that resident is (iv) a person other than an individual that is engaged in economic activities that are not wholly artificial.]
- Article X paragraph 3 would be deleted.
- Headquarter activities would be defined as “economic activities that are not wholly artificial”.
- Country holding activities are likewise defined as “economic activities that are not wholly artificial”.
- A broad derivative benefits test is added to Article X (reduction of withholding tax should not be mixed with tax planning that has nothing to do with treaty application).
- The main purposes test is scrapped as a requirement the taxpayer must meet, but is instead rephrased to provide that a taxpayer who meets none of the tests of the LOB, will still get treaty protection if he plausibly demonstrates that the transaction he entered into has a predominant bona fide business purpose other than tax.
- The proposal to change the tie-breaker rule is dropped. (This remedy is far worse than the mischief it seeks to avoid.)

**Limitation on Benefits**

11. (point 11 of the Discussion Draft) The proposed LOB-provision requires for non-listed resident companies either that at least 50% of their shares are held by certain resident companies and that their tax base may not be eroded, or that they are engaged in the active conduct of a trade or business in their State of residence. For many foreign-held companies this means they will have to rely on the active trade or business criterion. NOB fails to see how the stark dividing lines drawn by the proposed LOB-provision distinguish the legitimate use of tax treaties from the abuse of tax treaties.
12. To the extent taxpayers would not pass the requirements of the proposed LOB-provision, they should in the view of NOB at least be entitled to ‘reduced’ benefits (i.e., a 5% withholding tax rate instead of a 0% withholding tax rate) or, alternatively, relief in the residence State should be ensured.

13. It is recommended that the LOB provision take into account the position of, and provide sufficient tax treaty protection to, collective investment vehicles. Reference is made to the Commentary to Article 1 of the OECD Model Convention, par. C (Cross border issues relating to collective investment vehicles) and, in particular, to the recommendations in par. 6.17 [first approach: CIVs expressly entitled] and 6.21 [second (proportionate) approach: ‘equivalent beneficiaries’]

14. The proposed LOB-provision is detrimental to MNCs with either (i) >50% third State shareholders or (ii) a substantial third State trade or business, even though this constitutes absolutely no indication of ‘abuse’.

15. In general, the proposed LOB-provision contains many vague notions. NOB cannot overstate the importance of a detailed Commentary to which point 12 of the Discussion Draft refers.

16. It is not clear why paragraph 2(c)(i)(B) in conjunction with paragraph 5(d) of Article X requires a company's “primary place of management and control” to be in the Contracting State of which it is a resident, instead of its “place of effective management” within the meaning of Article 4(3) of [the current] OECD MC.

17. It remains vague when a trade or business is ‘substantial’ (paragraph 3(b) of Article X). Aside from the vagueness, the ‘substantial’-test is not only unsuitable to prevent abuse, it also leads to overkill, for instance when an active resident company is acquired by an unrelated, much larger company of a third State. The ‘substantial’-test should either be removed or be clarified, whereby in the latter case the relative sizes of the economies involved are to be taken into account as is the case for most LOB-provisions currently in place.

18. For the sake of legal certainty, NOB recommends the insertion of a ‘positive list’ of activities that constitute an active trade or business. The carve-out for the “business of making or managing investments for the resident’s own account” should be narrowed down to “passive investments”.

19. NOB recommends the insertion of a “headquarters test” similar to the one occurring in Article 26, paragraph 5, of the tax treaty between the Netherlands and the United States.

20. Examples of how unreasonable the LOB-provision could work out in practice:

**Example: a company is delisted**
A Corp. is a company resident in State A and it is the worldwide holding company of the AA Group. A Corp. is listed at the stock exchange of State A. A Corp. holds all the shares in B Ltd, a company
resident in State B. A Corp. is a “qualified person” pursuant to Article X(2)(c)(i) (“stock exchange test”). As a consequence, A Corp. is entitled to a reduction of withholding tax on dividend distributions by B Ltd. At some point in time, the shares in A Corp. are acquired by a private equity firm and A Corp. is de-listed. The acquiring company is resident in a third State. Although the activities do not change, A Corp. will no longer be entitled to tax treaty benefits if its activities do not qualify as an “active trade or business” within the meaning of Article X(3).

Example: disproportionate class of shares owned by the family
E Corp. is a family business that decides to list at the stock exchange in State E. Upon the listing, the family decides to retain a disproportionate class of shares and, as a result, E Corp. does not meet the “stock exchange test” in Article X(2)(c)(i).

Example: joint venture
F Corp. is a company resident in State F and listed on the stock exchange in State F. G Corp. is a company resident in State G and listed on the stock exchange in State G. F Corp. and G Corp. wish to set up a 50%/50% joint venture and choose State H as a ‘neutral’ location for their joint venture company, Company H. Company H will not be entitled to tax treaty benefits if its activities do not qualify as an “active trade or business” within the meaning of Article X(3).

21. NOB would like to point out that the competent authority procedure as proposed in the LOB-provision is likely to be cumbersome and time-consuming. NOB recommends that this part of the LOB-provision should be worded as an escape which the taxpayer can apply if it establishes that one of the principal purposes of its establishment, acquisition or maintenance and the conduct of its operations is not the obtaining of tax treaty benefits. The taxpayer should be given the possibility to ask the tax authorities for advice (or, even better, a ruling) on the application of the escape.

Derivative benefits provision
22. (point 13-17 of the Discussion Draft) As a general remark, it is in the view of NOB essential that a “derivative benefits” provision be included in the LOB-provision as compliance with this provision illustrates that the existing situation does not have ‘treaty shopping’ as its purpose.

23. (point 13 of the Discussion Draft) The currently considered version of a “derivative benefits” provision contains unnecessarily restrictive elements (i.e., for not giving any indication of treaty abuse) such as (i) the fact that at least 95 percent of the aggregate voting power and value of the shares should be owned, directly or indirectly, by no more than seven persons and (ii) the fact that in the case of indirect ownership, each intermediate owner should itself be an equivalent beneficiary.

24. (points 15-17 of the Discussion Draft) Excluding a “derivative benefits” provision in order to avoid that treaty benefits would have to be granted in the example in point 15 of the Discussion Draft, would be akin to using a bazooka to kill a fly. Apparently State S considers it undesirable
that it would have to give treaty benefits under the State S – State R tax treaty, although the IP is preferentially taxed in State R, while in the State with which there is a tax treaty with “derivative benefits” (State T), the royalty income would have been ordinarily taxed. What illustrates that this alleged ‘problem’ is not a ‘problem’ of the “derivative benefits” provision, but instead a ‘problem’ of the tax treatment in State R, is that State S would also have been required to grant tax treaty benefits if “Parent” were resident in State R (in which case recourse to the “derivative benefits” provision would not be necessary). If a solution should be sought for this ‘problem’, it should be sought outside the sphere of the LOB-provision. The solution is then: either State S cancels the tax treaty with State R, or State S makes the reduction of withholding tax dependent on the taxation of the royalty income in State R. NOB notes that, if the arm’s length principle is correctly applied, the profits incorporated in the transferred intangible have been taxed in State T upon their transfer to State R. In the view of NOB, the OECD’s Harmful Tax Competition criteria suffice to combat the undesirably low taxation of royalty income by a State where this does not lead to an increase in genuine R&D activity.

25. (point 13 of the Discussion Draft) With respect to the contents of the derivative benefits provision, NOB would propose to include that if the parent is a resident of a State with a less advantageous treaty, the intermediary should have the possibility to obtain that less advantageous treaty, since fully denying any treaty benefits would clearly be overkill in that situation.

“Main Purpose” Provision

26. (points 18-33 of the Discussion Draft) In the view of NOB it is undesirable that a taxpayer that has taken all the hurdles of the LOB-provision (paragraphs 1-5) still per arrangement or transaction runs the risk of being denied the tax treaty benefits pursuant to the “main purpose” test of Article X, paragraph 6.

27. The proposed “main purposes” test gives rise to legal uncertainty as it will be a grey area whether the obtaining of a benefit under a tax treaty was “one of the main purposes” given that the tax treatment is always an important component of every business transaction. It is not clear in the view of NOB what the starting point is for this analysis; is this whether or not the relevant agreement would have been entered into in the absence of tax reasons? Further, what is an “arrangement or transaction” exactly? Would setting up an entity which complies with the LOB-provision be an arrangement or transaction?

28. The excessively wide and vague wording (e.g., “reasonable to conclude” and “one of the main purposes”) gives ammunition to tax authorities for raising tax revenue in situations where there is no abuse. Furthermore, the main rule in the “main purpose” test and the “counter evidence” rule create a strong imbalance between the taxpayer and the tax inspector, as it suffices for the tax inspector to assert that “it is reasonable to conclude that obtaining that benefit was one of the main purposes”, whereas the taxpayer must demonstrate that “granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention”, a much more onerous burden of proof. As a result, transactions that are not tax-driven at all, such as loans between operating companies belonging to a group and the participation in a group cash pool may be adversely affected.
29. In the view of NOB there is tension between the proposed “main purpose” test, pursuant to which, in essence, the benefits under a tax treaty are only available if in accordance with the object and purpose of the relevant provisions of the tax treaty, and the interpretation rule in Article 31 VCLT, pursuant to which the “ordinary meaning to be given to the terms of the treaty in their context” is the starting point for the interpretation of a treaty provision.

30. To the extent the “main purpose” test would be directed towards the reduction of dividend withholding taxes, NOB has a strong preference for specific dividend stripping measures.

31. Given the above, NOB recommends to revise the “main purpose” test in such a manner that it provides for a positive exception based on which the taxpayer can apply the tax treaty to a transaction despite that the LOB-provision is not met. For such application the taxpayer would need to establish that the main purpose of its transaction was not to gain treaty access, whereby the taxpayer should be given the possibility to ask the tax authorities for advice (or, even better, a ruling) on the application of the positive exception.

Dividend transfer transactions

32. (points 41-46 of the Discussion Draft) If a minimum shareholding period were to be introduced, it is important in the view of NOB that the reduction of withholding tax is granted immediately, i.e., also before the minimum shareholding period is met, and that this benefit would possibly be withdrawn if, in the end, the required shareholding relation does not exist for the required period. Furthermore, even if a certain shareholding relation only exists for a short period, this does not necessarily imply that there is abuse, and the taxpayer should therefore be able to submit evidence that the reduction of withholding tax would in that case be justified.

Tie Breaker

33. (points 50-53 of the Discussion Draft) The extra uncertainty created by the proposed tie breaker rule requiring mutual agreement is in the view of NOB unnecessary. Instances of dual residency usually occur for non-tax reasons. Companies may want to change their place of effective management while keeping their corporate identity, for commercial reasons, for employment law reasons etc. All instances of abuse will already be covered by the other anti-abuse measures in the treaty. This proposal would merely add to the legal uncertainty.

34. Furthermore, States can easily unilaterally remove any undesirable consequences of dual-resident situations, for instance, by (i) stipulating in domestic law that, if the company is not a resident under the applicable tax treaty, it will not be regarded as a resident for domestic tax purposes (e.g. Canada, United Kingdom) or (ii) reducing for domestic tax purposes the effect of the incorporation rule (e.g. the Netherlands).

35. NOB fears that in many cases the mutual agreement process will be cumbersome and time-consuming and leaves companies in a vacuum until agreement is reached. Also this is especially detrimental for smaller States, where a change of location of the effective management will sooner be a cross-border-change.
Permanent establishments situated in third States
36. (points 54-56 of the Discussion Draft) The proposed anti-abuse rule for permanent establishments situated in third States (State PE) is in the view of NOB disproportional. In the provision as proposed the income attributable to a permanent establishment will not get any treaty protection, even in cases where there is a treaty between State PE and the source State (S). In the view of NOB, the application of such an anti-abuse rule for permanent establishment requires that State S applies the tax treaty between State S and State PE. Furthermore, State PE should also apply the tax treaty between State S and State PE.

37. However, according to NOB, the preferred solution would be a ‘switch over clause’: if it is considered undesirable that State PE offers preferential treatment to the income from shares, debt-claims etc., while State R exempts, or taxes at low rates, profits of such permanent establishments, the OECD MC should oblige State R to apply a credit instead of an exemption for the profits of such permanent establishments that are insufficiently taxed. In such a case the proposed anti-abuse rule is superfluous.

With kind regards,
The Dutch Association of Tax Advisers

mr. B.R. Zoetmulder
Chairman of Commission International Tax Affairs

prof. mr. J.W. Bellingwout
Member of Commission International Tax Affairs

mr. S.E. Faber
Member of Commission International Tax Affairs
Dear Sirs,

Public Discussion Draft – BEPS Action 6: Preventing The Granting Of Treaty Benefits In Inappropriate Circumstances

EFAMA\(^1\) is grateful for the opportunity to comment on the OECD Public Discussion Draft on Action Point 6 on treaty abuse. We agree with the aims of BEPS and support efforts to counter all forms of harmful tax practices. We also acknowledge that the BEPS Action Plan is designed around multinational company tax avoidance.

However, we noticed that the draft on Action Plan 6 may have significant unintended consequences for collective investment vehicles (CIVs) and therefore we wish to express our serious concern about the recommendation to include a limitation-on-benefits clause in existing treaties.

As was recognized in the OECD’s report on granting treaty benefits to CIVs of April 2010, a limitation-on-benefits clause is difficult to administer for funds because the ownership of interests in funds changes frequently. And because interests in funds are often held through intermediaries, funds themselves do not know who the underlying owners are.

The OECD report on CIVs recognises that a CIV that is widely held and regulated (such as a UCITS) represents a low risk of being used for treaty shopping purposes, and should be granted treaty benefits in its own right (provided that it is a "person" and "resident"). \textbf{We therefore believe that the list of "qualifying persons" under any limitation-on-benefits clause should include a regulated and widely held CIV.}

\(^1\) EFAMA is the representative association for the European investment management industry. EFAMA represents through its 27 member associations and 62 corporate members about EUR 15 trillion in assets under management of which EUR 9.8 trillion managed by 55,000 investment funds at end December 2013. Just over 35,600 of these funds were UCITS (Undertakings for Collective Investments in Transferable Securities) funds. For more information about EFAMA, please visit \url{www.efama.org}
The UCITS funds industry has been a remarkable realization of the Single Market within the EU to the benefit of many citizens. By breaking down the barriers for cross border investment, citizens of the EU have benefitted from:

- increased competition in the supply of financial products;
- lower administration costs associated with the purchase of funds;
- greater choice of investment vehicles;
- greater economies of scale associated with collective investment; and
- greater diversification of risk.

These benefits are particularly important to smaller investors, and investors from smaller countries without developed financial markets. They are afforded to citizens through the efforts of policymakers to break down the barriers of international trade and investment – efforts that double tax treaties seek to protect and advance.

We also ask for the OECD to reaffirm the validity of existing guidance on CIVs in the Commentary to Article 1 of the Model tax Convention, which has helped funds to administer existing limitation-on-benefits clauses in tax treaties.

Finally we would like to reaffirm our support for the development and implementation of a framework for administering treaty benefits. The OECD has already provided this in TRACE and we support the further work now being undertaken to ensure that this can be adopted alongside the OECD’s Common Reporting Standard on Automatic Exchange of Information.

We are grateful in advance for your attention to the concerns expressed in this letter and we welcome the opportunity to discuss these with you. In case there is any additional information that we can provide, please contact EFAMA at info@efama.org or +32 (0) 2513 3969.

Kind regards,

Peter De Proft
Director General
9 April 2014

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Comments on OECD Discussion Draft on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

Ladies and Gentlemen:

EY appreciates the opportunity to submit these comments to the OECD on the Discussion Draft on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances dated 14 March 2014.

The OECD’s work on the Model Tax Convention and the related Commentary has been critically important to the ongoing expansion of the global network of bilateral tax treaties. These tax treaties serve to reduce or eliminate double taxation which unrelieved would be a significant barrier to cross-border trade and investment. We recognize the need to protect against the granting of tax treaty benefits in inappropriate circumstances. At the same time, we would underscore the importance of ensuring that tax treaty benefits are granted in appropriate circumstances.

For the reasons discussed below, we are concerned that the recommendations in the Discussion Draft with respect to the incorporation of anti-abuse rules in tax treaties go too far and would interfere with the proper functioning of tax treaties for their intended purposes. We urge the OECD to reconsider its recommendations in order to strike an appropriate balance that allows tax treaties to achieve the objective of facilitating cross-border trade and investment.

Limitation on Benefits Test

The Discussion Draft proposes a two-prong approach to addressing potential treaty abuse, recommending the incorporation in tax treaties of both a more objective test in the form of a limitation on benefits (LOB) provision and a more subjective test that reflects a general anti-abuse rule in the form of a main purpose test.

LOB provisions are structured as a series of alternative mechanical tests that are intended to be relatively objective. However, mechanical tests by their nature cannot cover every circumstance that can arise. Thus, such tests – even multiple alternative tests – may not allow treaty benefits in situations where such benefits would be appropriate. In order to reduce the risk of inappropriate denial of access to treaty benefits, the
mechanical tests of an LOB provision must be as broad as possible and must be supplemented with an effective rule allowing the discretionary provision of treaty benefits when the mechanical tests otherwise would not achieve the right result.

LOB provisions should include the full range of alternative mechanical tests in order to cover the range of circumstances that can arise. The Discussion Draft’s formulation of an LOB provision should be expanded to include additional mechanical tests. For example, a headquarters company test should be added. A test that addresses the special circumstances of collective investment vehicles also should be added.

The mechanical tests in an LOB provision should not include conditions that make application of a test unrealistic in practice. In this regard, the LOB provision in the Discussion Draft includes restrictions on intermediate ownership in several of the tests. Given the complex organizational structures of global businesses, restrictions of this type on ownership through intermediate entities would render these tests inapplicable in many cases. We believe that these restrictions are not necessary to serve the policy objectives of the particular tests and recommend that their inclusion be reconsidered.

As noted above, even a series of mechanical tests would not capture all situations where treaty benefits are appropriate. For this reason, LOB provisions typically include a discretionary benefits provision under which the competent authority can make a determination to grant treaty benefits in an appropriate case. Given what is at stake, it is essential that the discretionary benefits provision operates effectively in practice. We believe that the OECD should include work on improving the operation of discretionary benefits provisions as an element of its work on Action 14 with respect to improving the mutual agreement procedure under treaties.

The global nature of business today and the complexity of tiers of ownership in corporate groups mean that a so-called derivative benefits test is an essential element of an LOB provision. However, the Discussion Draft cites concerns that such a test could apply to cover arrangements that involve what is viewed as BEPS activity and provides an example that is intended to illustrate these concerns. The example involves a transfer of royalty-generating intangible property by a parent company, which is in a country that has a treaty with the country where the royalty is generated, to a subsidiary in a third country that also has a treaty with such country but that taxes royalties at a preferential tax rate.

This example does not involve an arrangement that should be viewed as raising issues with respect to qualification for treaty benefits. Any concerns with respect to the particular arrangement described do not seem to involve a concern about treaty shopping because the same treaty results would have applied if the intangible property had remained in the parent company. Any issue with respect to the transfer of the intangible property to the subsidiary, which seems to be a focus of the concern expressed in the Discussion Draft, would seem to be a matter for the parent country that could be dealt with under its domestic law. It would not seem to be a concern of the source country to be dealt with by denying treaty benefits in this narrow case.

We do not believe that this example and the concern referenced provide sufficient justification for not including a derivative benefits test in the LOB provision set forth in the Discussion Draft. To the contrary, we believe that inclusion of a derivative benefits test that allows consideration of comparable benefits in a third-country treaty is essential to the functioning of an LOB provision.
Treaty-based GAAR Provision – Main Purpose Test

The Discussion Draft recommends inclusion in tax treaties of a general anti-abuse rule that would apply in addition to all other limitations and qualifications and could deny treaty benefits where the other limitations and qualifications, including the recommended LOB provision discussed above, all are satisfied. The Draft would deny treaty benefits “if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the main purposes of any arrangement or transaction that resulted directly or indirectly in that benefit.” An exception to this denial of benefits would apply if “it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.” The Discussion Draft notes the intent to supplement the main purpose test with detailed commentary explaining the functioning of the test and providing examples.

We are concerned that inclusion of this “main purpose” test would create significant uncertainty regarding the availability of treaty benefits that would seriously erode the functioning of treaties. The test is broad and subjective and the exception incorporated in the test is vague and subjective. Businesses will not know whether they qualify for benefits of a treaty until after the fact, potentially long after the fact. Similarly, a treaty country will not know how its treaty partner is interpreting and applying the test, either currently or in the future, with the potential for significant deviations from the intended or expected implementation of the treaty and substantial imbalances between the countries.

The Discussion Draft notes that this main purpose test is intended to “provide a more general way to address treaty shopping avoidance cases, including treaty shopping situations that would not be covered by the specific anti-abuse rule in [the recommended limitation on benefits provision] (such as certain conduit financing arrangements).” The reference to “certain conduit financing arrangements” is the only indication of the purpose for or intended aim of the main purpose test. The examples provided in the Discussion Draft to illustrate the application of the test all are arrangements that involve conduit features or accommodation parties:

- The example in paragraph 27 involves a transfer of a loan in exchange for promissory notes at almost the same interest rate.
- The first negative example in paragraph 33 involves a financial institution that seems to be acting as an accommodation party in an assignment of dividends that have been declared but not yet paid.
- The second negative example in paragraph 33 involves another financial institution that similarly seems to be acting as an accommodation party, this time in a usufruct of newly issued non-voting preferred shares.

We would suggest that the concerns underlying these types of arrangements could better be addressed through a targeted rule aimed at conduit financing arrangements or other transactions in which qualification for treaty benefits depends on an accommodation party. Indeed, the OECD has experience with more targeted rules and with addressing conduit companies in particular that it could draw on to craft an appropriately tailored rule that it could recommend. The OECD’s recent work on the beneficial ownership concept could be leveraged here as well.

A more targeted rule would create significantly less uncertainty and would cause substantially less collateral damage than the proposed main purpose test. The particular examples provided in the Discussion Draft are
not helpful in explaining the reach of the broader main purpose test. As an illustration, the example in paragraph 27 involves a loan that was transferred to a new intermediate company in exchange for promissory notes. The example concludes that the proposed provision would deny treaty benefits "if the facts of the case show that one of the main purposes" for transferring the loan was for the intermediate company to obtain treaty benefits with respect to the interest. However, the example does not come to a conclusion based on the stated facts. Moreover, it is not clear if the result would be different if the loan instead were transferred in exchange for an equity interest in the intermediate company. In other words, the reach, if any, of the proposed main purpose test beyond conduit type arrangements is not clear.

In this regard, it is important to remember that this main purpose test is being proposed in combination with a robust LOB provision. The Discussion Draft recognizes that the LOB provision “will address a large number of treaty shopping situations based on the legal nature, ownership in, and general activities of, residents” of a treaty country. Therefore, the main purpose test is intended to operate only as a form of backstop to the application of the LOB provision. The main purpose test is much too broad for the intended purpose of backstopping the recommended LOB provision and the specific aim of capturing certain conduit financing arrangements that might not be caught by the LOB provision. A much more narrowly targeted rule would be better suited to this objective.

While we appreciate the inclusion of an exception from the denial of treaty benefits for situations where “it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions” of the treaty, this exception is overly vague and subjective. The two examples illustrating this exception provide little guidance because there is no clear analysis or principles that support the conclusion that treaty benefits are available in those cases.

- The first positive example in paragraph 33 involves a decision to build a plant in a treaty country. The explanation focuses on the main purpose for building the plant which is related to business expansion and lower local manufacturing costs. However, these factors are true of all three countries under consideration for location of the plant and the company in the example chose the one country that had a treaty with the parent jurisdiction. The example cites the general treaty objective of encouraging cross-border investment as the rationale for concluding that the treaty benefits are appropriate.
- The second positive example in paragraph 33 involves a collective investment vehicle that holds dividend-paying investments in corporations in a country with which its home country has a treaty. The example here too cites the general treaty objective of encouraging cross-border investment and concludes that treaty benefits are appropriate unless the investment is part of an arrangement or relates to another transaction undertaken with a main purpose of obtaining treaty benefits.

These examples would be more useful if they included clearer guidance that could be extrapolated to other situations in order to evaluate the potential availability of the exception from the denial of treaty benefits.

If it is concluded that it is necessary to include a main purpose test as part of the recommended approach to addressing treaty abuse, we urge the OECD to make modifications to the test to make it more workable and to reduce the uncertainty that would be created by this subjective test. A formulation that looks to “the” main purpose instead of “one of the main purposes” would be easier to apply and would provide more certainty. In addition, the presence of active business operations of the group in either the residence country or the source
country should be a presumptive rebuttal of any main purpose inquiry. The inclusion of such an exception would help to reduce some of the subjectivity of the main purpose test.

The discussion of the treaty-based general anti-abuse provision in the Discussion Draft also in several places references the use of domestic law general anti-abuse rules to override treaties. We found this discussion especially troubling. Moreover, with the recommendation of an LOB provision in tandem with a treaty-based general anti-abuse rule, it appears that there could be situations where a transaction would have to run the gauntlet of the application of the LOB provision and the treaty-based general anti-abuse rule plus unilateral application of a domestic law general anti-abuse rule. We urge the OECD to take the opportunity to recommend unequivocally that anti-abuse rules with respect to tax treaty benefits must be included in the treaty itself.

Finally, the Discussion Draft recommends the use of targeted specific anti-abuse rules to address qualification for particular treaty benefits. In this regard, the Discussion Draft notes that although the main purpose test will address these situations, “targeted specific anti-abuse rules generally provide greater certainty for both taxpayers and tax administrations.” We agree that more specific rules provide greater certainty than do more general rules.

We believe that the use of targeted specific anti-abuse rules that support particular treaty provisions is a better approach than the main purpose test. Such rules could be used to supplement and backstop the LOB provision which applies more generally. Indeed, such rules could be used to address the conduit financing arrangements that have been identified as the target of the main purpose test. We urge the OECD to consider replacing the recommendation for a treaty-based general anti-abuse rule with an approach that uses targeted specific anti-abuse rules in tandem with an appropriately crafted LOB provision.

One of the areas where a targeted specific rule is recommended is the determination of residence for treaty purposes in the case of dual-resident entities. The Discussion Draft proposes the elimination of the tie-breaker rule currently contained in the OECD model and its replacement with a rule that would require affirmative competent authority action. Under the proposed rule, a dual resident entity generally would not be entitled to any treaty benefits unless the competent authorities affirmatively agree to treat it as resident of one country or the other.

The question of residence is a fundamental one and most of the benefits of a treaty turn on it. Leaving a determination as to residence to the competent authorities does not seem practical or appropriate given the resource constraints of the competent authorities, the significant other responsibilities of such competent authorities, and the difficulties that competent authorities can have in reaching agreement.

The issues associated with reforming the current tie-breaker rule for treaty residence determinations are necessarily intertwined with Action 14 on improving the functioning of the mutual agreement procedure. We urge that potential modifications to the tie-breaker rule be separated from the work on addressing treaty abuse and instead be examined as part of the work on Action 14 where any modifications can be coupled with approaches designed to facilitate resolution by the competent authorities.
If you have questions or would like further information regarding any of the points discussed above, please contact Barbara Angus (barbara.angus@ey.com), Jim Tobin (james.tobin@ey.com), or me (alex.postma@ey.com).

Yours sincerely
On behalf of EY

Alex Postma
Dear Committee on Fiscal Affairs,

Please find attached INREV’s response to OECD discussion draft BEPS Action 6: preventing the granting of treaty benefits in inappropriate circumstances, dated 14 March 2014.

We hope to provide a meaningful contribution to your work to support the development of a sound regulatory framework and remain available should you have any specific questions about the non-listed real estate fund industry.

Kind regards,

Matthias Thomas

Chief Executive INREV

Attachment:

- INREV response to OECD discussion draft BEPS Action 6: preventing the granting of treaty benefits in inappropriate circumstances, dated 14 March 2014

Submitted via email: taxtreaties@oecd.org
INREV comment on OECD Discussion Draft relating to Treaty Abuse (BEPS Action 6)

About INREV

INREV is the European Association for Investors in Non-Listed Real Estate Vehicles. We provide guidance and information related to the development and harmonisation of professional standards, reporting guidelines and corporate governance within the non-listed property funds industry across Europe. In addition, INREV undertakes research and surveys of the industry and constructs the INREV Index which covers the performance of institutional non-listed real estate funds investing in Europe.

INREV currently has 352 members. Our member base includes institutional investors from around the globe as well as investment banks, fund managers, fund of funds managers and advisors representing all facets of investing into the non-listed real estate funds industry.

Our fund manager members manage 461 European non-listed real estate investment funds with a combined Gross Asset Value of EUR 274.1 billion, as well as joint ventures, club deals and separate accounts for institutional investors. INREV’s members represent almost all jurisdictions of the European Union’s internal market and a range of underlying long-term investment vehicle structures that support European economic stability, job creation and growth.

Concerns regarding the Discussion Draft on Treaty Abuse

INREV shares the concerns of the G20 and the OECD that action is needed to effectively prevent double non-taxation, as well as cases of no or low taxation associated with practices that artificially segregate taxable income from the activities that generate it. INREV also supports a coordinated and comprehensive international approach to tackle these important issues.

However, the discussion draft has proposed measures that could inadvertently have a significant negative impact on institutional real estate investment and related sectors such as infrastructure that generally use the same or very similar investment fund structures, which are critical for economic stability, job creation and growth.

INREV is of the view that the Abuse Draft contains a number of anti-abuse rules that as applied may harm the main objective of tax treaties, which is the avoidance of double taxation. If implemented on a global scale, the proposed anti-abuse rules may severely impact genuine and bonafide cross border investments.

More specifically, INREV in concerned that the likely impact on collective investment vehicles (“CIVs”) is not being adequately considered in the BEPS Action Plan and the subsequent Abuse Draft. If implemented, the proposed main abuse concepts (LOB and Main Purpose tests) would disallow treaty access to many CIVs used in the real estate investment industry. Many of these CIVs will simply not pass the proposed LOB-test.

This result will not only apply to European property investment funds, but may likewise apply to CIVs investing in, for example, infrastructure companies, life science enterprises, high tech and renewable energy projects, etc. In other words, the Abuse Draft is likely to affect many European funds that invest cross border. As a result, the additional tax burden of investing via CIVs may substantially increase. This would clearly bring us
further away from the policy objective - adopted by the OECD Council - of tax neutrality between direct investments and investments via a CIV.\footnote{The granting of treaty benefits with respect to the income of collective investment vehicles, public discussion draft dated 9 December 2009 to 31 January 2010, released by the CFA-OECD (2010) and the Commentary to the OECD Model Convention regarding CIVs.}

INREV fears that institutional investors, especially domestically tax exempt investors such as pension funds, could favour domestic property investments, rather than international investments, if the additional tax burden associated with cross border investing becomes too high.

Hence, the recommendations in the Abuse Draft may well give rise to a substantial reduction in the cross border investments of institutional investors which are critical for supplying the capital needed to fund investment in European real assets. The application of the Abuse Draft would also be a setback for the aim of creating a level playing field within the EU internal market. For this reason INREV also believes that the proposed abuse rules - individually and as a whole - will violate European economic freedoms.

INREV urges that more attention be focused on the position of cross border property and similar investment funds, such as infrastructure, before the work on the Abuse Draft is taken further. INREV suggests that the OECD align the Abuse Draft with its work on providing CIVs with treaty benefits in order to achieve the policy objective of tax neutrality for CIVs.

**Specific Suggested Points of Focus**

Reference is made to the 2010 OECD Report on the treatment of collective investment vehicles (hereinafter: “the CIV Report“) and the Commentary to article 1 of the OECD Model Convention entitled the Application of the Convention to CIVs. The policy objective is to achieve tax neutrality between direct investment versus investment via a CIV. The CTPA has made several proposals to grant treaty benefits to CIVs in their own right as it recognises that treaty benefits may not be granted to the investors in a CIV on a transparent or look through basis in practise.

A large number of INREV members are large institutional investors such as pension funds, sovereign wealth funds, charities and insurance companies that invest via funds in a portfolio of real estate situated in various countries in order to diversify their investment portfolios while funding their long-term obligations. These investors are either subject to corporate income tax in their country of residence (insurance companies), or are by nature exempt (pension funds) but regularly pay pension benefits that are fully subject to tax in the hands of the recipients of the payments (retired workers).

On the basis of the proposed LOB-test (page 5 of the Abuse Draft), the typical investment vehicle of a European property fund would not be considered to be a “qualified person“. This is because the (beneficial) interests in the given investment vehicle are - in brief - often not owned by more than 50% by persons that are resident in the country where the investment vehicle is resident.

Moreover, it is uncertain whether an investment vehicle would pass the “substantial business test“ and the business of making investments for its own account could well be excluded as a qualifying activity, based on paragraph 3,a) of article X of the proposed LOB clause. Even if it is decided to include a so-called “derivative benefits test“, there would still be uncertainty in many cases regarding the circumstances under which an investment vehicle would qualify.

It is still unclear how the “main purpose test“ would work for a typical European property investment fund. The Abuse Draft states that “[t]o determine whether or not one of the main purposes of any person concerned with an arrangement or transaction is to obtain benefits under the Convention [a tax treaty], it is important to
undertake an objective analysis of the aims and objects of all persons involved in putting that arrangement or transaction in place or being a party to it”.

In combination with the recommendation to confirm that a tax treaty will not prevent a state from applying its domestic anti-abuse rules, INREV fears that many countries may take the position that a typical fund investment vehicle is not entitled to treaty benefits, as not all of the investors in a given fund would be entitled to (the same) treaty benefits, had they invested directly.

The provision of Clause X, 2., d) under iii) is too narrowly defined to provide benefits to the vast majority of CIVs, as this clause is only helps investment vehicles that are substantially held by pension funds.

No access to tax treaties could mean that property investment funds will be faced with a significant degree of uncertainty for a prolonged period of time. There will be inconsistency across jurisdictions because countries may apply the standards differently. The risk for property investment funds is liability to high withholding taxes on the repatriation of property income from the source states. Such withholding tax will not be creditable at the level of the fund, as investment funds are in general providing for a tax neutral regime.

Moreover, a transparent tax treatment whereby the underlying withholding tax can be credited at the level of the investors in the fund will, in most cases, not be possible and is, in practice, not a realistic option for tax treaty application (see also the CIV Report and the Commentary on article 1 of the OECD Model Convention, paras.6.8 to 6.34 on this issue). The result is that – in the absence of treaty benefits - there will be "triple taxation": the property income is subject to corporate income tax in the source state, repatriation to the investment fund / vehicle will be subject to withholding tax in most cases and the income will be subject to tax in the hands of the investors (either on a real time basis or when distributed).

European property investment funds are not in the business of treaty shopping. The primary purpose of a CIV is a business purpose: pooling of capital to make investments. As mentioned in the Commentary to article 1 of the OECD Model Convention: treaty abuse implies that there is initiative and control (para. 6.32) and that a CIV cannot be seen to be used effectively for "treaty shopping" if the investors do not have control (which they typically do not have). Therefore, most European property investment funds cannot be considered to make deliberately use of “treaty benefits in inappropriate circumstances”. On the contrary, the use of treaty relief is crucial in order to avoid triple taxation in otherwise genuine bona fide investment structures.

Nevertheless, introduction of the Abuse Draft as it is proposed would deny treaty benefits to many CIVs and may have severe adverse consequences on the role that institutional capital plays in a globalised economy. INREV urges that the critical economic role played by real estate CIVs in supporting long-term investment in the European economy that supports economic stability, job creation and growth be considered in the development of the Abuse Draft.

INREV urges the OECD to support a more specific anti-abuse system that is not unnecessarily burdensome for CIVs. This could be achieved by recommending that the objective of avoiding double taxation prevail over the objective of combatting tax avoidance when a CIV is controlled by parties that would be eligible for tax treaty benefits if had they invested directly. See also the observations in the CIV Report.

INREV further suggests aligning the recommendations in the Abuse Draft with those developed in the CIV Report (and implemented in the Commentary). One approach could be to recommend including CIVs in the LOB as “qualified persons”, provided certain conditions are met.

In this respect, we would like to remind the CTPA of the following suggestion in the CIV Report, (paragraph 55) on a specific anti-abuse concept for CIVs:

In the case of CIVs, an anti-treaty shopping provision generally would seek to determine whether a CIV is being used for treaty shopping by determining whether the owners, or a specific proportion of the
owners, of interests in the CIV are residents of the Contracting State in which the CIV is organised or, in some cases, whether the owners of interests in the CIV would have been entitled to equivalent benefits had they invested directly. The latter approach would help to ensure that investors who would have been entitled to benefits with respect to income derived from the source State had they received the income directly are not put in a worse position by investing through a CIV located in a third country. The approach thus serves the goals of neutrality as between direct investments and investments through a CIV. It also decreases the risk of double taxation as between the source State and the State of residence of the investor, to the extent that there is a tax treaty between them.

Such a specific “equivalent beneficiary” approach could easily be included in the proposed LOB-clause. The general rule in the proposed LOB-clause that an entity is more than 50% controlled by residents of one of the two treaty states is far too restrictive and ignores the globalisation of the investment management industry. INREV strongly believes that an equivalent beneficiary clause for CIVs is not unnecessarily restrictive.

A balanced solution for CIVs could be to broaden the proposed LOB provision, Clause X, 2., d) under iii), to include “persons” that are: (i) substantially owned by pension funds, Sovereign Wealth Funds, REITs, or other taxable investors, and; (ii) are not “controlled” (>50%) by persons that would not have been entitled to similar treaty benefits, had they invested directly in the source country.

INREV believes that such a clause is fully in line with the recommendations made by the OECD in the CIV Report. Also intermediate entities owned by such a “qualified CIV” should be eligible for treaty benefits. If such clause is adopted, there would be no need for a “main purpose test” to be applied to CIVs. A CIV that has the adequate equivalent beneficiaries is – by definition – not making inappropriate use of tax treaty benefits.
European Business Initiative on Taxation (EBIT)

Comments on the OECD's Discussion Draft on

BEPS ACTION 6:
PREVENTING THE GRANTING OF TREATY BENEFITS IN INAPPROPRIATE CIRCUMSTANCES
Pascal Saint-Amans
Director Centre for Tax Policy and Administration
OECD
2, rue André Pascal
75016 Paris
FRANCE

Brussels, April 2014

Dear Pascal,

EBIT welcomes this opportunity to provide comments on the OECD Discussion Draft entitled “BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, 14 March 2014 – 9 April 2014” (hereinafter “the Discussion Draft”).

General comments

EBIT supports the principle that treaties should not be used to create non-taxation or for treaty shopping and supports moves to eliminate the use of treaties in situations which were not envisaged when signed and can be considered abusive.

Treaties should, however, be available in all situations where there is a commercial transaction between parties with economic substance in both contracting states, and where one side is not a conduit to a person not entitled to treaty benefits. This is needed to ensure that international trade is not compromised by double taxation, unpredictability and uncertainty.

EBIT is particularly concerned about the OECD’s proposals to introduce several new and incremental layers of Anti-Abuse tests to police treaty abuse which companies will all have to satisfy before they can get down to doing business. The combination of first a US-style limitation of benefits (LoB) test but without a derivatives benefits test, then a UK-style main purpose test (MPT) - which actually appears to be a looser “one of the main purposes” test in reality - with on top a domestic general anti-abuse rule (GAAR) and targeted Specific Anti-Abuse provisions (SAARs) will lead to “anti-abuse overkill”. This would clearly create an unworkable situation which would considerably raise the potential for conflicts of interpretation and application, and leaving legitimate business for instance much more reliant on local tax rulings, which cannot be the OECD’s aim.

EBIT has significant concerns that the proposals made, whilst they may reduce treaty abuse and thereby restore source taxation in some situations, will also severely limit the benefits of treaties in non-abusive situations, and lead to increased double taxation -or even triple taxation- and/or a substantial increase in mutual agreement procedure (MAP) requests (when available and when chosen by taxpayers), putting great strain on tax authorities. EBIT does hope that the OECD takes into account that there is a clear distinction between intended and unintended non-taxation. Secondly, it would be a pity if the newly stated target of preventing non-taxation through treaty abuse negatively impacted on other key and essential targets of tax treaties, i.e. the elimination of double taxation, the creation of a predictable business environment, and compromised the important work and achievements realised by
EBIT Comments on BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

the OECD since the mid-1950s. Indeed, we believe that treaty abuse can be tackled without such negative results for cross-border commercial activity.

Whilst we appreciate that the way tax treaties should apply is changing, EBIT wishes to reiterate to the OECD and G20 that there are currently several issues in relation to the application of tax treaties (i.e. pure non application, application of tax treaties subject to such conditions that application remains uncertain, misinterpretation of clear provisions...) in important emerging economies including Brazil and India. From our daily experience, many emerging economies still lack the required sophistication and technical and juridical expertise or the legal framework to be able to apply and interpret the OECD’s proposals in a correct and consistent manner. In such a context, it seems to us that the OECD’s proposal to introduce a US style LoB, which can be applied much more easily in mature economies than in less mature economies, in particular is a step too soon and too far. More generally, the existing gaps in treaty application between OECD members and the abovementioned economies is establishing two different worlds for international business practitioners in terms of complexity, treaty access, treaty interpretation, certainty, the duration of procedures and enforcement. This development is undesirable and in essence undermines the level playing field and competitiveness of OECD and European businesses.

EBIT is generally also concerned that the OECD’s current treaty access proposals will lead to a gap in efficiency at company level if the rules are made overly complex. For EBIT, simplification is the answer and goes at the heart of this whole exercise, which is something that the OECD has acknowledged itself.

EBIT recommends that the OECD clarify its notion of “inappropriate circumstances”.

Lastly, EBIT urges the OECD to take into account that some of its current Discussion Draft proposals are not in line with EU law (as detailed below), which effectively means that the OECD is proposing international recommendations which 23 out of the 42 countries participating in the BEPS project will be unable to adopt.

A. TREATY PROVISIONS AND/OR DOMESTIC RULES TO PREVENT THE GRANTING OF TREATY BENEFITS IN INAPPROPRIATE CIRCUMSTANCES

New Model Article X - Entitlement to Benefits

1. Cases where a person tries to circumvent limitations provided by the treaty itself

EBIT is concerned that the Discussion Draft proposes various anti-abuse provisions to be inserted into the OECD Model Convention, i.e. a LoB, a MPT and a number of SAARs, which create a very complex compliance landscape for businesses in the sense that multiple anti-abuse treaty access tests will have to be fulfilled. We would like to remind the OECD that ensuring the appropriate application of the anti-abuse provisions by countries is key to providing a predictable environment to taxpayers. Due to the complexity of the anti-abuse provisions contained in the Discussion Draft, it is clear that ensuring the appropriate application of such provisions is becoming very much dependant on tax authorities’ levels of technical expertise and “reasonable behaviour”, and this notably so - but not only - in less mature economies. We are generally concerned that the proposals will lead to a gap in efficiency at company level if the rules are made overly complex and when they are not sufficiently targeted.

EBIT recommends specific and targeted anti-abuse provisions over the introduction of another layer of non-targeted domestic GAARs and SAARs.

a) Treaty shopping
EBIT Comments on BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

i) Limitation-on-benefits provision

**ARTICLE X ENTITLEMENT TO BENEFITS**

EBIT notes that whilst the LoB clause and the MPT are both more general in nature and their main aim is to prevent treaty shopping, they follow fundamentally different approaches. The LoB clause is very complex but clear in the sense that it is based on objective criteria which leaves little room for arbitrary assessment, whereas the MPT, however, is more subjective and the opposite in regards to leaving room for arbitrary assessment. EBIT believes that it does not seem an even-handed approach by the OECD, and it is not desirable, to introduce such a duplicate anti-abuse treaty access test for addressing the same issue. Neither has the OECD made any case to demonstrate that both approaches to limitation of benefits are required to address abuse of treaties.

Paragraphs 13-17 of the Discussion Draft raise the issue of whether or not any LoB rule adopted by the OECD/G20 under Action 6 should include a “derivative benefits” provision, and the examples of situations that should be covered by any such provision, having regard to the paragraph 15/16 situation where IP is located in an intermediate state with a preferential rate on royalties.

However, the lack of a derivative benefits provision such as that envisaged in Paragraph 13 of the Discussion Draft will create problems for many cross-border multinational groups. Centralisation of certain functions is a reality, and is generally acknowledged not to be abusive as long as the return to the function follows genuine economic activity. A lack of a derivative benefits clause will leave groups relying on the active trade or business test or discretionary tests, where functions such as IP management and treasury have been centralised, or regional headquarters companies have been established. Both of these tests are likely to be subjectively applied by tax authorities, leading to cases of potential double taxation, which taxpayers will increasingly seek to resolve through MAP - when available, and even when available, MAP is in practice not really adapted to business needs / to all cases.

EBIT would like to draw the OECD’s attention to the judgment of the Court of Justice of the European Union (CJEU) in the 2002 Open Skies cases (C-466/98, C-467/98, C-468/98, C-469/98, C-471/98, C-472/98, C-475/98 and C-476/98) of 5 November 2002, in which the CJEU held that the “nationality clauses” in eight EU Member States bilateral international air transport agreements with the US were considered to be in breach of EU law i.e. contrary to the EU’s fundamental freedoms. In particular, the requirement in most of those bilateral agreements for more than 50% of the shares in their national airline to be held by nationals of that airline’s home country breached the freedom of establishment of the EC Treaty (now TFEU).

Accordingly, we urge the OECD to take this important issue into account, because otherwise the OECD is proposing a form of LoB rule which 23 out of the 42 countries participating in the BEPS project will be unable to adopt, as this provision would be prohibited under EU law.

Similarly, in our view EU (and also EEA) law, in particular the Papillon case (C-418/07), requires EU/EEA countries to be able to trace bilateral treaty entitlement via any EU/EEA country entity, and not just via the relevant EU/EEA country and its treaty partner entities.

Likewise, the proposed paragraph 2c)(i)A) requirement for shares to be traded on a local stock exchange should, to be EU/EEA law compliant, be expanded to include where they are traded on a stock exchange anywhere in the EU/EEA, in particular per the CJEU’s Royal Bank of Scotland case (C-311/97).

ii) Rules aimed at arrangements one of the main purposes of which is to obtain treaty benefits
EBIT Comments on BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

The case identified in paragraph 15 of the Discussion Draft is better dealt with by effective exit taxes or CFC rules. We also see no reason why OPPCO 2 should not be entitled to treaty benefits if it is genuinely managing IP and entitled to an intangible related return under OECD transfer pricing guidelines, and not acting as a conduit.

In addition to the LoB clause an MPT/ GAAR is proposed in paragraph 18 of the Discussion Draft. This is broadly similar to the UK rules on treaty abuse e.g. UK/India new Article 28C and would deny access to the treaty when there are arrangements with a main purpose of obtaining treaty benefits, unless (EU law) it was considered that those benefits were in line with the object and purpose of the treaty. The language of the MPT should be carefully crafted for it to be applicable only where a structure has been set up wholly artificially solely for the purposes of benefiting from the treaty.

In respect of paragraph 6 of the proposed Article X Entitlement to benefits, EBIT would say that there is a good case that this provision should be an “either/or” with paragraphs 1-5 rather than both being in place. However, we note the points made in paragraph 24 of the Discussion Draft and it is our view that those points made in paragraph 24 would have greater validity if a full derivative benefits provision were available.

With regard to the example given at paragraph 27 of the Discussion Draft, if State R has no withholding tax on interest, then RCo can be seen as a conduit company. However, if State R has a withholding tax on interest then it makes little sense to deny treaty benefits under the R-S treaty.

According to paragraph 28 of the Discussion Draft, if a company changes its residence and becomes fully taxable in a new state where it is carrying on economic activities, in our view it should be entitled to treaty benefits.

With regard to paragraph 29-32 of the Discussion Draft, it should be explicitly stated that just because a beneficial tax result arises from a transaction, this does not of itself mean that obtaining a tax advantage was a main purpose. Tax authorities are prone to assume that any tax benefit – however small – is a main purpose of a transaction, whatever the other commercial benefits that may arise.

Regarding paragraph 33 of the Discussion Draft, EBIT considers that the possible examples of situations presented in which paragraph 6 would or would not apply are not very helpful, as they are too extreme and they may not assist much in anticipating how it would apply to many intra-group situations. For example, many groups establish regional headquarter companies to manage enterprise tangible and intangible assets effectively. If a group is considering establishing such an entity, with significant numbers of employees of sufficient skill and expertise and appropriately capitalised; and it identifies suitable locations which have different double tax conventions with the state of the parent company, if the enterprise decides, taking other cost, economic and geographical factors into consideration, that the location that does not impose a withholding tax under the double taxation convention would be the most suitable for the investment, would the conclusion be that the provisions of paragraph 6 would apply?

b) Other situations where a person seeks to circumvent treaty limitations

iv) Dividend transfer transactions

In respect of paragraph 43 of the Discussion Draft, consideration should be given to ensuring that the 25% holding requirement takes account of holdings under common ultimate ownership. EBIT notes that the requirement to hold a qualifying percentage of 25% of the shares before the dividend is paid sometimes works against non-abusive and long term investment decisions. This is the case where the investment is made e.g. one month before the
EBIT Comments on BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

dividend payment date but the qualifying percentage is maintained for 12 or more months after the purchase is made.

vi) Tie-breaker rule for determining the treaty residence of dual-resident persons other than individuals

Paragraph 50 of the Discussion Draft includes perhaps the most far-reaching of these specific points and is a proposed change to the residence tie-breaker rule in the Model Convention for determining the treaty residence of a dual-residence person. The test would change from place of effective management to mutual agreement between the competent authorities (having regard to, inter alia, place of effective management). This approach already exists as an alternative in the Model Convention and in some treaties (e.g. UK/Netherlands) but a wider move would cause significant uncertainty for groups with dual resident companies.

EBIT is very concerned that the OECD proposes to substitute a 100 years old concept which works well with a US based competent authorities test which will inevitably result in an increased resource burden on tax authorities, significant delay and uncertainty for international business and many more instances of double taxation; compare the Glaxo case.

vii) Anti-abuse rule for permanent establishments situated in third States

Paragraph 54-56 of the Discussion Draft deal with PE triangulation, i.e. having a good treaty company allocate an asset to an overseas branch in a non-treaty territory. An anti-abuse provision similar to the triangulation provisions in many US treaties is one option but other suggestions should be considered according to the OECD.

EBIT believes that the OECD’s proposal to require a minimum effective tax rate before a PE in a third country can be afforded treaty benefits would represent a major departure from the existing operation of most tax treaties and would seem to require justification in any particular case on the grounds of treaty abuse rather than simply by reference to an effective tax rate measure. EBIT is concerned that the OECD is proposing to include yet another (specific) anti-abuse provision in the Model Convention itself where EBIT believes that this provision is superfluous and better dealt with through the application of domestic law provisions.

b) Other situations where a person seeks to circumvent treaty limitations

2. Cases where a person tries to abuse the provisions of domestic tax law using treaty benefits

EBIT is concerned about the Discussion Draft’s anti-abuse proposals targeted at circumventing domestic tax law by using treaties (relationship treaties and domestic anti-abuse rules). Whilst we understand that it is reasonable that the OECD wants to undertake action against this type of treaty abuse, the proposed approach would be a serious departure from the hitherto widely accepted practice based on Article 27 of the Vienna Convention on the Law of Treaties. EBIT would expect from the OECD, if it is decided that this is the way forward, that the OECD will provide very clear guidance on which very specific situations would be affected and on the saving clause and its exceptions.

B. CLARIFICATION THAT TAX TREATIES ARE NOT INTENDED TO BE USED TO GENERATE DOUBLE NON-TAXATION

EBIT generally believes that it can be helpful to state clearly in the Title of and the Preamble to the Model Tax Convention that the prevention of tax evasion and avoidance and treaty shopping is also an intrinsic purpose of tax treaties as much as the elimination of double taxation is. EBIT also agrees generally with the proposed changes to paragraph 16 of the Introduction to the Convention.
EBIT Comments on BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

C. TAX POLICY CONSIDERATIONS THAT, IN GENERAL, COUNTRIES SHOULD CONSIDER BEFORE DECIDING TO ENTER INTO A TAX TREATY WITH ANOTHER COUNTRY

EBIT considers generally that the OECD’s proposed paragraphs on pages 30 and 31 of the Discussion Draft identify a number of valid points under the new proposed heading C. Tax policy considerations that are relevant to the decision of whether to enter into a tax treaty or amend an existing treaty. However, having said that, at the same time, it seems to EBIT that “suggesting” not to enter into a tax treaty or terminate a tax treaty because a change in circumstances raises BEPS concerns related to that treaty seems a little extreme when compared to modification of tax treaties to placate BEPS concerns.

EBIT is concerned whether the OECD’s observation that: “A large number of cases of residence-source juridical double taxation can be eliminated through domestic provisions”, which, as we interpret it, also means domestic law changes, is fully consistent with the OECD’s call throughout the BEPS debate for bi- or multilaterally coordinated action, rather than for uncoordinated unilateral action by States.

EBIT trusts that the above comments are helpful and will be taken into account by the OECD in finalising its work in this area. We are happy to discuss with, and remain committed to a constructive dialogue with, the OECD.

Yours sincerely,

The European Business Initiative on Taxation – April 2014

For further information on EBIT, please contact its Secretariat via Bob van der Made, Tel: +31 6 130 96 296; Email: bob.van.der.made@nl.pwc.com.

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Commentary on the Discussion Draft for Treaty Abuse

Introduction

EPRA has taken note of the Public Discussion Draft “BEPS Action 6: preventing the granting of treaty benefits in inappropriate Circumstances”, dated March 14, 2014 (hereinafter: “the Abuse Draft”). Given the short time frame of the consultation process, please find below EPRA’s preliminary comments.

The European Public Real Estate Association – is the voice of the publicly traded European real estate sector. With more than 200 active members, EPRA represents over EUR 300 billion of real estate assets and 90% of the market capitalisation of the FTSE EPRA/NAREIT Europe Index. Through the provision of better information to investors, improvement of the general operating environment, encouragement of best practices and the cohesion and strengthening of the industry, EPRA works to encourage greater investment in listed real estate companies in Europe.

Importance of REITs

The use of Real Estate Investment Trusts (“REITs”) has significantly expanded worldwide and has a very significant impact on today’s economy.

REIT regimes have been introduced over the years as a means to:

- Attract capital into the built environment/infrastructure
- Make the benefits of investing into commercial real estate accessible for small investors
- Professionalise the property sector (normally through the growth of the publicly quoted property sector)
- Lower the cost of capital for commercial property businesses
- Prevent the proliferation of offshore property funds/private ownership

In summary, we believe that the overall purpose of REITs can be described as achieving the dual objectives of 1) making the commercial real estate market more accessible to investors and 2) improving the quality and efficiency of the end-product – the built environment, which is extremely important to sustainable economic growth and development.

Also the European Commission¹ has recognized that long-term investments, such as the ones of REITs, boost innovation and competitiveness and have wider public benefits, “since they generate greater returns for society as a whole by supporting essential services and improving living standards”. REITs have an important role for tomorrow’s economy, in particular regarding large property projects with an infrastructural character.

The OECD has also recognized the importance of REITs in its Public discussion draft on Tax Treaty Issues related to REITs (“the REITs Report”)\(^2\). Further, in the REITs Report the OECD made reference to the legitimate concerns of the industry participants in the group that prepared such Report by indicating that:

\[
\ldots \text{in order to achieve a more efficient market for portfolio investment in immovable property, REITs established in one country need to be able to invest in foreign countries’ immovable property and in REITs established in other countries. Therefore, the tax obstacles that hinder such cross-border investments should be addressed}^3.\]

In addition, the OECD has recognized that "one of the primary purposes of tax treaties is to reduce tax barriers to cross-border trade and investment"\(^4\). REITS with just one layer of tax are simple and absolutely not aggressive in eroding a tax base of the res situs territory.

**Analysis of the impact of the Abuse Draft**

In our view, it is unfortunate that the OECD in the Abuse Draft has failed to recognize the importance of REITs and the need to remove tax obstacles and barriers that hinder cross-border investments. The objective of REIT regimes in many countries is to support the development of the property sector and to realise the objective of achieving tax neutrality between direct and indirect investing in real estate by the society, namely pension funds, insurance companies, sovereign funds and the retail investors. One of the key features of a REIT is that the point of taxation is moved from the entity (the REIT) to the shareholders. Domestic REIT regimes already contain various provisions that need to safeguard that the REIT income is effectively taxed in the hands of the shareholders (investors). Moreover, substantially all REIT regimes contain specific provisions preventing abusive use of REITs and the possibility of undesired treaty shopping. Should these provisions not be in place, then countries would risk to lose their taxing rights in respect of the property income earned by REITs. This is why substantially all REIT regimes provide for a “waterproof” system whereby the property income is subject to tax on an annual basis.

Moreover, most REITs are either stock listed, or subject to regulatory supervision with all related and appropriate reporting and transparency requirements. Dividends distributed by REITs are invariably subject to withholding tax. Hence, REITs can be seen as a solid concept to prevent the proliferation of offshore property schemes and aggressive tax structures, being exactly the type of structures that the Abuse Draft is eying. Moreover, REITs are almost ideal taxpayers since the REIT withholding tax is flowing steadily with the mandatory distributions to be made regularly, in some cases even monthly.

However, if the Abuse Draft was to be implemented as proposed, it may well lead to the result that access to tax treaty benefits is denied to many bona fides legitimate pooled investment structures, like REITs.

\(^2\) Public discussion draft on Tax Treaty Issues related to REITs, 30 October 2007, p. 3.
\(^3\) Public discussion draft on Tax Treaty issues related to REITs, 30 October 2007, p. 13.
\(^4\) The Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles, adopted by the OECD Committee of Fiscal Affairs on 23 April 2010, p. 3.
To illustrate this, we have applied the various tests in the suggested limitation on benefits provision (“the LOB”) to REITs with the following results:

1. **Legal form**: Considering their legal form, REITs are not qualified persons under paragraph 2.a) and 2.b) of the LOB (“company”).

2. **Stock exchange test**: REITs have to fulfil one of the following tests, mentioned under a) and b) below:
   
   a) REITs should either (i) be listed on a recognized stock exchange located in the Contracting State where the company is resident or (ii) be listed on a recognized stock exchange and the company’s primary place of management and control should be located in the Contracting State where the company is resident.

   There does not seem to exist a valid reason to limit the listing of the REITs to recognized stock exchanges located in the Contracting State where the company is resident and in many cases, this test will not be met. Moreover, it is frequently the case that participations in REITs are traded in secondary markets, that do not fall under the definition of recognized stock exchange, or that a REIT is widely held, but not listed at an official stock exchange.

   b) At least 50% of the company (voting power and value of shares) is owned directly or indirectly (with each intermediate owner being resident in either Contracting State) by five or fewer listed companies.

   Under the current market practise, where many REITs have a broad international investors' base, including other REITs – this being one of their advantages in order to raise the required capital for large institutional / infrastructural property projects - this test is highly unlikely to be met.

3. **Charities/ Pension funds**: REITs do not fall within the scope of the qualified persons under paragraph 2.d) of the LOB.

4. **Shareholders’ test / equivalent beneficiary test**: REITs may be considered as qualified persons under paragraph 2.e) of the LOB if the following two conditions are met mentioned under a) and b) below:

   a) At least 50% of the REIT (voting power and value) is own, directly or indirectly (with each intermediate owner being resident in the State of residence of the REIT) in the hands of qualified persons (as described in 2.a), 2.b), 2.c).i) or 2.d) of the LOB) which are resident of the Contracting State where the REIT is resident.

   As previously mentioned, under current market practise, many REITs have a broad international investors’ base, including other REITs, and such condition is highly unlikely to be met.
b) Less than 50% of the income of the REIT’s tax income, is deducted by the REIT and paid or accrued, directly or indirectly to persons that are not residents of the Contracting State where the REIT is resident and are not considered as qualified persons (as described in 2.a), 2.b), 2.c), i) or 2.d) of the LOB).

Under the domestic tax law of many countries, in order to achieve the desired look-through approach in respect of REITs, REITs are required to distribute most of the income they have received as dividends to their participants and REITs are entitled to deduct from their tax base such income. In respect of REITs located in countries with this type of provisions, this second condition would neither be met.

Based on the above, it is unlikely that REITs meet the conditions set out in paragraph 2.e) of the LOB in order to be considered as qualified persons.

5. **Substantial business test:** Paragraph 3 of the LOB contains a “substantial business test”. However, it is uncertain whether REITs would pass this test and the business of making investments for its own account could very well be excluded as a qualifying activity, based on paragraph 3.a) of the LOB.

6. **Competent authority procedure:** Paragraph 4 of the LOB provides the possibility that competent authorities determine on case by case basis the application of the particular tax treaty. However, it is well known that such request would involve an additional administrative burden for the REITs, with a highly uncertain result.

7. **Derivative benefits test:** Even if it is decided to include a so-called “derivative benefits test”, there would still be uncertainty in many cases regarding the circumstances under which an investment vehicle would qualify.

As the illustration of the application of the LOB to REITs clearly demonstrates, the Abuse Draft goes too far in restricting tax treaty access, without having a clear notion of where genuine use of tax treaties ends and where abuse starts. It seems as if the balance may flip to the other side: instead of tax treaties being primarily instruments to avoid double taxation, their objective would shift to merely prevent international tax avoidance.

It is clear that REITs will be severely affected by the Abuse Draft and that many REITS face the risk of access to tax treaty benefits being denied. No access to tax treaties could mean that REITs will be faced with a significant degree of uncertainty and with constant double taxation, which would result in an increase of the costs of cross border investing.

The Abuse Draft is part of the exercise to prevent double non-taxation and cases of no or low taxation associated with practices that artificially segregate taxable income from the activities that generate it. However, the Abuse Draft is completely underestimating and ignoring the importance of cross border capital invested in and deployed by REITs. Implementation of the recommendations in the Abuse Draft would seriously hamper the interests of bona fides legitimate REITs and cross-border investors,
without realizing the impact that this would have on the global economy, in particular on the international property market, where REITS play a fundamental role.

It is unfortunate that the proposal ignores the recognition which has been granted by the OECD REIT Report built on REITs being the one of the most transparent and simplest and least tax aggressive investment forms for the building of capital of the societies through pensions funds, insurance companies and sovereign funds allocating their capital to diversified REITs.

It is even more unfortunate that this potential discrimination coincides with the EU initiatives to stimulate long term financing and long term investment for which it has been recognised that pooling vehicles like REITs or Investment Funds are ideal pooling vehicles to bundle capital from all possible sources.

**Suggestion of additional wording on the LOB**

As discussed above, there is no reason to include REITs in the scope of the “suspected persons”. This is why EPRA suggests that REITs as defined in the OECD REIT Report be considered qualified persons for purposes of LOB and that the “main purposes test” is taken out of the Abuse Draft.

Moreover, EPRA invites the OECD to include in the Abuse Draft the specific recommendations approved by OECD Working Party No. 1 on Tax Conventions and Related Questions in the REITs Report.

**Andrew Saunders**

EPRA Finance Director

09/04/14
Dear Sir or Madam,

BDI\textsuperscript{\textdagger} refers to the OECD Discussion Draft “Preventing the Granting of Treaty Benefits in Inappropriate Circumstances”, issued on 14\textsuperscript{th} March 2014 and likes to thank you for the possibility to provide our comments that allow us to engage with you on this important issue.

Tax treaties play an important role in cross border investments and transactions by providing relief from double taxation and thereby promoting economic growth and creation of jobs in the contracting states. Business acknowledges that the benefits of tax treaties should only be available in sound business structures and that it is legitimate for the treaty partners to avoid abuse of treaty provisions by generating double non-taxation in inappropriate circumstances. It is appreciated that the OECD discussion draft strives to address tax treaty abuse situations.

Before commenting on specific issues we want to express some preliminary considerations that need to be kept in mind.

- The OECD identifies Treaty Abuse as “one of the most important sources of BEPS concerns”. We fully support the intention to develop “rules to prevent the granting of treaty benefits in inappropriate circumstances”, especially when it comes to treaty shopping.

However, it is important to take into account that in the public discussion tax treaty abuse cases have been triggered by the practices of a very limited number of MNEs under very specific circumstances. Therefore it needs to be emphasized that the vast majority of

\textsuperscript{\textdagger} BDI (Federation of German Industries) is the umbrella organization of German industry and industry-related service providers. It speaks on behalf of 38 sector associations and represents over 100,000 large, medium-sized and small enterprises with more than eight million employees. A third of German gross domestic product (GDP) is generated by German industry and industry-related service.
businesses is not abusing tax treaty provisions and should not have to bear additional administrative and compliance burden. These companies contribute to financing public expenditure to a high extent and account for an enormous amount of tax revenue in the countries they operate in.

Thus we would appreciate a carefully balanced solution to the individual cases that have given rise to the OECD/G20 deliberations in order to be constructive, meet public concerns and on the other hand not to cause collateral damages for the majority of MNEs.

- Beyond that, we think the measures being proposed in the Discussion Draft will not only tackle inappropriate circumstances but will also affect ordinary and legitimate group structures that do not aim at generating treaty benefits, and thus, will lead to double taxation. Contracting states should keep in mind that the main purpose of Double Tax Treaties still is to avoid double taxation. Therefore, also measures to prevent double taxation, especially participating in binding mutual agreement procedures should be encouraged. If contracting states want to limit treaty benefits as proposed in the Discussion Draft domestic law changes to prevent double taxation should be introduced also. Unilateral domestic law must then protect against double taxation from a legal perspective but also from an economical perspective (indirect credit method).

Furthermore we would like to take the chance to provide some comments on specific issues.

**Draft LOB provision is too restrictive**

LOB provisions are an accepted way of tackling treaty abuse but the OECD Discussion Draft is overly broad and much too restrictive.

Basically, abuse of treaty benefits shall be limited by restricting the entitlement to “qualified persons” Article X(2) and qualified “items of income” Article X(3). If such criteria are not met, contracting states can grant treaty benefits under Article X(4) with respect to a specific item of income. Furthermore, the Discussion Draft includes a general anti-abuse-provision in Article X(6) and, in addition, contracting states shall agree that they are not hindered to introduce and apply domestic anti-avoidance-rules. Treaty override discussion would thereby be avoided.

Such changes would also have an impact on legitimate group structures not aiming at unjustified application of treaty benefits since the Draft is widely standardizing and using typifications. Within a group basically only a listed parent company shall be a “qualified person” if its primary place of management and control is in the same contracting state of which it is resident. Not listed subsidiaries shall only be a “qualified person“ if further criteria are met Article X(2) lit. e (i, ii). If a not listed subsidiary has, for example, itself a participation in a subsidiary not resident in the contracting state, treaty benefits are denied. Such group structures obviously can be the result of acquisitions without having aimed at treaty abuse.
“Qualifying items of income” require active activities, such as trade or business Article X(3) which exceeds legitimate anti-abuse measures by far.

This might cause several difficulties within the European Union as an implementation can be seen as incompatible with the freedom of capital movement and establishment.

Thus, the following should be considered:

- It should be clarified that treaty shopping only applies if treaties are improperly used by third country residents. Any concerns about ownership of an entity resident in a treaty country and owned by a resident of the other contracting state should be covered through domestic CFC rules.
- The requirement that all intermediary companies be resident in one of the contracting states should be omitted as multi country ownership chains are not unusual and regularly have historical or other sound business reasons.
- The restrictions on deductible payments in paragraph 2(e) (ii) of the LOB provision are too tight. For example, payments made in the ordinary course of business should not be limited to “services” or “tangible property”. Rather, any type of payments made in the ordinary course of business should be acceptable as non-base eroding.
- The active trade or business safe harbor can be effectively useless if it is unclear how it should be applied in practice. Therefore, it needs to be clarified what constitutes an “active trade or business” and whether that must be conducted through own employees, whether group financing activities can be considered an active trade or business, how similar or related the two businesses must be, and how to determine whether the residence country business is “substantial” in relation to the source country business.
- Consultations with the other competent authority should be required before a request for discretionary benefits is denied.
- There is a need to consider carefully the procedural application of LOB clauses, to make sure they do not severely disrupt normal application of treaties.

If a resident of a contracting state is not a “qualified person” or the income item is not qualifying, Article X (4) provides that the “competent authority of the other Contracting State shall nevertheless treat the resident as being entitled […] if such competent authority determines that the establishment, acquisition or maintenance […] did not have as one of its principle purposes the obtaining of benefits…”. Such clause provides for a high level of uncertainty so that Double Tax Treaties would lack their main purpose to protect against double taxation.

**Proposed Main Purpose Test leads to uncertainty and should be omitted**

A main purpose test (MPT) Article X(6) is not required to counter treaty abuse as such a provision can be highly uncertain and can discourage
legitimate commercial and investment transactions. It creates particular uncertainty where it applies as an overlay to LOB provisions or other specific anti-abuse rules. A MPT is vague and subjective and the resulting uncertainty will cause great disruptions to the legitimate operation of treaty benefits.

Interaction between treaty and domestic law anti-abuse rules

The targeted treaty anti-abuse rules can unduly restrict benefits in cases which present no abuse and involve normal business arrangements. This applies, for instance, to the proposed minimum shareholding period in Article 10(2) a) OECD-MTC or the proposed addition of a look-back period to Article 13(4) OECD-MTC. Regarding the interaction of treaties with domestic law anti-abuse provisions, the latter should only be able to deny treaty benefits where those rules determine the true facts on which tax liability arises, or where – as already stated in Paragraph 9.5 of the Commentary on Art. 1 OECD-MTC – “a main purpose for entering into certain transactions or arrangements was to secure a more favorable tax position and obtaining that more favorable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions”.

By opening Double Tax Treaties to domestic anti-abuse provisions (see comment 59 on page 21 of the Draft) Double Tax Treaties miss the purpose of preventing double taxation. Alarming is especially to include transfer mispricing and arbitrage transaction as examples for treaty abuse. Many contracting states apply different principles of arm’s length transaction (e.g. Brazil, were certain margins are legally required). In such cases double taxation would be the result if contracting states would be entitled to apply domestic anti-abuse provisions. Article 9 OECD-MTC and the purpose of mutual agreement procedures would erode. To include arbitrage transactions would mean that timing differences can result in double taxation.

Treaties should be aimed at the avoidance of double taxation only

The proposed clarification that Tax Treaties are not intended to be used to generate opportunities for tax evasion or avoidance should be dropped as it will lead to substantial uncertainty and potential disputes for legitimate commercial transactions and arrangements, without significantly helping the discussion draft’s objective to combat abuse. The primary route to tackle avoidance must be through local tax law. Rather, the Commentary language should acknowledge that many instances of double non taxation or reduced taxation do not constitute tax evasion or avoidance, and should provide guidance to distinguish acceptable from unacceptable double non taxation.

Yours faithfully,

Berthold Welling                      Katja Kallert
Comments on The OECD Discussion Draft - BEPS Action 6: Preventing the granting of treaty benefits in inappropriate circumstances dated 14 March 2014

General introduction
The OECD released its public discussion draft BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances on 14 March 2014 and comments are invited by 9 April 2014.

The comments provided below are prepared by the author as representative of Gazprom Marketing & Trading Ltd.

General comment
In order to fulfill the treaty objective of expanding economic relations between the Contracting States and promoting trade and investment, taxpayers require reasonable certainty about the tax treatment of their commercial activities. A number of the proposed changes would introduce significant uncertainty that would frustrate these objectives and inhibit trade and investment. We are specifically concerned about the widespread adoption of limitation-on-benefits provisions, a treaty GAAR and the sole use of Competent Authority proceedings to resolve situations of corporate dual residence. Widespread adoption of these provisions would undermine treaty objectives unless Contracting States have a timely, effective and inexpensive procedure for providing taxpayers with advance rulings on the application of the provisions in their facts and circumstances. We are concerned that such ruling procedures do not currently exist in a great many cases, and may not be available and adequately resourced in future. As such we do not support the proposed limitation-on-benefits provisions, treaty GAAR and dual residence tie-breaker provisions.

Section A: Develop model treaty provisions and/or domestic rules to prevent the granting of treaty benefits in inappropriate circumstances

Limitation-on-benefits (“LOB”) provision
Although there are LOB articles in existing treaties they remain rare. The reason for this may be that they – and especially one as wide as the draft proposes – are overly complicated and genuinely pose a real challenge to determine eligibility for treaty benefits. They create unnecessary uncertainty leading to increased compliance costs. LOB articles have been at the disposal of Contracting States for many years and the lack of adoption is testimony to the fact that they are unpopular. It is unclear why the OECD has overlooked this clear rejection by Contracting States.

General anti-abuse rule (“GAAR”)
The proposed GAAR is based on the premise that treaty benefits should be denied where it can be shown that one of the main purposes of an arrangement or transaction was to obtain a more favourable tax treatment. Double tax treaties clearly apply in an international context. Taxpayers have choices over factors such as where to locate and transact their business. Most countries offer various tax incentives to businesses, and taxation is always considered in any international investment decision and all other things being equal it is reasonable to assume that competently run businesses will choose the lowest tax option. Given the very wide drafting of the proposed GAAR genuine commercial decisions that include taxation could be caught by
the GAAR. It is therefore recommended that a treaty GAAR be changed to make it clear that it only applies to artificial or uncommercial arrangements and transactions.

Furthermore, it is not clear that a treaty GAAR is necessary or desirable. Some countries currently have domestic GAAR’s (either statutory or otherwise) and courts have been willing to apply domestic GAARs to deny treaty benefits. It is not clear why Contracting States could not address the examples of abuse given in the discussion draft through domestic anti-avoidance provisions if they wished. It is also not clear how a treaty GAAR would interact with domestic GAARs in the event of a difference in the nature and scope of the GAARs. Countries with domestic GAARs apply them in the context of legal systems and traditions of statutory interpretation that have evolved over years and both tax authorities and taxpayers can apply widely understood and established principles to interpret and apply the GAAR. There is no corresponding body of law that is applicable to the interpretation of a treaty GAAR, and the many and varied interpretations that may arise in numerous countries with different legal systems are more likely to increase uncertainty than to provide clarity. In lieu of a treaty GAAR, we recommend that treaty partners consider and specifically address the application of domestic anti-avoidance rules to the interpretation of the treaty, as typically occurs today with CFC rules.

Other situation where a person seeks to circumvent treaty limitations: tie-breaker rule for determining the treaty residence of dual-resident persons other than individuals

We agree the overall aim of trying to align the allocation of income more closely with the economic activities that generate that income. The author accepts that there are likely to be examples of companies introducing dual resident companies for tax avoidance purposes, but in today’s highly mobile and international business environment, many will have been set up for genuine commercial purposes, typically for corporate law purposes including profit repatriation.

The draft states that: “although situations of double residence of entities other than individuals were relatively rare, there had been a number of tax avoidance cases involving dual resident companies”. The proposed provision will add substantial uncertainty in many situations where tax avoidance is not present. ‘Place of effective management’ is a well understood concept that aligns taxation with economic substance and we urge that it be retained as the residence tie-breaker with more targeted measures to address the specific concerns arising from the admittedly rare cases of tax avoidance involving dual resident companies. We would also challenge why the proposed treaty GAAR (or domestic anti-avoidance rules) and changes to the preamble do not adequately address tax avoidance through the use of dual-resident companies.

The discussion draft specifically discusses the tie-breaker test currently applied within the model OECD convention using only the concept of “place of effective management” and proposes that this be replaced by a Mutual Agreement Procedure between the Contracting States. The draft also sets out the various factors that would determine residence, including place of effective management and place of incorporation.

Mutual agreement procedures are notoriously slow and are also outside the control of the applying company. It is our view that this proposal is unworkable in practice. This is especially so given that the proposed new rules deny access to treaty benefits in the absence of agreement between the Contracting States. The lack of certainty would be damaging for most companies and the risk remains that the Contracting States would still not be able to agree, leading to double taxation. The risk of this happening in
practice could be quite high as there is no requirement for the Competent Authorities to agree and no recourse for a taxpayer that is unable to achieve an acceptable outcome within a reasonable time via Competent Authority.

Businesses want clarity and certainty. It is our view that this can be achieved by keeping the existing approach but strengthening the guidance and being more prescriptive around what place of effective management actually means. The revised commentary could include the factors set out in the revised 24.1 although it is our view that these should be expanded and examples included. The factors should also be advisory rather than mandatory. Mandatory tests are limiting in scope and can just as easily be manipulated by those seeking to circumvent the ‘tests’. As an example, in an environment of shared services and outsourcing, having a formal requirement about where the accounting records are held is not indicative of where the business is effectively managed.

**Section B: Clarification that tax treaties are not intended to be used to generate double non-taxation**

This is non-controversial and is generally accepted that as the main objective of tax treaties is the avoidance of double taxation in order to reduce tax obstacles to cross border trade and investment, the _quid pro quo_ is that circumstances of double non-taxation is similarly reduced or eliminated. Other than providing additional clarification – or some may say stating the obvious - it remains to be seen how effective such preamble will be for persons who seek to deliberately circumvent the conditions to gain advantages that are inherent in certain treaties.

**Conclusion**

The draft tries to resolve the issue of treaty abuse and makes suggestions as to how this could be achieved. The suggestions have some merit but the overall conclusion is that they create greater uncertainty for responsible taxpayers without necessarily addressing the attitude of tax jurisdictions and aggressive taxpayers. Of greatest concern are the proposed changes to the residency tie-breaker test, the proposed widespread introduction of a complex and so far little-used LOB clause, and a very widely drafted GAAR. It is our view that these proposals should be dropped. The majority of abuses within the system can be managed via the other areas in the Action Plan on BEPS.

These comments have been prepared by:

**Tim Branston - Director of Global Taxation**

Gazprom Marketing & Trading Ltd

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Dear Madam / Sir,

ZIA response to OECD Discussion Draft “Preventing the Granting of Treaty Benefits in Inappropriate Circumstances”, issued March 14th 2014

The German Property Federation (ZIA) is one of the major interest groups of the German real estate industry. We consider ourselves to be the voice of Germany’s real estate industry, speaking for numerous most notable companies of the real estate industry as well as 22 associations, together representing more than 37,000 members. ZIA’s main goal is to act as a comprehensive and homogenous lobby for the diverse real estate industry in line with its vital importance for the German economy. As a union of businesses and associations, ZIA enables the whole real estate industry to speak with one voice on a national and European level – as well as within the Federation of German Industries (BDI).

ZIA welcomes the opportunity to respond to the OECD Discussion Draft “Preventing the Granting of Treaty Benefits in Inappropriate Circumstances” (the “Discussion Draft”). The real estate industry is interested in contributing to the work on how to handle cross-border tax issues insofar as it is concerned.

Tax treaties play a critical role in removing barriers to cross-border trade and investment. In light of this, our primary concern with the Discussion Draft is that its focus on treaty shopping is likely to impact cross-border investing in real estate, which would interfere with the goal of achieving a Common Market.

Also, we would like to observe with regard to the general intent of the Discussion Draft, that facilitating cross-border investment should not be hampered by creating uncertainties with regard to the applicable tax treaties. We would suggest that the Discussion Draft minimizes unpredictability for taxpayers whether they may benefit from a treaty.
We are concerned that the likely impact on (closed-end) collective investment vehicles ("CIVs") is not being adequately considered in the BEPS Action Plan and the subsequent Discussion Draft. If implemented, the proposed main abuse concepts (LOB-test) would disallow treaty access to many CIVs used in the (real estate) investment industry. Many of these CIVs will simply not pass the proposed LOB-test. This result will not only apply to property investment funds, but may likewise apply to CIVs investing in, for example, infrastructure companies, life science enterprises, high tech and renewable energy projects, etc. In other words, the Discussion Draft is likely to affect many funds that invest cross border. As a result, the additional tax burden of investing via CIVs may substantially increase. This would clearly bring us further away from the policy objective - adopted by the OECD Council – of tax neutrality between direct investments and investments via a CIV.

In more detail:

The proposed LOB-test (page 5 of the Discussion Draft) would possibly pose an obstacle to an investment vehicle, when it is not owned by more than 50% by persons that are resident in the country where the investment vehicle is resident. An investment vehicle would also have problems to pass the "substantial business test", because the business of making investments for its own account could, especially when it concerns real estate, well be excluded as a qualifying activity, based on paragraph 3,a) of article X of the proposed LOB clause.

No access to tax treaties could mean that property investment funds will be faced with a significant degree of uncertainty for a prolonged period of time. There will be inconsistency across jurisdictions because countries may apply the standards differently. The risk for property investment funds is liability to high withholding taxes on the repatriation of property income from the source states. Such withholding tax will not be creditable at the level of the fund, as investment funds are in general providing for a tax neutral regime.

Thus, the following should be considered:

- CIVs should be explicitly mentioned as 'qualified persons' in the LOB, especially when they are not used for treaty shopping.
- Also, fully licensed funds established under the European UCITS and AIFMD directives or similar regulated fund vehicles under other national regimes should generally be 'qualified persons'.

We remain at your disposal, if you should wish to discuss in more detail any of the issues raised in this letter. Please feel free to contact us.

Kind regards,

Carsten Rothbart     Dirk Friedrich
Submission on the OECD discussion draft on preventing the granting of treaty benefits in inappropriate circumstances

9 April 2014
Ms Marlies de Ruiter  
Tax Treaties, Transfer Pricing and Financial Transactions Division  
OECD Centre for Tax Policy and Administration  
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France  

By e-mail to: taxtreaties@oecd.org 

CC: BIAC  
BusinessEurope  

9 April 2014  

Ref: OECD public discussion draft on preventing the granting of Treaty benefits in inappropriate circumstances (BEPS Action 6)  

Dear Ms de Ruiter,  

I am pleased to respond to communicate the views of Ibec and its members on the public discussion draft published by the OECD on ‘Preventing the granting of Treaty benefits in inappropriate circumstances’ (BEPS Action 6). Ibec represents the interests of Irish business including indigenous and multinational enterprises, SMEs, spanning all sectors of the Irish economy. Ibec and its sector associations work with government and policy makers at national and international level to shape business conditions and drive economic growth. Ibec is also a member of BIAC and Business Europe and broadly supports the views communicated by these partners in their submissions on the OECD discussion draft.  

**General comments**  
Ibec supports the intentions of BEPS Action Plan 6, particularly in relation to preventing the granting of treaty benefits in inappropriate circumstances and clarifying that tax treaties are not intended to generate double non-taxation. But Ibec considers that in seeking to address treaty abuse by a minority of taxpayers, sight has been lost of the core objective of tax treaties; to facilitate and promote international trade and investment by removing double taxation and providing clear regulatory frameworks which provide certainty for business, helping to sustain and promote growth and employment. 

Ibec welcomes the stated aim in the introduction to the BEPS Action Plan project to secure agreement on international rules ‘which are clear and predictable, giving certainty to both governments and business’ to prevent Treaty abuse. But it considers that many of the elements of the current draft text require greater clarification and definition to avoid generating uncertainty and confusion for both taxpayers and tax administrations. One key overarching issue is that the draft document and examples contained in the discussion draft do not always make clear what constitutes abuse. 

Ibec also strongly believes in the importance of clear operational frameworks which reduce the cost and administrative burdens of doing business internationally and also reduce ambiguity and strengthen clarity for both taxpayers and tax authorities. However, Ibec considers that some of the options set out in the draft discussion paper (particularly in relation to the introduction of a number
of more subjective tests to guard against treaty abuse) are not necessary and will add to the costs and administrative complexity of trading internationally.

Ibec considers that tax avoidance can be best tackled locally rather than in treaties, which should instead serve to provide a strong framework to support international trade and remove double taxation, (except in instances where benefits are obtained under a Treaty in an unintended way leading to double non-taxation, or where the Treaty would otherwise override local law aimed at tackling the offending avoidance).

Ibec shares the views made by BIAC in its submission, that when businesses structure themselves in response to incentives developed by states which are specifically targeted at attracting business, this should not be considered to be tax avoidance or as abusive. Moreover, if the establishment of a final business structure generates a tax result that is not considered desirable (but which does not necessarily arise due to any form of avoidance), the issue should be tackled through local tax law.

Ibec has concerns that work on this BEPS action may also -unintentionally- impact on treaty access for collective investment vehicles (CIVs). Ibec calls on the OECD to ensure that the recommendations of the "the Granting of Treaty Benefits on the income of CIVs" (OECD 2010) are fully respected in ongoing work on BEPS Action 6 to avoid unintended negative consequences for the CIV sector and its clients.

Ibec calls on the OECD and participating states to carefully assess the practical and administrative operation of the measures proposed in the discussion draft. While seeking to tackle abuse and tax avoidance by a minority of taxpayers, sight should not be lost of the critical importance of maintaining a workable, clear, fair and balanced framework to support the majority of compliant taxpayers, whose commercial activity and international trade sustain millions of jobs worldwide.

Ibec also wishes to highlight its views on a number of specific elements of the discussion paper:

A.1 Cases where a person tries to circumvent limitations provided by the Treaty itself
a) Treaty shopping
Ibec considers that the current references in the draft discussion paper on what constitutes abusive practice require further clarification; broad/general definitions can lead to lack of clarity and confusion for taxpayers. Ibec also considers that the ‘three-pronged’ approach outlined in the draft discussion (paragraph 9) will add greatly to the administrative complexity of doing business, and prove confusing for taxpayers and tax administrations given the potential for varying interpretation in different states.

The manner in which the Limitation of Benefits (LOB) test or a main purpose/General Anti-Abuse Rule (GAAR) test are framed in the discussion document highlights that any such broad based test involves a degree of subjectivity in its application. However extensive, guidance even in the case of tests which attempt to be ‘objective’ such as the ‘substantial business test’ in the LOB provisions can only hope to encompass a certain number of transactions and circumstances and cannot guarantee a consistent application of approach across taxing jurisdictions. This is particularly the case in a LOB test which has developed from US jurisprudence using terms which cannot be hoped to be understood and applied in like manner by taxpayers and taxing authorities acting across jurisdictions which do not have the same concepts in local law. Both the LOB and GAAR tests as currently framed are at grave risk of denying taxpayers access to treaties by reason of the uncertainty that will arise in the application of the proposed measures.
Including both provisions is unnecessary and will make international trade more expensive and complex. The OECD should clarify why it considers both provisions are necessary rather than one over the other.

If either approach is adopted, an effective binding arbitration/resolution process must be developed to deal speedily and decisively with disputes (and to promote greater certainty for taxpayers). Clarification on how this process might work in case of disputes between treaty parties would be welcome.

It is preferred that the outcome of Action 6 should be implemented in new treaties as and when renegotiated. Since there is unlikely to be a single approach that will suit all jurisdictions, it is preferred that Action 15 should not incorporate the outcomes of Action 6 and should not add further requirements in addition to the outcome of Action 6.

Given the potentially material impact of the proposals on global trade, we suggest that a detailed study should be done to assess the impact of the proposals on global trade before deciding on what approach to take.

The proposals could also have an impact on the provision of international finance. The OECD’s proposals will materially favour jurisdictions which impose high rates of withholding taxes rather than jurisdictions which impose lower rates of withholding taxes. It appears to us that those who will bear the additional cost which will arise from facilitating high withholding taxes are the fiscal authorities in the lending/lessee jurisdiction and/or the borrowers/lessees (the level of costs borne by each party will depend on the foreign tax credit rules in the ‘lender’ jurisdiction and the terms of the tax clauses in the relevant finance agreements). This could potentially cause a material reduction in the exchequer revenues for ‘lending’ jurisdictions (via foreign increased foreign tax relief claims), with the resulting tax savings being in many cases paid back to the ‘borrowers’ in the high withholding tax jurisdictions. It would seem counterproductive to the overall objective of facilitating and promoting international trade and investment to reward jurisdictions that impose high withholding taxes, with the costs thereof being borne by fiscal authorities in other jurisdictions that have generous foreign tax credit relief rules.

**A.1.(a).(i) Limitation on benefits (LOB) provision**

If adopted LoB-based assessment provisions can both address Treaty abuse and provide greater certainty to all stakeholders. However, LoB tests are complex and occasionally render residents of a Contracting State as ineligible. We have grave concerns that the risk of uncertainty in application of a series of tests in the proposed LOB provisions can be addressed adequately by guidance so as not to result in a process which is complex, time consuming and uncertain for taxpayers and taxing authorities alike.

As an EU member state, under the Single Market provisions Ireland is a domicile for the location of internationally traded financial services. An important component of this activity is focused on collective investment vehicles (CIVs). Public policy has consistently supported the development of an international CIV industry to meet the needs of savers, pension funds, and other institutions to ensure that they have access to a diverse and well managed portfolio of investments at reasonable cost and low risk.

Under EU Single Market rules a CIV domiciled in any one EU member state can be distributed to investors in all EU, and most OECD, countries. Therefore, it is important that treaty LOB clauses have a multilateral derivative benefits dimension to accommodate legitimate cross border investment.
The complex issues that pertain to treaty benefits for widely distributed CIVs were addressed in the OECD report "the Granting of Treaty Benefits on the income of CIVs" adopted by the CFA on 23 April 2010. This report recognises the legitimate concerns of Governments and investors and proposes practical solutions that are fully in line with current public policy objectives. We would urge that the recommendations of that report be respected.

Ibec also proposes the inclusion of a provision for regional HQ companies to qualify for treaty benefits, reflecting the importance of regional business in managing important local elements of international trade and investment.

The limitations on local access to capital markets and finance faced by taxpayers resident in small economies with large volumes of international trade should be recognised in any LOB provision as should the requirements of EU Member States to adhere to freedoms guaranteed under EU treaties.

The discussion draft reviews whether ‘derivative benefits’ provisions should be included in a LOB. In the view of Ibec, inclusion of such provisions is essential to guard against inappropriate restriction of treaty benefits where there is no treaty shopping.

• Ibec believes that the OECD should consider a derivatives benefits clause that takes into account ownership by ‘equivalent beneficiaries’ where similar benefits are provided under another treaty.
• Testing each intermediary company in the ownership structure imposes duplication, appears unwarranted and adds undue complexity to an LOB provision thereby further restricting the ability of treaties to enhance cross-border trade and investment.
• Any derivatives benefits tests should be crafted to account of potential conflicts with principles of freedoms of establishment for situations where EU law is applicable.
• In addition, base erosion tests should reflect the EU as a single market recognising that EU based taxpayers should be free to make payments to other EU residents on equivalent terms to those made to local residents. Base erosion measures should also allow relief for payments made to persons resident in ‘equivalent treaty jurisdictions’.
• The OECD should include substance considerations in order to protect genuine commercial structures where ownership or income requirements are not met under a proposed derivatives benefits article.

Ibec also endorses the inclusion in any new LoB provision of objective tests and safe harbour provisions that can be applied and recognised/confirmed by tax authorities to confirm treaty applicability.

It is important to again stress that international treaties should be as simple, clear and unambiguous as possible to provide certainty for taxpayers and tax administrations alike. The current wording of LoB clauses in the discussion draft should be simplified and re-focussed to address more clearly what constitutes Treaty benefits abuse (to tackle avoidance) and to ensure that genuine business operations are not negatively impacted.

A.1.(a).(ii) Main purpose/General anti-abuse rule (GAAR)

Ibec is concerned at the potential of GAAR to be applied independently of, or in addition to, the LoB clause. Many states (including Ireland) already have domestic GAAR provisions. The addition of a new Treaty-level GAAR provision as proposed in the discussion draft would increase existing administrative and costs burdens. The provision could also generate uncertainty and impact negatively on trade as business could potentially be faced with three types of test (Treaty LoB, Treaty GAAR, and domestic main purpose rule).
The key challenge of a general anti-avoidance provision that is framed as a ‘main purposes’ test is that it is also subjective and left open to the risk of taxing authorities in each jurisdiction forming a different view and interpretation of the provisions. This can only lead to increased uncertainty for taxpayers which restricts their ability to rely on the treaty.

A.2. Specific anti-avoidance rules where persons otherwise seeking to circumvent Treaty limitations
Ibec notes that some of the issues highlighted in the discussion draft are linked with other BEPS actions currently under review. In relation to holding periods (paragraph 43), a three month period would be preferable. The tie-break proposals for determining Treaty residence should be reviewed with the aim of establishing a more efficient and faster approach to dealing with dual residences under Treaties. Ibec is also concerned that the proposals in relation to PEs in third states appear to be firmly grounded on a presumption of tax avoidance. The discussion paper should place a stronger emphasis on recognising ranges of genuine commercial activities.

2. Cases where a person tries to abuse the provisions of domestic tax law using treaty benefits
Ibec notes the links between issues highlighted in this section of the discussion paper and other BEPS actions. To support clarity and certainty for taxpayers, it calls for the inclusion of provisions to better highlight local legislation that is not overridden by the Treaty.

B. Clarification that tax treaties are not intended to be used to generate double non-taxation
Ibec agrees that tax treaties should not be used to avoid local tax. However, it reiterates its strong view that tax treaties should focus primarily on addressing double taxation and facilitating and supporting international trade, and that tax avoidance is best tackled through domestic tax law.

C. Tax policy considerations that, in general, counties should consider before deciding to enter into a tax treaty with another country
Ibec broadly supports the proposal outlined in the discussion draft, but hopes that changes to domestic legislation in contracting states aimed at preventing double taxation will not lead to a rise in uncoordinated activity which would promote greater confusion and uncertainty for taxpayers.

Conclusion
Ibec welcomes the opportunity provided by the OECD to outline the views of its members on the draft discussion document and looks forward to ongoing engagement with the OECD on the BEPS process. Ibec remains available to the OECD to elaborate on any of the issues highlighted in this draft.

Yours sincerely,

_______________________
Fergal O’Brien
Head of Policy and Chief Economist
BEPS ACTION 6: PREVENTING THE GRANTING OF TREATY BENEFITS IN INAPPROPRIATE CIRCUMSTANCES

Comments submitted on 9 April 2014 by ICAEW Tax Faculty in response to OECD public discussion draft *BEPS Action 6: preventing the granting of treaty benefits in inappropriate circumstances* published on 14 March 2014

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INTRODUCTION


2. We will be represented at the OECD Public Consultation Meeting at OECD Headquarters in Paris on 14 and 15 April 2014.

3. Information about the Tax Faculty and ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty’s Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

WHO WE ARE

4. ICAEW is a world leading professional membership organisation that promotes, develops and supports over 142,000 chartered accountants worldwide. We provide qualifications and professional development, share our knowledge, insight and technical expertise, and protect the quality and integrity of the accountancy and finance profession.

5. As leaders in accountancy, finance and business our members have the knowledge, skills and commitment to maintain the highest professional standards and integrity. Together we contribute to the success of individuals, organisations, communities and economies around the world.

6. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including TAXline, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

RESPONSE TO DISCUSSION DRAFT

7. The discussion draft contains three main recommendations:

   1. A treaty title and preamble should contain a clear statement that it is (being entered into) to prevent tax avoidance and to avoid creating opportunities for treaty shopping;
   2. A treaty should include a specific anti-abuse rule based on the Limitation of Benefits (LOB) provisions included in treaties concluded by the United States (US) and other countries; and
   3. A treaty should also include a more general anti-abuse provision.

8. These recommendations are amplified in the discussion draft in section A and there is also section B to clarify that treaties are not intended to create double non-taxation and section C which sets out tax policy considerations that countries should consider before entering into a tax treaty with another country.

9. The major part of the discussion draft, section A, is taken up with detailed consideration of the provisions that should be included in tax treaties and the interrelationships between domestic and treaty provisions.

10. Our general view is that recommendations 1 and 2 above should be put forward as alternatives and that there should not be a formal OECD position that both LOB and a general anti-abuse rule are necessary.
11. We also believe it is unhelpful, and will create uncertainty, if the term “tax avoidance” is used rather than treaty abuse. Some countries have a very broad view as to what is, or is not, tax avoidance and we believe its indiscriminate use in OECD documents will create uncertainty for business which will, in our view, be undesirable.

12. In our view, and in the experience of our members, US style LOB provisions have proved exceedingly complex and difficult to administer.

13. We also do not believe that a formulaic LOB provision is necessary because it is difficult to conceive of a tax abuse situation that would fall within the LOB and not also fall within the general anti-abuse rule.

14. Indeed the discussion draft itself supports this proposition because it suggests that the general rule may be needed in case tax abuse situations fall outside the LOB provisions.

15. Paragraph 18 of the discussion draft, introducing the general anti-abuse rule states:

   “the following [general anti-abuse] rule ….would provide a more general way to address treaty abuse cases, including treaty shopping situations that would not be covered by the specific [LOB] anti abuse rule .. (such as certain conduit financing arrangements.”

16. It is also interesting to note that the discussion draft does not suggest the opposite scenario that an LOB provision is required to deal with cases that would not be caught by a general anti-abuse rule.

Detail comments on LOB provisions
17. Because it is formulaic with no reference to purpose or intent, there is a real risk that a LOB provision will catch situations which are not abusive and which are actually within the spirit of the treaty. For instance our members have direct experience with the existing LOBs that the wording can cause real issues for portfolio companies into which Pension Funds and Private Equity houses co-invest (as they cannot easily meet any of the tests of qualified persons).

18. The LOB rules are so densely drafted and complicated that very few companies or individuals can understand them. Given the proposal to also have a wider and simpler general rule, it is very hard to see how such difficult to understand provisions can be viewed as meeting the standard tenets of taxation (simplicity, (lack of) complexity and proportionality). See the section below which sets out the OECD Ottawa Taxation Framework condition principles.

19. Our members and member firms know from US experience that a whole industry can develop around giving advice on the meaning of LOB provisions even for the many residents who should clearly qualify for treaty relief.

20. Before any country considers bringing in any such provisions into its own treaties it should consider whether, within their tax system, it is appropriate to have such complex rules without also introducing a clearance or ruling mechanism. This will be particularly so in countries (such as the UK) where it is necessary to apply for treaty relief.

The Ottawa Taxation Framework Conditions – Principles
21. The OECD Committee of Fiscal Affairs produced a report “Electronic Commerce: Taxation Framework Conditions” in which it set out taxation principles that should apply to electronic commerce. These principles were welcomed by the Ministers attending the Ottawa Conference on Electronic Commerce in 1998 and these continue to form the basis for appropriate tax policy.

22. These Principles were reproduced in the OECD discussion draft published on 24 March on BEPS Action 1: Address the tax challenges of the digital economy and we believe the
principles are equally sound in the context of domestic tax systems more generally and international and tax treaty rules. We have reproduced the principles in Annex 2 to this paper.

**Derivative benefit provisions**

23. This is discussed in paragraphs 13 to 17 of the discussion draft.

24. We believe that a derivative benefit provision is necessary in conjunction with an LOB provision as satisfaction of such a provision will be a clear indication that treaty shopping is not in point.

25. We also believe that under EU/EEA law (Open Sky judgment C-467/98) a Derivatives Benefits provision is required in all treaties entered into by EU/EEA countries.

26. EU law, the Papillon case (C-418/07) also requires an intermediate company test to encompass all EU/EEA subsidiaries.

**Comments on a more general anti-abuse rule**

27. This is discussed in paragraphs 18 to 33 of the discussion draft.

28. We fully support the intention that this general anti-abuse rule should be supplemented by detailed Commentary and that there will also be a number of examples to illustrate its potential impact. We have included some of our own examples below which we hope will be helpful when drafting the document for the OECD CFA to approve at its meeting in June.

29. We note that example A in paragraph 33 more or less repeats the facts of the Royal Dutch Shell case on ‘beneficial ownership’ in the Netherlands Supreme Court while example B repeats the facts of the Royal Bank of Scotland case on the same issue in the French Supreme Court. The judgments in these two cases demonstrate that existing treaty provisions are up to the task of preventing improper use of treaties and combating treaty shopping.

30. In terms of the proposed Article X subsection 6 in the discussion draft many genuine commercial transactions will fall within the first leg of the test since there are few major business decisions which are made without factoring in tax costs, in the same way with other relevant costs. The risk that most business structures will be caught by the first leg is increased by the distinction drawn on page 12 between: a) the decision around the ‘form’ of the transaction finally takes; versus, b) the initial decision to proceed with the transaction in the first place. While tax is often not a key factor in deciding to structure a businesses operation (such as manufacturing, distribution etc) in a certain way, it would be normal for tax to then factor into the decision on the exact form of the operation, (along with all other relevant costs). Companies which accept the responsibility to pay a fair and reasonable amount of tax will still look at how different locations, for example, can bring with them different tax costs in the same way that they would look at how different locations might reduce labour costs. This would be a normal business consideration as a way to further enhance an existing business decision where this can be done without tax abuse.

31. For these reasons, it is likely that a lot of focus will be placed on the second leg of the general anti-abuse test. Since this is a subjective and developing test it will be important for the OECD paper to give significant guidance in this area and include as many examples as possible. Further, since history has shown that views can develop in this respect, it should be recommended that the Contracting Parties, when entering into a new treaty, specifically state the extent to which they still agree with the commentary. Such statements could also address the treatment of new business models etc that have developed since the commentary and are now common place.
ICAEW examples

32. We have set out in Annex 3 some examples which we believe are relatively commonplace in today’s (international) business world and which if included in the Commentary would, we believe, help to understimate the potential impact of the general anti-abuse rule.

Resolving dual residence cases of persons other than individuals

33. This issue is discussed in paragraph 50 to 53.

34. We believe that the proposed approach will undermine legal certainty and the rule of law by placing the matter within the hands of the competent authorities without real guidelines or rules for them to apply.

35. The mere assertion that there have been cases involving avoidance is insufficient to displacing a legal rule with administrative power. The proposal assumes that the tie-breaker rule ought to be aimed primarily at preventing abuse and not at resolving double taxation. No actual abuse is identified or explained. The problem should be identified and if genuine, a solution may be found.

36. A sound principle based approach would involve reverting to the discussion in the 2003 paper on company residence and the communication revolution to consider whether the current single factor test continues to be appropriate in the 21st century.

37. We also believe that dual resident companies are now relatively rare. When they were used in the past it was usually to allow for double utilisation of losses or deductions. Most countries that were concerned with this abuse have now introduced domestic laws to prevent the benefit so that, in practice, such companies are now extremely rare. The UK legislation, section 18 Corporation Tax Act 2009, is an example of such domestic law which ensures that a company cannot in fact be dual resident.

38. In the few situations where dual residents are now seen, it is usually due to commercial reasons (e.g., a company being incorporated in one place for corporate law or listing benefits but managed in another as this is when the management live for historic, commercial or family reasons).

Abuse of domestic law by use of treaties

39. We believe greater prominence needs to be given to the principles of public international law, see footnote 12 on page 21 of the discussion draft, which ensure that where an issue is covered in a treaty it cannot be overridden by domestic law.

40. If treaty partners want to ensure that domestic law prevails then this should be specifically provided for as a “carve out” in the wording of the relevant treaty.

Double non-taxation – section B of discussion draft

41. The expression "tax treaties are not intended to be used to generate double non-taxation” carries with it the implication of artifice. No attempt is made in the document to distinguish between double non-taxation that may occur as a result of the simple coexistence of national tax systems and the normal operation of tax treaties on the one hand, and transactions involving artifice that are regarded as abusive which result in unintended double non-taxation.

42. Further, it would be helpful for the wording to clarify that the focus is on tax abuse 'under the treaty' to avoid unnecessary uncertainty and discussions in the future. Consider, for example, a multinational group that chooses to set up a processing centre or manufacturing site in a certain location to take advantage of local labour laws, cheaper human capital and lower social security costs etc. While one of these purposes might be viewed as 'tax' related, social security costs are not usually the remit of double tax treaties and so a group should not need to worry about uncertainty of treaty relief on other income flows etc in this situation.
43. The proposed preamble is, by itself unhelpful. It is no substitute for a clear description of the class of persons who qualify for treaty benefits. In the absence, for example, of the US style of limitation on benefits article such statements are only confusing, since, in terms, the treaty would apply to any person meeting the residence requirements of article 4, and subject to any specific limitations set out in the distributive provisions of the treaty. It should only be recommended where such substantive general limitations on benefits are agreed by the contracting states.

Policy considerations when entering into a tax treaty – section C of discussion draft

44. This is an important section. It should emphasise that States should have a clear understanding of the relevant rules of a State with whom they proposed to conclude a treaty. It should make clear that States that conclude treaties must grant the treaty benefits they have agreed, and should be taken to recognise the implications of their international obligations. In this respect States should be cautioned that the Model treaty functions as a precedent that must be tailored to specific circumstances.

45. The Model however also presupposes a comprehensive approach to the subject and proposed paragraph 15.2 should clarify that a comprehensive approach is recommended rather than picking out odd topics.

46. Proposed paragraph 15.1 should make clear that these paragraphs drafted in the context of the BEPS project, focus on the concerns of that project and are not intended to be comprehensive (It may be noted that of the six proposed paragraphs, 4 are devoted to avoidance).

47. Proposed paragraph 15.3 should be rephrased to be clear that it is not an encouragement to unilateralism. States should be encouraged to conclude treaties rather than simply relying on unilateral measures. The fact that domestic law measures such as relief for foreign tax coincide with treaty provisions is not a reason for treaties not to exist. Treaties provide a measure of stability and certainty in framing the international tax order and States wishing to adopt different approaches should be encouraged to do so on a consensual, rather than a unilateral, basis.
ICAEW TAX FACULTY’S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.

4. Easy to collect and to calculate: a person’s tax liability should be easy to calculate and straightforward and cheap to collect.

5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

APPENDIX 2

Ottawa Taxation Framework Conditions – Principles

The OECD Committee of Fiscal Affairs produced a report “Electronic Commerce: Taxation Framework Conditions” in which it set out taxation principles that should apply to electronic commerce. These principles were welcomed by the Ministers attending the Ottawa Conference on Electronic Commerce in 1998 and these continue to form the basis for appropriate tax policy.

These principles are:

Neutrality: Taxation should seek to be neutral and equitable between forms of electronic commerce and between conventional and electronic forms of commerce. Business decisions should be motivated by economic rather than tax considerations. Taxpayers in similar situations carrying out similar transactions should be subject to similar levels of taxation.

Efficiency: Compliance costs for taxpayers and administrative costs for the tax authorities should be minimised as far as possible.

Certainty and Simplicity: The tax rules should be clear and simple to understand so that taxpayers can anticipate the tax consequences in advance of a transaction, including knowing when, where and how the tax is to be accounted.

Effectiveness and Fairness: Taxation should produce the right amount of tax at the right time. The potential for tax evasion and avoidance should be minimised while keeping counteracting measures proportionate to the risks involved.

Flexibility: The systems for taxation should be flexible and dynamic to ensure that they keep pace with technological and commercial developments.
ICAEW examples of commonplace international business structures

**Shared service company**
A shared service company (covering operational activities such as human resources, IT, accounting, legal etc) is set up to reduce costs by taking advantage of economies of scale (enabling a reduction in staff numbers and other costs) and to allow for standardised processes and a common technology platform. The company's location has been chosen with reference to labour costs, labour expertise and infrastructure but social security costs and also the treaty network of the relevant country have also been factored in.

**Central procurement company**
A central procurement company is set up to reduce input costs as a result of great purchasing power and better controls/processes over spending. The company's location has been chosen by reference to labour costs and access to appropriate personnel but the local tax rate has also been taken into account.

**Data processing hub or call centre**
A data processing hub or call centre is set up to reduce staff and IT costs and to improve quality. Again the location is chosen by reference to labour laws, costs and expertise but the local tax rate are social security costs are also considered.

**Regional distribution centre**
A regional distribution centre is set up to allow for better stock management and reduced delivery times. The company's location has been chosen with reference to the quality and quantity of transport links and labour laws but also taking into account local GST/VAT rules and/or custom duties. In an extension of this example, consideration may also have been given to whether a tax holiday might be possible for such activities in certain countries, particularly in Asia. It would be good to cover both variants of the example to enable readers to understand whether the OECD members see a difference between tax being considered where it is a tax covered by the double tax treaty and tax being considered where it is not.

**Manufacturing subsidiary**
Similarly, a new manufacturing subsidiary has been set up and the location chosen with reference to labour issues, access to materials and expertise etc but also taking into account the local tax rate and custom duties.

**Group IP company**
A group IP company is set up to help protect IP value and strengthen IP enforcement. The location has been chosen by reference to local IP protection laws. However, there are various different scenarios here. It could be a pure IP management company or it could also carry out marketing of trademarks or R+D etc. In such cases, the location would also have been based on access to staff with the right expertise and experience. In each scenario, it is likely that the treaty network would also be relevant as might local incentives such as patent boxes etc. It would be good for the guidance to have an example like this which builds in the substance/activities of the IP Co to establish what current thinking is on what is acceptable. This is particularly important given the example on page 9 of the discussion draft since whether IPco in that example should be considered outside the intent of the treaties may depend on the actual facts regarding what it does locally.

**Regional sales company**
A regional sales company is set up to create a local footprint. However, it is also located to take advantage of a low local tax rate and/or low GST/VAT.
Holding company
A Holding company is located in a good treaty network company. Again, there are variations to this example which it would be good to explore in the commentary from, at one extreme, a pure holding company which is just set up and into which only 1 subsidiary is transferred to, at the other extreme, one which has been set up for many years as a regional holding company with many subsidiaries.

Parent company
A parent company, P Co, has 3 subs (Subs 1,2 and 3). Sub 3 needs cash or services. All of subs 1, 2 and P Co are companies with good substance and which have the available cash and resources to help. But each company is in a different location and each country has a treaty with Sub 3 country but with different rates for interest and royalty WHT. Therefore, P Co recommends that the services/ cash are provided in the most tax efficient manner as all other things are equal. An example like this, compared to a pure conduit or empty subsidiary providing cash/services, would help again to show where the limits are on what’s seen as being within the spirit of the treaties.
April 9, 2014

Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

Comments by the Insurance Company Working Group on BEPS

1. Introduction and Summary of Comments

These comments are being submitted to the OECD by the Insurance Company Working Group on Base Erosion and Profit Shifting (BEPS), which consists of insurance companies conducting international business, in response to the OECD’s Discussion Draft on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances (March 19, 2014). These comments respond to the OECD’s requests for comments on the Discussion Draft.

Our comments on the Discussion Draft may be summarized as follows:

- We are not convinced that tax treaties should necessarily include a limitation-on-benefits (LOB) article of the type recommended in the Discussion Draft, and we have concerns about the recommended LOB provision. In particular, the requirement in paragraph 2.c.ii that, in the case of indirect ownership, each intermediate owner must be a resident of one of the Contracting States seems overly restrictive.

- Based on the explanations and examples in the Discussion Draft, we also are concerned as to whether tax treaties should necessarily include a general anti-abuse rule denying treaty benefits where one of the main purposes of an arrangement or transaction was the obtaining of such treaty benefits and granting the benefits would not accord with the object and purpose of the relevant provisions of the treaty. Such a general rule would create significant uncertainty regarding the applicability of treaties in many circumstances, thereby defeating one of the purposes of treaties.

- Rather than mandating that all treaties contain both an LOB article and a general anti-abuse rule, we suggest that it would be more appropriate to recommend that countries be given the flexibility to consider both alternatives and choose a version of one or the other that both sides agree is suitable in their particular circumstances.

- To the extent that an LOB article is used, it should include a derivative benefits provision. States should be encouraged to allow treaty benefits for entities that are owned by parent companies that would themselves qualify for treaty benefits, as there is no abuse inherent in such a structure. The abuse described in paragraphs 15 and 16 of the Discussion Draft is narrow and can be better addressed in other ways. In addition, the LOB article should either provide an exemption for widely held authorized collective investment vehicles or provide a special derivative-benefits rule for collective investment
vehicles ensuring that investors in those vehicles that are equivalent beneficiaries are not denied the benefits of the treaty (consistent with paragraph 6.23 of the Commentary on Article 1 of the OECD Model Tax Convention).

- If the title and preamble of tax treaties are to be amended as proposed in the Discussion Draft, the effect of these amendments on the interpretation of treaty provisions needs to be explained in far more detail than is contained in the minimal explanation in the Discussion Draft.
- The activities of an insurance company should be expressly included in the list of activities that are deemed to be within the meaning of “active conduct of a trade or business” for the purposes of the Discussion Draft’s proposed rule regarding triangular cases (in paragraph 4.b on page 20 of the Discussion Draft). There is no rationale for expressly including “banking or securities activities carried on by a bank or registered securities dealer” but not insurance activities carried on by a licensed insurance company.
- Regarding dual resident companies, a grandfathering rule should allow an entity that is currently treated as a resident of a particular country under the existing place-of-effective-management rule to continue to be so treated.

2. **LOB provision**

The recommendation that all treaties contain an LOB provision such as the one set out in the Discussion Draft gives rise to a number of concerns. The proposed LOB article is complex and formulaic, containing many terms and concepts that may be fairly well understood in certain countries but not so well understood in other countries.

The recommended LOB article also seems overly restrictive. For example, paragraph 2.c.ii of the proposed LOB article requires, in the case of indirect ownership, that each intermediate owner be a resident of one of the Contracting States. This conflicts with many corporate ownership structures that were not designed with tax avoidance or treaty shopping in mind.

We suggest that it would be worth considering a more limited recommendation regarding the use of an LOB article or other type of anti-treaty-shopping provision in treaties, namely, that the two countries that are negotiating a bilateral tax treaty should carefully evaluate which type of provision will be least likely to create uncertainty or other issues for their residents and adopt an appropriately drafted provision. A “one size fits all” approach is not workable.

3. **General anti-abuse rule**

The general anti-abuse rule is recommended in the Discussion Draft as a backstop to the more specific LOB clause, in order to ensure that certain treaty-shopping arrangements would not succeed. The only examples of such arrangements in the Discussion Draft are:
• a conduit financing arrangement involving a treaty-qualified intermediary that passes muster under the LOB clause because its stock is traded on a recognized stock exchange located in its country of residence (paragraph 24),
• a transfer of debt of a newly-acquired subsidiary from the parent to a subsidiary resident in a jurisdiction which provides treaty benefits with respect to interest payments from the new subsidiary (paragraph 27),
• an assignment to a treaty-qualified accommodation party of the right to receive declared but unpaid dividends on stock of a subsidiary (Example A in paragraph 33), and
• an assignment to a treaty-qualified accommodation party of the beneficial interest in non-voting preferred stock of a subsidiary (Example B in paragraph 33).

The Discussion Draft recognizes that the recommended rule is general in nature and states the OECD’s intention that the rule would be supplemented by “a detailed Commentary that would explain its main features.” Much of the section of the Discussion Draft that addresses this proposal is devoted to “explanations that could be included in the Commentary” on the provision. The fact that the proposed rule requires such a lengthy commentary suggests that it is far too vague and that taxpayers will not know when it is applicable, and that it will lead to increased disagreements between taxpayers and governments, and between governments over when the provision is applicable.

The Discussion Draft states that the proposed general anti-abuse rule "mirrors the guidance" in paragraphs 9.5, 22, 22.1 and 22.2 of the Commentary to Article 1 of the OECD Model Tax Convention. However, paragraphs 9.5 et seq. provide inadequate guidance on when treaty benefits are appropriate. Paragraph 9.5 states as a "guiding principle" that treaty benefits should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favorable tax position and obtaining that more favorable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions. However, this guidance was provided in the context of paragraphs 9.1 through 9.4, which state that countries do not have to grant the benefits of a double taxation convention where arrangements that constitute an abuse of the provisions of the convention have been entered into, and suggests that some countries might enact specific rules of domestic law that are intended to prevent tax abuse, or disregard abusive transactions under the terms of the treaty itself rather than enacting appropriate domestic legislation. Thus, the Discussion Draft takes language that was intended to articulate a "guiding principle" for domestic action, and elevates it to the status of a treaty provision. Since the original "guiding principle" stated in the Commentary to the Model was necessarily vague, that vagueness is inherent in the language proposed in the Discussion Draft.

Given the general and potentially vague nature of a main-purpose test, it is essential that any such test be accompanied by a detailed and clear explanation and detailed and clear examples, as is stated in the Discussion Draft. We appreciate the effort in the Discussion Draft to accomplish these objectives, but we believe the explanation and examples in the draft do not clarify the
The scope of the proposed rule. At the end of this submission, we have included a more detailed series of questions and comments relating to the examples included in the draft. We hope you will find these questions helpful.

Tax treaties are meant to provide the benefits of certainty and reduced tax rates to residents of the two contracting states. As articulated in the Discussion Draft, the recommended general anti-abuse rule would cast doubt on the availability of these benefits in almost every case where the taxpayer had taken the treaty benefits into account in deciding whether or not to enter into the relevant transaction. The creation of this level of uncertainty is contrary to the purpose of tax treaties.

Alternatively, a better and more effective approach would be to craft a targeted provision that could be incorporated into an LOB article or other treaty provision to address cases such as the examples noted above. For example, such a provision might deny the benefit of reduced withholding tax rates in cases where the qualified resident acquired the right to receive the relevant payments from a person who would not have been entitled to equivalent treaty benefits and the acquisition did not occur as part of a transaction having a bona fide non-tax business purpose.

4. Inclusion of a “derivative benefits” provision in the LOB article

If an LOB article is used, it should include a derivative benefits provision. States should be encouraged to allow treaty benefits for entities that are owned by companies that would themselves qualify for treaty benefits, as there is no abuse inherent in such a structure.

In addition, the LOB article should either provide an exemption for widely held authorized collective investment vehicles (CIVs) or provide a special derivative-benefits rule for CIVs ensuring that investors in those vehicles that are equivalent beneficiaries are not denied the benefits of the treaty. In this regard, we note the following passage in the OECD’s report, *The Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles* (23 April 2010):

In the case of CIVs, an anti-treaty shopping provision generally would seek to determine whether a CIV is being used for treaty shopping by determining whether the owners, or a specific proportion of the owners, of interests in the CIV are residents of the Contracting State in which the CIV is organised or, in some cases, whether the owners of interests in the CIV would have been entitled to equivalent benefits had they invested directly. The latter approach would help to ensure that investors who would have been entitled to benefits with respect to income derived from the source State had they received the income directly are not put in a worse position by investing through a CIV located in a third country. The approach thus serves the goals of neutrality as between direct investments and investments through a CIV. It also decreases the risk of double taxation.
as between the source State and the State of residence of the investor, to the extent that there is a tax treaty between them. It is beneficial for investors, particularly those from small countries, who will consequently enjoy a greater choice of investment vehicles. It also increases economies of scale, which are a primary economic benefit of investing through CIVs. Finally, adopting this approach substantially simplifies compliance procedures. Compliance procedures could be greatly simplified, because in many cases, nearly all of a CIV’s investors will be “equivalent beneficiaries”, given the extent of bilateral treaty coverage . . . (paragraph 55)

This language was subsequently incorporated into the Commentary on Article 1 of the OECD Model Tax Convention, in paragraph 6.23, along with suggested treaty provisions in paragraph 6.21.

Regarding the abuse described in paragraphs 15 and 16 of the Discussion Draft, we believe that the issue is narrow and can be addressed by specific treaty provisions or domestic law that is more targeted at the abuse described. The example involves the transfer of a portable intangible from Parent in State T to a subsidiary resident in low-tax jurisdiction State R. In the example, State S would grant treaty benefits to the subsidiary in State R by reason of the Parent’s residence in State T.

It is by no means clear that the source of the tax abuse is the derivative benefits provision of the State R-State S treaty. In the example, State R has chosen to impose a low rate of tax despite a lack of relevant business activity by the owner of the income, and State T has chosen not to tax the income of the State R subsidiary in State T. Nor is the law of State S being abused, as State S would not have collected withholding tax had the intangible been retained in Parent in State T. If there is a tax-motivated transaction here that is inconsistent with the principles underlying the BEPS project, it is the transfer of the intangible for little or no consideration. This type of abuse is better targeted under Action 8, which requires that transfer pricing outcomes with respect to the transfer of intangibles be in line with value creation. Alternatively, it could be dealt with through recommendations against harmful tax practices under Action 5 of the OECD’s Action Plan on BEPS, which would require substantial business activity in order to qualify for a preferential tax regime.

5. Proposed changes to the title and preamble of tax treaties

The Discussion Draft recommends the inclusion of language in the title and preamble of tax treaties to clarify that the treaty is not meant to facilitate double nontaxation or reduce taxes for the benefit of residents of third countries. In paragraphs 76 and 77 of the Discussion Draft, the OECD indicates that this would affect the interpretation and application of the provisions of the treaty.
Given that the OECD Model Convention has been in existence for many decades, and the interpretation of its provisions is contained in a Commentary that has been relied on for all of those years, taxpayers need guidance on how the current interpretation of particular treaty provisions would be affected in the future by the proposed new language in the title and preamble. The Discussion Draft proposes changes to the Introduction to the Model Tax Convention in this regard, but there is no explanation of the interpretive effect other than the general statements in the proposed new paragraph 16.2 in the Introduction (in paragraph 77 of the Discussion Draft, at p. 29).

At the same time, taxpayers should be given the benefit of some type of grandfathering of the existing interpretation of the affected provisions.

6. **Income of an active trade or business**

The Discussion Draft’s proposed LOB provision includes, in paragraph 3.a), “banking, insurance or securities activities carried on by a bank, insurance company or registered securities dealer respectively” in the scope of “active conduct of a trade or business” for the purposes of that paragraph. However, in the Discussion Draft’s proposed rule regarding triangular cases, which has a substantially similar “active conduct of a trade or business” requirement (in paragraph 4.b on page 20 of the Discussion Draft), the activities of an insurance company are omitted: only “banking or securities activities carried on by a bank or registered securities dealer” are included in “active conduct of a trade or business” for the purposes of the rule. This appears to be an oversight by the authors of the Discussion Draft, as there is no rationale for excluding insurance activities of an insurance company in the proposed rule regarding triangular cases.

7. **Grandfathering of existing dual resident companies**

With respect to the proposal to have the competent authorities determine the residence of dual resident companies based on all relevant facts and circumstances, a grandfathering rule should be provided to allow entities that have been treated as residents of a specific country under the old rule, which determines residence by reference to the effective place of management, to continue to be so treated. Otherwise, an entity whose residence has been established for years, and all of whose activities are structured based on that determination of residence, may find itself treated (or potentially treated) as a resident of a different country.

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**Questions and Comments Relating to General Anti-Abuse Rule Examples**

The explanations and examples in the Discussion Draft do not fully clarify the scope of the proposed general anti-abuse rule. In the example stated in paragraph 27 of the Discussion Draft, the new parent company TCo transfers a debt of newly-acquired subsidiary SCo to a new subsidiary in State R, RCo, so as to benefit from the terms of the State R-State S tax convention.
The indebtedness is transferred in exchange for three demand notes of RCo. The example seems to suggest that had RCo been the original lender, there would not have been any basis for challenging the availability of treaty benefits. If that is true, then the example provides no coherent guidance as to whether a specific arrangement or transaction would be subject to challenge under the general anti-abuse rule. If a loan directly by RCo would have been acceptable, why should the arrangement no longer be acceptable in the context of a corporate acquisition (even assuming that one of the main purposes of TCo in transferring its loan to RCo was for RCo to obtain the benefit of the State R-S treaty)? Would the arrangement have been acceptable if the SCo indebtedness had been acquired directly by RCo, rather than acquired by TCo and transferred to RCo? Assuming the structure described in the example was dictated by legitimate non-tax business purposes (a point on which the example is silent) why should it make a difference whether the loan is acquired directly by RCo?

In addition, having TCo transfer the indebtedness for notes of RCo implies that the back-to-back indebtedness is a crucial factor. If so, that should be made explicit. If that implication was not intended, having TCo transfer the indebtedness in exchange for demand notes is misleading, and the example should be revised so that TCo transfers the indebtedness in exchange for equity (common stock).

Examples A and B in paragraph 33 of the Discussion Draft are also problematic because both examples implicate issues of beneficial ownership of income which the Discussion Draft acknowledges have already been introduced into the Model. Fact patterns that may be subject to challenge under principles already embodied in the Model before the inclusion of a general anti-abuse rule provide little guidance or clarity as to the application of the proposed general anti-abuse rule.

Example C (in paragraph 33 of the Discussion Draft) is held out as an example in which building a manufacturing plant in State R would be in accordance with the object and purpose of the tax convention. However, it is difficult to see how the facts of Example C differ in principle from those of the example in paragraph 27, and yet an opposite result is reached. Assuming the loan to SCo in paragraph 27 was entered into for valid commercial reasons (a point which the Discussion Draft concedes) then the decision to transfer the loan to RCo in paragraph 27 is arguably no less valid than the decision to establish the manufacturing plant in State S in Example C.

More troubling still, in Example D (in paragraph 33 of the Discussion Draft), no definitive conclusion is stated as to whether the general anti-abuse rule applies to the facts that have been described. The stated conclusion is that the rule should not apply “unless [the treaty-qualified resident’s] investment is part of an arrangement or relates to another transaction undertaken for a main purpose of obtaining the benefit of the Convention.” In other words, the example indicates that the rule should not apply to the stated facts, unless it should apply to the stated facts. We are concerned that it is so difficult to determine the scope of the rule.
The vagueness and uncertainty inherent in the proposed general anti-abuse rule derives in large part from the broad definition of an "arrangement or transaction" (discussed in paragraph 28 of the Discussion Draft). What is the "arrangement or transaction" in Example C (paragraph 33)? Is it the building of the plant (as the example suggests), or is it the decision to do so through an entity resident in State S? Paragraph 28 admits of either interpretation. In the example described in paragraph 27, in our reading, the broad definition of "arrangement or transaction" would have resulted in the denial of treaty benefits even if the loan had been originated in RCo, since apparently even the decision to incorporate an entity in a treaty-eligible jurisdiction is problematic (paragraph 28 defines "arrangement or transaction" to include "arrangements concerning the establishment … of a person who derives the income").
31 March 2014

To: Tax Treaties, Transfer Pricing and Financial Transactions Division OECD/CTPA
(sent via email to taxtreaties@oecd.org)

Dear Sir,

BEPS Action 6: Preventing the granting of Treaty benefits in inappropriate circumstances

IHG welcomes the opportunity to submit comments on the OECD Discussion Draft on BEPS Action 6: Preventing the granting of Treaty benefits in inappropriate circumstances (‘The Discussion Draft’).

IHG is supportive of the BEPS Action Plan in general and of the specific Action 6 objectives of preventing abuse of tax treaties. For the reasons set out below we are, however, concerned that the proposals set out in the Discussion Draft would make it impossible for tax treaties to fulfil their primary role of facilitating international trade by achieving an agreed allocation of taxing rights between treaty parties and reducing risks of double taxation.

In our view two fundamental requirements for achieving those objectives are that:

(i) Companies entering into international trade can have confidence that normal commercial arrangements will benefit from treaty provisions; and
(ii) Countries entering into tax treaties can have confidence that their treaty partners will grant treaty benefits to those normal commercial arrangements.

We believe that, in turn, in order to deliver these requirements it is essential that:

(a) The vast majority of normal commercial arrangements can be assured of meeting the conditions for treaty entitlement based on objective criteria without the need for complex calculation or reliance on favourable subjective assessments of facts by treaty countries; and
(b) Where it is proposed that treaty benefits will be denied based on subjective criteria then that should require the agreement of the treaty partners under competent authority arrangements (on the basis of an appeal by the taxpayer) and that there should be a requirement to report to the treaty counterparty all cases in which claimed treaty benefits are denied.

Our comments are made in the context of multinational groups and apply for situations involving companies rather than individuals.
In our view, a key factual area which should be investigated for the purpose of arriving at conclusions is consideration of the range of structures and relationships that typically arise as a result of normal commercial fact patterns and developments. In this respect, it is important to recognise that such normal commercial fact patterns do not comprise just simple companies that carry out trading operations involving third parties but all companies carrying out supporting functions. That includes companies such as regional headquarter companies and companies that provide services and expertise to other group companies. For continuing regionalised operational reasons, or as a legacy from acquisitions of other multinational groups, that will normally also include investment holding activities in jurisdictions other than the ultimate parent jurisdiction.

We do not believe that IHG’s fact pattern of growth, which involves both the acquisition of a number of multinational groups with their own histories and legal structures, and of regionalised operational management involving change over time in designated operating regions, is unusual. In contrast the Discussion Draft seems to assume a profile which is only likely to fit groups which are in the early stages of organic growth outside their home jurisdiction.

Our overall view is that a better approach than that proposed in the Discussion Draft would be to have a Limitation of Benefits clause which contained Derivative Benefit and other (e.g. genuine establishment) clauses which provide a simple route for concluding that most normal commercial arrangements are entitled to treaty benefits, but supplemented by a General Anti-Abuse Rule which can be applied subject to bilateral agreement by the treaty parties.

A high level overview of IHG may be helpful in setting the context in which our comments are made.

**About IHG**

IHG is a global organisation with a broad portfolio of nine hotel brands including InterContinental® Hotels & Resorts, Hotel Indigo®, Crowne Plaza® Hotels & Resorts, Holiday Inn® Hotels and Resorts, Holiday Inn Express®, Staybridge Suites®, Candlewood Suites®, EVEN™ Hotels and HUALUXE™ Hotels & Resorts. IHG franchises, leases, manages or owns almost 4,700 hotels and 687,000 guest rooms in nearly 100 countries and territories. Our primary franchise and management business involves providing a package of services and rights to enable third-party hotel owners to deliver hotel services which reflect the standards and character of the particular IHG brand concerned.

The IHG Group started life as the Bass Group in 1777, focused on brewing operations in Burton-upon-Trent. The business diversified over time with many acquisitions across a number of areas such as casinos, soft drinks and pubs and restaurants. In 1988 Bass added a hotel business to its portfolio, buying Holiday Inn International before further expanding with the purchase of InterContinental hotels in 1998. By 2003, the Group had disposed of its brewing operations and had demerged its hotels business from its pubs and restaurants business to create a standalone hotel Group, IHG. In the last 10 years or so since the demerger, the Group has focused on pursuing an “asset-light” strategy that has seen over 180 owned hotels sold, over $8bn returned to shareholders and a focus on adding to the number of third party hotels operating under IHG brands through IHG franchise or management agreements.
As a result of the evolution of the IHG business, our Group may be considered a complex one in legal structure terms, with employees, offices and legal entities in numerous territories worldwide. Whilst the provision of hotel franchise and management services will, in itself, typically require either limited or no IHG presence in the local jurisdiction where the hotel is, as a result of our history and international scope, we currently hold over 250 legal entities worldwide, including both legacy entities that either were inherited with acquisitions or not sold as part of wider disposal transactions, regional and sub-regional operations headquarter and holding companies, and numerous local trading entities. The role of many of these entities has changed over time as the business has changed, and will inevitably do so again in the future as the commercial and operating structures of the business change.

**Detailed Comments on Treaty Policy**

We believe that there are a number of areas of policy that require clarity or further thought in order to make them more effective for all of the parties involved in agreeing, and relying upon, tax treaties. We set these out below:

1. **The purpose of tax treaties**

   We welcome, and agree with, the statements which it is proposed to introduce as paragraph 15.2 of the Introduction of the OECD Model Convention (see paragraph 81 of the Discussion Draft). In particular that:

   ‘Since a main objective of tax treaties is the avoidance of double taxation in order to reduce tax obstacles to cross-border services, trade and investment, the existence of risks of double taxation resulting from the inter-action of the tax systems of the two States involved will be the primary tax policy concern’; and

   ‘Most of the provisions of tax treaties seek to alleviate double taxation by allocating taxing rights between the two States…..’

   We also note and agree with the proposed insert as paragraph 15.4 that:

   ‘Another tax policy consideration that is relevant to the conclusion of a tax treaty is the risk of excessive taxation that may result from high withholding taxes in the source State. Whilst mechanisms for the relief of double taxation will normally ensure that such withholding taxes do not result in double taxation, to the extent that such taxes levied in the State of source exceed the amount of tax normally levied on profits in the State of residence, they may have a detrimental effect on cross-border trade and investment.’

   As touched on in the introduction to this letter our concerns are that the proposals in the Discussion Draft would result in either or both of:

   (a) Companies being concerned that double taxation will not be avoided because treaty benefits may be denied with respect to normal commercial arrangements; and
   (b) Treaty parties being concerned that their counterparty may use the subjective provisions of the treaty to unilaterally deny treaty benefits in circumstances which is inconsistent with the first mentioned treaty party’s understanding of the intention and meaning of the treaty –
and thereby claim taxing rights which are intended to rest with the first mentioned treaty party.

The concerns arise because the proposed ‘Entitlement to Benefits’ section in Article X only gives clear objective rights to claim treaty benefits in the very limited circumstances where one party to the transaction is a company in the jurisdiction where the multinational group is listed. For the reasons given above, and illustrated by reference to IHG’s commercial facts, we believe that most typical multinational group commercial fact patterns will fall outside that profile.

For example, although IHG is a UK-parented and listed group, the Holiday Inn business which it acquired originated in the US and its operations for the Americas region are still conducted by US companies which IHG acquired. Because of their prior independent history, and their continuing operating role as the head office for the Americas region, those companies will have substantial investments in subsidiaries and in joint venture partners. Those US companies rely on treaty benefits for their entire franchise and management business, as well as with respect to investment income and gains.

Whereas it should be expected that subjective provisions should still give an entitlement to benefits it seems that this would be at the subjective discretion of the relevant treaty partner and may require the provision of substantial factual information and history. It cannot be a reasonable outcome that changes in ownership of multinational groups, or the regional management of their operations and investments, create either this type of uncertainty or this type of discretion concerning the retention of treaty benefits.

We believe it is essential, if tax treaties are to serve their primary purpose of promoting cross-border trade and investment, that they provide sufficient certainty for those who will need to rely on them (whether that be companies or governments entering into treaties).

2. **Be bilateral, not unilateral**

A fundamental requirement for providing sufficient certainty is of course that the meaning of the language in the treaty is as clear and as unambiguous as possible. A further necessary component is having mechanisms which help ensure that the Contracting States are interpreting and applying the treaty in a consistent fashion. The aspect of application is a particularly difficult one because that can sometimes be a matter not just of outcome but of practise. A practical approach which makes it excessively difficult or costly to claim treaty benefits in one of the treaty jurisdictions will have a practical effect of denying treaty benefits in many cases where they should be granted, and result in allocation outcomes which are inconsistent with the intention of the treaty parties.

Thus, although we agree with the points raised in the Discussion Draft in section C, we suggest that additional commentary should be included to the effect that ensuring that the treaty has its intended effects of facilitating cross-border trade and investment, and allocating associated taxing rights in an agreed manner will require that:

(a) It is not made excessively difficult or costly as a practical matter for companies entering into normal commercial arrangements to benefit from the terms of the tax treaty; and  
(b) There are procedures in place to help ensure that treaty benefits are only denied in
circumstances where it is clearly intended, under the terms of the agreement between the treaty partners, that benefits should be denied.

We suggest that the latter principle should be reflected more broadly in the drafting proposed in the Discussion Draft and that it should not be possible to deny treaty benefits without either the possibility of a reference to competent authority provisions for a final decision or some equivalent bilateral process. A decision to set aside the normal allocation of taxing rights agreed between the treaty partners is a significant one and should not be taken unilaterally. There thus needs to be transparency and agreement between the treaty partners as to where, and how frequently, such measures are being taken – as, if there is substantial disagreement in this area, then it calls into question whether it is appropriate for a treaty to be in place at all.

We consider that there are situations (such as para 4 of the Discussion Draft’s Limitation of Benefits clause) where a Contracting State is afforded the opportunity to act in a unilateral manner in deciding whether a person is entitled to a treaty benefit. Whereas we accept that States will enter into treaty agreements in good faith and with the best of intentions, unilateral clauses, by their very nature, lead to uncertainty for businesses and governments if there are not provisions which ensure consistent interpretation across territories. Additional issues arise with unilateral clauses because they will typically fall as a matter of practice to be applied by tax authorities at a local level within the countries concerned, who are not so familiar with the broader purposes and intentions of the treaty. This can add to the risk of inconsistent interpretation or, at worst, the risk of such clauses being used to meet local tax raising objectives by levying more domestic tax than the treaty parties intend. This can be particularly problematic where there are other practical restrictions, such as Exchange Control restrictions, which may prevent payments being made until agreement is reached with the local tax authority.

We would prefer to see an approach where Contracting States make bilateral decisions on key Treaty aspects, and especially where suspected Treaty Shopping/Treaty Abuse cases are in point. The advantage of this approach would be to offer companies more certainty of treatment under a Tax Treaty. Additionally, if both Contracting States assert, for example, that a company is Treaty Shopping, that is a powerful statement for the company to consider versus receiving a decision it does not agree with which has been made unilaterally by one of the Contracting States.

3. Use treaty abuse clauses to counteract treaty abuse and not other issues

We believe that it is essential that further consideration is given to the specific types of abuse which the provisions are intended to counter, their extent, and whether they are best addressed by the type of provisions proposed, or by other provisions (whether existing provisions or those proposed under other BEPS Actions). Attempting to address problems which are not treaty abuse problems using treaty abuse provisions is, firstly, not likely to succeed (because the provisions are not properly targeted) and is, secondly, (for the same reason), likely to undermine the main purpose of treaties of promoting international trade and investment.

We believe that the example given in paragraph 15 as a reason for not including a ‘derivative benefits’ provision illustrates this problem. If the abuse concerned is one of diverting profits
from the parent company then the problem is most appropriately addressed by CFC provisions. If the abuse is overcharging Opco 1 (or attributing unjustified levels of profits to Opco 2) then those problems are most appropriately addressed by transfer pricing provisions. If the problem is harmful tax practices of State R then the most appropriate avenue for State S to protect itself is to simply not have a tax treaty with State R (i.e. following the principles of section C of the Discussion Draft). If the treaty is in place then it must reasonably be concluded that it is intended to be available to those who are properly established and carrying on the relevant activity in State R.

In short the problem is not one of abusing a treaty which is justifiably in place. Having anti-abuse provisions which attempt to address this problem will therefore inevitably undermine the treaty’s intended purpose of encouraging cross-border trade and investment, by denying or making uncertain, the treaty entitlement of State R businesses generally.

4. **Entitlement not disentitlement – ease of qualification**

If the intention of a tax treaty is to promote cross-border trade and investment, then this requires that the vast majority of normal commercial arrangements can be reasonably certain of benefiting from the treaty - and can reach this conclusion based on a limited review of the facts rather than needing to seek expert advice and carry out complex calculations. This requires easily applicable tests which can be used to generate a presumption of qualification. One such test is a derivative benefits test which grants benefits where equivalent benefits would have been available if the same business had been conducted by the relevant parent entity. As a point of detail we are not clear why the position of ‘each intermediate owner’ is relevant to this test.

More generally we believe that there should be a defeasible working assumption that a company will qualify for treaty benefits on the basis of its residence where it can reasonably be concluded (based on substantive factors) that it is genuinely established and conducting the relevant business or activity in its state of residence. Indeed our understanding is that, within the EU, any tax treaty would need to be interpreted consistently with that requirement. Such a company should then only be excluded from qualification to the extent Contracting States both agree that there is evidence which justifies the application of an anti-abuse provision to deny benefits.

This contrasts with the current Discussion Draft’s Limitation of Benefits clause which, despite containing very complex wording, effectively seeks a justification for being granted treaty benefits rather than providing them more automatically (and then removing them in cases of abuse).

We therefore prefer an approach of “you are in (the treaty) unless you are out (i.e. there is treaty abuse)”, rather than “prove why you should be in (the treaty)”. The former enables speed of commercial dealings, certainty, less cost for business (and Contracting States) and, possibly, the opportunity of clearer, simpler wording.

**Summary**

We reiterate our support for the BEPS Action Plan and hope that our comments are useful inclusions into the debate and future direction on Action 6. From IHG’s perspective, we look
for tax treaties to enable genuine commercial activities and not restrict them. We believe tax treaties should remain focused on their primary intention of eliminating double tax on cross-border trade and that there be clear and binding processes to ensure Contracting States interpret them fairly and consistently.

We would be happy to provide additional explanation and comment whether within the forum of the proposed public consultation or otherwise.

Yours faithfully,

C.P. Garwood
Head of Group Tax
April 9, 2014

VIA E-MAIL

Ms. Marlies de Ruiter
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Centre for Tax Policy & Administration
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France
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Re: Comments on Discussion Draft on BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

Dear Ms. de Ruiter:

The International Alliance for Principled Taxation (IAPT or Alliance) is a group of about two dozen major multinational corporations based throughout the world, and representing business sectors as diverse as consumer products, media, mining, telecommunications, oilfield services, transportation, luxury goods, computer technology, energy, pharmaceuticals, heavy equipment, entertainment, software, beverages, automotive, IT systems, publishing, electronics, and advertising. The group’s purpose is to promote the development and application of international tax rules and policies based on principles designed to prevent double taxation and to provide predictable treatment to businesses operating internationally.

The Alliance appreciates the opportunity to provide input to the OECD with respect to its Discussion Draft on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances (Discussion Draft) released on March 14, 2014. Our comments are set forth in Annex 1 to this letter.

As you know, the IAPT submitted comments on Action 6 of the July 2013 BEPS Action Plan on October 16, 2013, and we include copies of those comments as Annex 2 to this letter for reference.
As outlined in our attached comments, we believe that significant changes need to be made to the proposed amendments to the OECD Model Tax Convention set forth in the Discussion Draft in order to strike the appropriate balance between preventing treaty abuse and allowing legitimate treaty benefits to be obtained without undue difficulty or uncertainty in routine business and investment transactions. In its current form, the Discussion Draft risks creating substantial disruptions to cross-border trade and investment in a manner that will undermine the very purpose of tax treaties. We have made every effort to provide constructive suggestions on how we believe the Discussion Draft can best be improved and to set forth the rationale for our suggestions.

Once again, the Alliance appreciates the opportunity to comment on this important element of the BEPS project and stands ready to respond to any questions or to provide further input as the work of the OECD on this item continues.

Sincerely yours on behalf of the Alliance,

Mary C. Bennett
Baker & McKenzie LLP
Counsel to the Alliance

Annex 1: Comments on the March 14, 2014 Discussion Draft
ANNEX 1

INTERNATIONAL ALLIANCE FOR PRINCIPLE TAXATION

COMMENTS ON MARCH 14, 2014 DISCUSSION DRAFT ON PREVENTING THE GRANTING OF TREATY BENEFITS IN INAPPROPRIATE CIRCUMSTANCES

APRIL 9, 2014
1. Executive Summary

1. Tax treaties have played a critical role in eliminating barriers to cross-border trade and investment over a number of decades, thereby contributing to economic growth, productivity, jobs, and prosperity in jurisdictions across the world. In seeking to address Action 6 of the BEPS Action Plan, the OECD cannot lose sight of the importance of preserving a well-functioning network of double tax treaties to support the legitimate conduct of international business.

2. While the Discussion Draft on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances contains a number of laudable proposals for addressing treaty abuse situations, it is, when viewed in its entirety, a dangerously disproportionate response to the perceived problem, which risks seriously disrupting the availability of treaty benefits to legitimate commercial transactions and structures, thereby undermining the core purpose of tax treaties.

3. The IAPT supports in principle the inclusion of a properly crafted, objective LOB provision in treaties as the principal tool to address treaty shopping concerns. That being said, the version proposed in the Discussion Draft is much too restrictive. The IAPT recommends a number of changes to that LOB provision, including:

- Defining treaty shopping to include only improper use of treaties by third country residents
- In the safe harbor for publicly traded companies:
  - Endorsing a liberal approach to the designation of recognized stock exchanges
  - Providing a definition of “regularly traded”
  - Deleting the primarily traded / primary place of management and control requirement
- In the safe harbor for subsidiaries of publicly traded companies:
  - Confirming that it applies to a subsidiary of a publicly traded parent resident in either of the two Contracting States
  - Eliminating the requirement that all intermediate companies be resident of either the treaty’s source State or the treaty’s residence State
- In the ownership / base erosion safe harbor:
  - Treating residents of either Contracting State as “good” owners
o Eliminating the requirement that all intermediate owners of a company be residents of the company’s residence State

o Confirming that an entity is entitled to look through its publicly traded parent to the residence of its public shareholders for purposes of satisfying the ownership test

o Deleting the base erosion prong entirely

o Alternatively, liberalizing the categories of “good” payees of deductible payments, liberalizing the types of ordinary course of business payments that may be made, and confirming that payments to associated enterprises are not necessarily “bad” payments

• In the active trade or business safe harbor, providing clear guidance on the application of the essential elements of the test

• Providing a critically needed derivative benefits safe harbor, which should treat residents of any treaty partner whose treaty provides equivalent benefits as “good” owners and should provide clear guidance on the standard for applying a rate comparison test

• In connection with the discretionary grant of treaty benefits:

  o Providing clear guidance on the standards to be applied by the competent authorities making the determination, and

  o Requiring a competent authority to whom an application for relief has been made to consult in good faith with the other competent authority on a timely basis before deciding to reject the application

• Carefully considering the procedural implementation of the LOB provision to ensure that it does not, in practice, make treaty benefits effectively inaccessible or prohibitively expensive to obtain

4. The main purpose test provision proposed at paragraph 18 of the Discussion Draft should be dropped, on the grounds that it is unnecessary, vague, and subjective, that it fundamentally differs from the standard set forth in the existing Commentary, and that the uncertainty it will cause will result in too great a disruption to the legitimate operation of treaty benefits. If the test is retained:

• It should be reformulated to apply to deny benefits only where both States agree that “a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions”.

• Moreover, it should be explicitly limited so as not to re-test issues that have already been tested under other treaty provisions, such as ownership under the LOB provision or conduit status under the beneficial owner conditions.
• The OECD should provide clear examples of why the test is needed as well as clear examples of when it should not be applied to circumstances where its application could realistically be in doubt.

• Finally, an advance ruling procedure should be available so that taxpayers could determine with certainty, within 6 months from filing a ruling request, whether a country intends to invoke the provision and within no more than 3 months thereafter whether the two competent authorities agree on the application of the provision.

5. Regarding the proposed addition of a minimum shareholding period to Article 10(2), the IAPT recommends that it be dropped on the grounds that it would unduly restrict benefits in cases which present no abuse and involve normal business arrangements. If the proposal is retained, the IAPT recommends that the required holding period be limited to a brief holding period (e.g., 2 months) so as to minimize potential disruption to normal parent-subsidiary dividend payments.

6. Regarding the proposed addition of a look-back period to Article 13(4), the OECD should re-emphasize the need for the types of reasonable exceptions from Article 13(4) that can be found in the treaty practice of some countries or in the OECD Commentary (e.g., exempting sales by small minority shareholders or sales taking place through public trading on stock exchanges or over the counter).

7. Regarding the proposed change to the tie-breaker rule for determining the treaty residence of entities, the OECD should explicitly acknowledge that such situations can and do arise outside the context of tax planning, and it should clarify that either: (i) a request for a competent authority resolution pursuant to the proposed Article 4 language and Article 25(1) will be eligible for arbitration under Article 25(5); or (ii) the competent authorities shall endeavor to resolve the issue with a specified period after the request is made, not to exceed one year.

8. Regarding the interaction of treaties with domestic law anti-abuse rules, the IAPT recommends that the Commentary clarify that domestic law anti-abuse provisions can operate to deny treaty benefits only where those rules meet the standards expressed in the current Commentary, namely that they: (i) legitimately operate within general domestic law principles to determine the true facts on which tax liability arises, or (ii) have the effect of denying treaty benefits only where “a main purpose for entering into certain transactions or arrangements was to secure a more favorable tax position and obtaining that more favorable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions”.

9. Regarding the proposed Preamble language on the lack of an intention to create opportunities for tax evasion or avoidance, the IAPT believes that it should be dropped on the grounds that it will lead to substantial uncertainty and potential disputes for legitimate commercial transactions and arrangements, without significantly improving the landscape for combatting abuse. Recognizing, however, that the BEPS Action Plan mandates inclusion of some form of language along these lines, the IAPT recommends:
• That the parenthetical reference to treaty shopping be dropped, and
• That the language be accompanied by Commentary language that acknowledges there are many instances of double non-taxation or reduced taxation that do not constitute tax evasion or avoidance, and that provides guidance on what standards are to apply to distinguish acceptable from unacceptable double non-taxation.

10. Finally, the IAPT strongly supports the initiative to lay out considerations countries should take into account in deciding whether to enter into, or to maintain, tax treaty relationships with other countries, endorses the considerations set forth in the Discussion Draft as legitimate and reasonable factors to take into account, and suggests that the OECD may wish to consider whether certain other factors should be taken into account, such as:

• Whether the treaty partner’s negotiating positions fall within or near internationally recognized norms,
• How reliable the treaty partner is in applying the treaty provisions in good faith,
• To what extent their procedural rules and practices accommodate or impede reasonable access to treaty benefits in legitimate cases, and
• To what extent they are committed to the goal of eliminating double taxation.

2. Introduction

11. Tax treaties have played a critical role in eliminating barriers to cross-border trade and investment over a number of decades, thereby contributing to economic growth, productivity, jobs, and prosperity in jurisdictions across the world. In seeking to address Action 6 of the BEPS Action Plan, the OECD cannot lose sight of the importance of preserving a well-functioning network of double tax treaties to support the legitimate conduct of international business. Businesses operating internationally contribute enormously to the economic well-being of the countries in which they operate, bringing products, services, jobs, capital, investment, growth, know-how, and innovation to jurisdictions around the world. In order to do this, they need to engage in all kinds of cross-border activities – purchases and sales of goods, provision of services, licenses, financings, equipment rentals, marketing, acquisitions and dispositions of assets and operations – all with a minimum of the friction that can come from double taxation, excessive taxation, or unacceptably uncertain taxation. The ability to rely on treaty provisions that are clear and reasonable in their design is fundamentally important to this everyday flow of commercial activity, and a breakdown in that network would have highly undesirable consequences.

12. While the Discussion Draft on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances contains a number of laudable proposals for addressing treaty abuse situations, it is, when viewed in its entirety, a dangerously disproportionate response to the perceived problem, which risks
seriously disrupting the availability of treaty benefits to legitimate commercial transactions and structures, thereby undermining the core purpose of tax treaties.

3. Comments on Limitation on Benefits (LOB) provision

In principle, the IAPT supports the inclusion of a properly crafted, objective LOB provision in treaties as the principal tool to address treaty shopping concerns. The experience of many of our members after operating under these kinds of provisions in U.S. treaties over many years is that the provisions can be very effective in addressing treaty shopping concerns while at the same time providing multinational businesses with the certainty they need to determine their eligibility to treaty benefits for purposes of the conduct of normal cross-border business operations. As drafted, however, the proposed LOB provision in the Discussion Draft is too restrictive and, if widely adopted, could drastically impede cross-border trade and investment. Our comments on the individual elements of the proposed provision, and our recommendations for improving it, are set out below.

3.1 Defining treaty shopping appropriately: improper use of treaties by third country residents

Before crafting an appropriate LOB provision, it is important to identify the type of abuse at which the provision should be targeted. The IAPT believes that “treaty shopping” is appropriately defined as arrangements in which a resident of a third State attempts to access indirectly and inappropriately the benefits of a treaty between two Contracting States. The principal purpose of a bilateral tax treaty is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons, between the two States. In agreeing to grant reciprocal benefits to each other’s residents, the two Contracting States seek to achieve that objective in a manner that takes into account their political and economic relationship with each other. Each State agrees to limitations on its taxing rights and seeks reciprocal limits from the other Contracting State on the latter’s taxing rights. Neither State typically intends to make the benefits of that treaty relief indirectly available to residents of third States with which the first State does not have a comparable treaty relationship (e.g. because the third State does not have a tax system that presents significant risks of double taxation when interacting with the tax system of the first State, or because the third State has not been prepared to grant treaty relief from its tax to an equivalent extent as the treaty partner in question). Having an anti-treaty shopping provision in the treaty between the first two Contracting States helps to preserve the negotiating leverage of the first State vis-à-vis the third State.

Situations where a resident of one of the Contracting States owns an interest in a company of the other State which derives income from the first State do not fall within this concept of treaty shopping. Such situations often arise where residents of the two States join together to conduct a business or make an investment through an entity resident in one of the States, or where a resident of one State, as part of normal business developments, acquires a company resident in the other State which has pre-existing investments or business operations in the first State. These types of situations do not present the kind of treaty shopping concerns posed by third country ownership as described above, such as the need to preserve negotiating leverage vis-à-vis a third State. Indeed, treating these types of situations as “treaty
shopping” undermines a primary purpose of the treaty between the two Contracting States by discouraging that normal free flow of business relationships between residents of the two States. If the first State is concerned that its residents are inappropriately escaping or deferring tax on locally sourced income under its law in such situations, it can address those concerns through its domestic law controlled foreign corporation regime or other domestic law mechanisms. But treating its own residents as “bad” treaty shoppers in blanket fashion is an inappropriate and disproportionate response to such concerns.

16. Accordingly, the IAPT recommends that, contrary to the assertion in footnote 3 of the Discussion Draft, cases where a resident of the Contracting State in which income originates seeks to obtain treaty benefits through the use of an entity established in that other State should not be considered to constitute a form of treaty shopping. As discussed below, this recommendation will affect several aspects of the LOB provision.

3.2 Publicly traded company safe harbor

17. The safe harbor for publicly traded companies is a very important part of the LOB provision. The general principle underlying these safe harbors is that publicly traded companies exist to conduct bona fide business activities and there is very little chance that they are being manipulated by their shareholders to operate primarily for treaty shopping purposes. We would like to make several suggestions to improve on the current drafting of this safe harbor.

3.2.1 Definition of recognized stock exchange

18. As capital markets become more and more integrated, companies are increasingly being traded on multiple exchanges around the world in order to better access capital from outside their home jurisdiction and for any number of other legitimate commercial reasons (e.g. greater visibility, benefiting from the economic status of the exchange’s jurisdiction, timing considerations for listing within a favorable market window, volatility in certain markets due to currency considerations, etc.). Exchanges themselves are undergoing constant evolution, including both mergers and specialization for different market niches. Publicly traded company safe harbors should take these developments into account and allow for a broad and flexible definition of “recognized stock exchange”.

19. In principle, the Discussion Draft allows for such an approach by suggesting that the recognized stock exchanges should include designated exchanges in each of the Contracting States and any other exchanges on which the competent authorities agree. In practice, however, negotiators have often been hesitant to designate exchanges beyond their own jurisdictions, or have decided upon arbitrary limitations to a small number of third country exchanges. An overly conservative approach to defining “recognized stock exchanges” can create unwarranted distortions in deserving companies’ access to treaty benefits. This would be especially unfair to companies resident in developing countries or emerging markets, as they often face a particular need to list their stock abroad to get access to well-developed capital markets, but it is an increasing concern for companies resident in developed countries as well.
20. The IAPT therefore recommends that the OECD explicitly endorse a liberal approach to the designation of recognized stock exchanges.

3.2.2 Meaning of “regularly traded”

21. The safe harbor requires that the principal class of shares be “regularly traded” on one or more recognized stock exchanges, but it does not provide guidance on what is meant by “regularly traded”.

22. The IAPT recommends that the OECD provide a definition for that term, which should include guidance on the time period during which the necessary trading must occur.

3.2.3 Primarily traded / primary place of management and control requirement.

23. The Discussion Draft version of the safe harbor includes a requirement that either the company’s principal class of shares be “primarily traded” on a home country stock exchange or the company’s “primary place of management and control” be in its country of residence. This requirement, which appears to be drawn from recent U.S. treaty practice, was inspired by a desire to discourage corporate inversions by U.S. companies.¹

24. This requirement is not well-grounded in traditional treaty “abuse” concepts. It can in principle and does in practice have an overly restrictive impact, particularly given the increasing trend toward cross-border listings and the factual complexity of determining the location of the “primary place of management and control” of large multinational groups.

25. If a country is concerned about corporate inversions out of its jurisdiction, its primary tool for addressing those scenarios should be its domestic legislation. Trying to address these indirectly through added complication in a treaty LOB provision is not the appropriate policy choice, particularly given the extent to which this requirement can adversely affect publicly traded companies that were never the subject of a corporate inversion transaction.

26. The IAPT therefore recommends that this primarily traded / primary place of management and control requirement be dropped from paragraph 2(c)(i) of the LOB provision.

3.3 Subsidiary of publicly traded company safe harbor

3.3.1 Cross-border subsidiaries

27. The IAPT assumes that paragraph 2(c)(ii) of the LOB provision allows a subsidiary of a publicly traded company resident in either Contracting State to benefit from the safe harbor for subsidiaries of publicly traded companies. It would nevertheless be helpful for that point to be clarified, particularly in light of indications elsewhere in the Discussion Draft that ownership of an entity resident in one Contracting State by residents of the other Contracting State is disfavored. This would not open the door to treaty shopping by taxpayers based in third countries and would recognize the not infrequent need for treaty coverage of payments to subsidiaries resident in one of the Contracting States that derive income from engaging in normal commercial transactions with affiliates or other persons resident in the publicly traded parent company’s State.

28. Accordingly, the IAPT recommends that the OECD confirm, through Commentary or otherwise, that the safe harbor for subsidiaries of publicly traded companies applies to a subsidiary of a publicly traded parent resident in either of the two Contracting States.

3.3.2 Intermediate owners

29. As drafted, the provision requires that each intermediate owner between the publicly traded parent resident in State A and the company resident in State B which is seeking treaty benefits must be a resident of State A or State B. The IAPT notes that this requirement makes this crucially important safe harbor essentially useless to many groups which, for historical or other reasons completely unrelated to treaty shopping, have multi-country ownership chains. That includes virtually the entire universe of large multinational groups. For example, it is extremely common for groups to have regional holding companies between the operating subsidiaries and the publicly traded parent, and for those holding companies to have a tax residence which is different from that of the operating subsidiary or the publicly traded parent. Similarly, groups often acquire multi-country ownership chains through normal merger and acquisition activity.

30. Other measures, such as the treaty’s beneficial ownership requirement or the parent country’s CFC regime, can operate to ensure that income from a source State will not enjoy treaty benefits and then routinely pass through a treaty country subsidiary to a third country resident intermediate company in its ownership chain, where the income may be deferred from parent company taxation. It would be highly disproportionate and unjustified to deny the benefit of the safe harbor for subsidiaries of publicly traded companies.

31. Accordingly, the IAPT recommends that paragraph 2(c)(ii) of the LOB provision be amended to eliminate the requirement that any intermediate company be resident of either the treaty’s source State or the treaty’s residence State.
3.4 Ownership / base erosion safe harbor

32. The ownership / base erosion safe harbor found at paragraph 2(e) of the LOB provision is too restrictive.

3.4.1 Class of “good” owners

33. As drafted, the ownership / base erosion safe harbor treats as “good” owners only residents of the same Contracting State as the company in question. This appears to be linked to the misguided policy, described above, which would treat residents of a Contracting State as “treaty shopping” vis-à-vis their own residence jurisdiction where they have an interest in an entity resident in the other Contracting State which derives income from their Contracting State.

34. In light of the many bona fide commercial reasons why such ownership structures exist, the IAPT recommends that the safe harbor treat residents of either Contracting State as “good” owners for purposes of satisfying the ownership condition in the ownership / base erosion safe harbor.

3.4.2 Intermediate owners

35. For the reasons given above in connection with the safe harbor for subsidiaries of publicly traded companies, the IAPT recommends the deletion of the requirement that all intermediate owners of a company be residents of the company’s residence State in order for the company to satisfy the ownership / base erosion safe harbor.

3.4.3 Public shareholders

36. It is not infrequently the case that a subsidiary of a publicly traded entity would not qualify for the safe harbor for subsidiaries of publicly traded parent companies because the parent is not resident in either of the two Contracting States, but it could qualify under the ownership / base erosion safe harbor as long as that safe harbor takes into consideration the residence of its owners at the public shareholder level. Particularly given the Discussion Draft’s propensity towards treating the owners of a publicly traded entity as reflective of the jurisdiction with which the entity should be treated as connected, the IAPT recommends that the OECD clarify that an entity is entitled to look through its publicly traded parent to the residence of its public shareholders for purposes of satisfying the ownership prong of the ownership / base erosion test.

3.4.4 Deductible payments in the base erosion test

37. The IAPT believes that the base erosion test found at paragraph 2(e)(ii) of the LOB provision is too tightly drawn.

38. As an initial point, one could question the need for the base erosion prong at all. Concerns about use of a treaty country entity as a conduit for deductible payments to third country residents can be satisfactorily addressed through the beneficial ownership condition in the Model, for which the base
erosion prong is merely a clumsy substitute. The practice of some countries reveals that they do not include a base erosion prong in this particular safe harbor.²

39. One problem relates to the category of persons to whom deductible payments may be made before running afoul of the base erosion prong. For example, as drafted, the test would treat an entity seeking to qualify under this safe harbor as potentially violating the base erosion prong merely because it made deductible payments (e.g., royalties or interest) to a sister company resident in the same or the other Contracting State which was itself able to satisfy the ownership / base erosion test. This kind of restriction obviously would impede the normal course of business transactions within a group without furthering any anti-treaty shopping policy.

40. The IAPT therefore recommends that the OECD liberalize the categories of “good” payees of deductible payments.

41. Another issue relates to the types of deductible payments that can be made without running afoul of the base erosion test. As drafted, the provision allows certain ordinary course of business payments for “services or tangible property” to be made. The IAPT does not understand why other deductible payments, including those for the use of intangibles or for interest, should not also be protected if they are ordinary course of business payments.

42. The IAPT therefore recommends that any type of payment made in the ordinary course of business be treated as non-base-eroding.

43. The IAPT further suggests that the OECD confirm that payments made to associated enterprises can qualify as “arm’s length” payments in the ordinary course of business where they satisfy the arm’s length principle. In addition, because transfer pricing is not an exact science, and because reasonable people can differ over what is arm’s length, a related party payment that is found to be non-arm’s length should not be treated as base-eroding in its entirety, but only as to the portion that exceeds an arm’s length payment. This point should be confirmed in the Commentary on the LOB provision.

3.5 Active trade or business safe harbor

44. While the type of active trade or business safe harbor set forth at paragraph 3 of the LOB provision is often characterized as one that compensates for some of the technical rigidities of other safe harbors, experience has shown that taxpayers often find this safe harbor very difficult to rely upon in practice due to the absence of clear guidance on questions such as:

² See, e.g., Article 21(2)(e) of the 2010 Japan-Netherlands Treaty.
• What constitutes an “active trade or business” (and whether a company must conduct that through its own employees);

• Whether group financing activities can be considered an active trade or business;

• What it means for income to be derived “in connection with, or incidental to: the active business in the treaty country, particularly in relation to income such as dividends, interest, and royalties;

• How similar or related the two businesses must be; and

• How to determine whether the residence country business is “substantial” in relation to the source country business, including questions such as:
  o What percentage constitutes “substantial”; and
  o If a three factor formula is used, how the factors are measured.

45. The IAPT therefore recommends that the OECD provide clarity on the above issues in relation to the active trade or business safe harbor.

3.6 Derivative benefits safe harbor

3.6.1 Need for a derivative benefits safe harbor

46. The IAPT believes that it is critical for any LOB provision the OECD may endorse to include a derivative benefits safe harbor. Such a safe harbor is a crucial safety valve to prevent the LOB provision from inappropriately restricting benefits in very common situations which present no treaty shopping concern. At least where they have not been too tightly drafted, derivative benefits safe harbors have worked well in practice to take much pressure off the administration of LOB provisions, and have allowed taxpayers and tax administrations alike to derive certainty as to the proper application of treaty benefits with relatively little cost and difficulty, as compared to reliance upon a procedure for applying a discretionary grant of benefits.

47. The rationale set forth in the Discussion Draft for the OECD’s hesitancy to include such a safe harbor (i.e. not to facilitate tax planning into low tax jurisdictions) does not justify the omission of the safe harbor. If a country has entered into equivalent treaties with 2 jurisdictions, the assumption should be that it has determined that each of them presents a significant enough risk of double or excessive taxation that a treaty was justified and that equivalent benefits were warranted. The fact that a taxpayer may have placed certain operations or investments in one country rather than the other under such circumstances is very likely to be the result of pure commercial considerations or healthy tax competition between the two, not a BEPS concern or harmful tax competition that should be discouraged.

48. In treaties involving EU Member States, there is also the risk that a lack of a derivative benefits safe harbor in an LOB provision may raise concerns about violations of the EU’s fundamental freedoms.
49. Accordingly, the IAPT strongly recommends inclusion of a derivative safe harbor in the LOB provision.

3.6.2 Design of a derivative benefits safe harbor

50. There are also particular considerations that should be taken into account in drafting a derivative benefits safe harbor.

51. First, the safe harbor should allow “good” derivative owners to be resident in any country which has a treaty with the source country which provides the requisite equivalent benefits, rather than restricting the eligible third countries to certain regions. The latter approach unfairly discriminates among treaty partners, places unnecessary administrative burdens on taxpayers and competent authorities, and does not reflect the increasing globalization of business structures.

52. In addition, where the derivative benefits provision includes a “rate comparison” requirement, it is critical to describe very clearly what the two rates are that are to be compared. The appropriate comparison should focus on the rate being claimed by the actual company under its treaty with the source State and the rate that would be available to a hypothetical similarly situated third country company resident in the State where the derivative owner is resident under that State’s treaty with the source State.

53. Accordingly, the IAPT recommends that the rate comparison language read as follows: “with respect to income referred to in Articles 10, 11 and 12 of this Convention, the rate of tax that would be available under such convention to a company resident in such other State and eligible for benefits under such convention (and otherwise comparable to the company claiming benefits under this Convention) with respect to the particular class of income for which benefits are being claimed under this Convention is at least as low as the rate being claimed under this Convention”.

3.7 Discretionary grants of benefits

54. Experience has shown that the competent authority personnel responsible for considering applications for discretionary grants of treaty benefits under LOB clauses that permit such grants benefit from having clear guidance from the treaty negotiators about the standards to be applied in such cases. While the various safe harbors described above provide clear examples of cases where the treaty negotiators have agreed that benefits should be allowed, discretionary grants of benefits should be considered potentially appropriate in a broader range of circumstances and not only, for example, those cases that “just miss” fitting into one or more of the safe harbors.

55. For example, there are circumstances where businesses with long-standing structures that satisfy LOB provisions are sold and the acquirer group can no longer satisfy the LOB provisions although the intercompany transactions are unchanged. While it would appear that such circumstances are clear cases for discretionary relief, an overly narrow interpretation of the discretionary authority granted to the competent authority would risk a denial of benefits.
56. In order to provide some certainty that discretionary authority will be exercised in a reasonable manner, it makes sense for the LOB provision to require a competent authority to whom an application for relief has been made to consult in good faith with the other competent authority on a timely basis before deciding to reject the application.

3.8 Application of LOB provisions

57. The IAPT has previously communicated suggestions to the OECD about the manner in which LOB provisions can most appropriately be applied in practice, but it takes the opportunity to reiterate those suggestions here:

58. While the Alliance believes that introduction of such a comprehensive LOB clause could be a reasonable measure to undertake to address governments’ concerns about treaty shopping, it also wishes to note several considerations relevant to its support for that recommendation. First, such clauses are appropriate only where the countries using them accept that they address, in a generally exhaustive fashion, the anti-treaty-shopping concerns to which they are targeted, and that taxpayers will not face the difficulty that arrangements which satisfy the terms of those clauses and other applicable requirements of the treaty will nevertheless face challenges to treaty entitlement based on the application of General Anti-Avoidance Rules or similar anti-abuse principles to treaty-shopping concerns. This concern will be addressed further below in relation to the Discussion Draft’s proposed “main purpose test” provision.

59. The effective operation of LOB clauses also requires that their provisions be clear to both taxpayers and tax administrators. For this purpose, and to avoid creating excessive administrative and compliance burdens, it is important to minimize the complexity of LOB clauses.

60. There is also a need to consider carefully the procedural application of such clauses. Especially if they are complex or ambiguous, such clauses could severely disrupt normal application of treaties. For example, they can work well in a system, such as that followed by the United States, which generally allows taxpayers to evaluate their own eligibility under the governing provisions and to self-certify their qualification for benefits, subject to review on audit. Under a different approach, where taxpayers would be required to affirmatively prove to the tax administration every element of a complex test before being able to claim benefits at all, the clauses could be much more disruptive to trade and investment decisions. Moreover, it is important for a general LOB clause to recognize that holding, financing, and investment functions represent normal and legitimate business activities which should not suffer blanket exclusions from treaty protection.
4. Comments on Main Purpose Test

61. The IAPT has previously submitted comments indicating that we do not support the inclusion of a main purpose test, such as that proposed at paragraph 18 of the Discussion Draft, as a means of countering treaty abuse. The reasons for this relate to the potential level of uncertainty such provisions can cause and the extent to which they can chill legitimate commercial and investment transactions.3

62. The objection to such a provision increases immeasurably where, as proposed in the Discussion Draft, it is layered on top of an LOB provision and a whole series of specific treaty anti-abuse rules. The combination of specific, objective anti-abuse rules, such as the LOB provision to address treaty shopping and other specific rules to address other forms of treaty abuse, with a main purpose test provision which is explicitly described as intended to cover not only residual issues but also the same topics covered by the specific anti-abuse rules, leads to intolerable levels of uncertainty. For example, paragraph 18 of the Discussion Draft says that the main purpose test “would provide a more general way to address treaty avoidance cases, including treaty shopping situations that would not be covered by the” proposed LOB provision. Does this mean that a Contracting State could decide, for example, that a company that satisfied the ownership / base erosion safe harbor described above could be denied treaty benefits on the grounds that it was up to 50 percent owned by a third country resident if the State concluded that one of the main purposes of the ownership structure was to obtain a benefit under the treaty? How can the LOB provision possibly provide an acceptable level of certainty to taxpayers trying to determine their eligibility for treaty benefits if the main purpose test can be layered on top of that provision to re-test the same issue? The inclusion of such a main purpose test completely eliminates the certainty value to be obtained from having an objective set of LOB standards to evaluate treaty shopping, leaving taxpayers with no guidance on what will and will not be deemed treaty shopping by individual States. The same problem arises with respect to the potential interaction of the main purpose test with other specific anti-abuse rules in the treaty.

63. Moreover, based on the examples cited in the Discussion Draft to support the alleged need for a main purpose test, it appears that the areas of concern all center around conduit structures. The issue of potential treaty avoidance through conduit arrangements is already fully addressed by the inclusion of the “beneficial owner” standard in the Model Tax Convention. The Discussion Draft provides no explanation of why the beneficial owner standard is inadequate to deal with concerns about the use of conduit arrangements, nor any explanation of how the main purpose test is intended to interact with the existing beneficial owner requirement in circumstances that might raise conduit concerns. Examples A and B set

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3 These are the same concerns that led the U.S. Senate to reject the inclusion of a main purpose test provision in the proposed U.S.-Italy Treaty in 1999 and to direct the U.S. Treasury not to include such provisions in future U.S. treaties. See S. Exec. Rpt. 106-8, November 3, 1999, reprinted by Tax Analysts as Doc 2000-24385.
forth at paragraph 33 of the Discussion Draft to illustrate the application of the main purpose test appear to be situations (an assignment of income and a usufruct) that would be squarely addressed by the existing beneficial owner standard, leaving it completely unclear why a main purpose test provision is considered necessary.

64. The Discussion Draft’s description of the standard to be applied under the main purpose test further contributes to the tremendous uncertainty created by the provision. The description is littered with phrases stressing how broadly it is intended to operate, such as:

- “The term ‘benefit’ includes all limitations…” (paragraph 26)
- “The phrase ‘that resulted directly or indirectly in that benefit’ is deliberately broad…” (paragraph 27)
- “The terms ‘arrangement or transaction’ should be interpreted broadly…” (paragraph 28)

65. When it comes, however, to describing cases where the main purpose test would not operate to deny benefits, the Discussion Draft is absurdly conservative. For example, paragraph 32 begrudgingly states: “[W]here an arrangement is inextricably linked to a core commercial activity, and its form has not been driven by considerations of obtaining a benefit, it is unlikely that its main purpose will be considered to be the obtaining of that benefit.” [Emphasis added.] Examples C and D set forth at paragraph 33 of the Discussion Draft are so far removed from any situations normal businesspeople or practitioners would think of as raising treaty avoidance concerns as to be useless as guideposts for the kind of “reasonable” evaluation the Discussion Draft purports to endorse.  

66. Indeed, there is even a concern that the main purpose test, or even the LOB provision, could be read as broad enough to deny access to the mutual agreement procedure under Article 25(3) to alleviate cases of double taxation that are not addressed by the treaty (e.g., involving treaty country branches of a third country resident). This concern arises because the proposals are drafted in such a way as to call into question access to “all” benefits under the treaty (e.g., potentially including administrative benefits such as MAP), rather than being limited to the provisions relating to the taxation of income and capital (i.e., Chapters III and IV of the Model Tax Convention, comprising Articles 6-22). In order to avoid unintended consequences of this type, a proposal likeb this should be limited to the latter category of benefit.

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4 Indeed, Example D is actually troubling because its focus on whether the majority of the shareholders of the publicly traded company are residents of the entity’s State of residence seems to undercut the assurance given in paragraph 24 regarding the protection offered by the publicly traded company safe harbour.
67. The experience of IAPT members is that the tendency under a standard based on “a main purpose” of obtaining a tax benefit is to subdivide a taxpayer’s decision-making with respect to a particular transaction into a number of different decisional points, each related to a specific aspect of the transaction. The inquiry then focuses, not on the overall purposes for engaging in the transaction but instead on the specific purposes for selecting a particular form for the transaction. Of course, once a taxpayer has a commercial purpose for engaging in a particular transaction, normal tax planning decision-making by the taxpayer will dictate the specific form of the transaction. In that context, it is highly probable that specific features of the transaction’s form, while imbued with commercial significance, may be exclusively motivated by a tax reduction purpose.

68. The potential triggering of the “a main purpose” standard in cases where there are both significant tax and non-tax motivations squarely raises the difficulty of distinguishing between legitimate tax planning and illegitimate tax avoidance in applying the standard. It is also our experience that tax authorities frequently argue that the “effect” of tax reduction demonstrates a tax avoidance purpose under provisions based on the “a main purpose” standard.

69. Main purpose tests raise two fundamental areas of uncertainty as a general matter. The first is the uncertainty of knowing whether a tax reduction purpose will be deemed in any particular case to be on a par with other important purposes for the existence and/or form of a transaction, such that it will be considered one of the principal purposes. Even on the assumption that the test would be triggered only where the tax reduction in question is inconsistent with the intent of the relevant benefit provision, notwithstanding the transaction’s literal satisfaction of the benefit provision’s conditions, the second area of uncertainty is having to determine whether the particular transaction’s tax reduction is inconsistent with the provision’s intent. Both of these aspects involve subjective judgments and pose considerable risks of controversy.

70. Particularly in the context of bilateral tax treaties, the assessments required to apply a main purpose test provision pose significant difficulties. One reason for this is the general absence of guidance on the policy reasons underlying particular treaty provisions. While the OECD Commentaries and the explanatory materials prepared by some governments in the ratification process may provide some insight into the underlying policies, they do not reliably do so on a consistent basis. One can think of innumerable issues on which such materials tend not to provide significant policy guidance (e.g., why the ownership threshold for the direct investment dividend withholding rate is set at a particular level, why that withholding rate has been set at 0% or 5%, etc.). In many countries, no explanatory materials exist with respect to the policies underlying their treaties, and it is even rarer to find any materials that memorialize the joint understandings of the two Contracting States as to the underlying intent. Indeed, a particular point to note about the application of the main purpose standard in the treaty context is the particular difficulty of having to divine a particular treaty provision’s underlying policy that is mutually accepted by both countries. This is especially difficult when one recognizes that the lines drawn in treaties are frequently the result of a compromise of the two governments’ competing policies.
71. For example, suppose two Contracting States amend their existing treaty to allow for greater taxing rights in the source jurisdiction, subject to a mutually agreed multi-year transition period during which the existing treaty’s benefits apply. If a new investment is made during the transition period for which treaty benefits are claimed, can those benefits be denied on the basis that one of the main purposes for making the investment was to claim the more generous benefits during that period? In a real life situation, business has seen a government make that argument, even though the intent of the other government in negotiating the transition period was to maximize benefits for its residents during that period.

72. Another source for uncertainty from the inclusion of a main purpose test in a treaty relates to the interaction between that test and other anti-abuse rules in the same treaty. In general, as discussed above, the issue here is whether a taxpayer that satisfies the conditions of a specific anti-abuse rule in the treaty, including any applicable LOB provision, is nevertheless still at risk as to that category of alleged abuse under the main purpose standard. Where a government has agreed to grant a particular treaty benefit and has further agreed to the terms of a specific anti-abuse rule concerning that benefit, the overlay of the main purpose test will create tremendous uncertainty if that government can invoke the test to challenge the taxpayer’s entitlement to the benefit on the grounds that the taxpayer has arranged its affairs to fall on the right side of the specific anti-abuse rule.

73. If a main purpose test were to be included in a treaty, a number of questions would arise concerning the procedural aspects of the test’s implementation. These questions relate to the conditions (if any) required to be fulfilled before the test can be invoked, the manner in which guidance about the application of the test will be made available, the standard of judicial review of any exercise of the test, and the unilateral or bilateral nature of its implementation. In situations where the test would be self-executing and could be applied by tax authorities without the issuance of specific guidance on particular transactions, there would be tremendous pressure on the adequacy of the available general guidance on the circumstances and standards relevant to the test’s application. This is a particular problem in countries that do not have substantial experience in applying treaty main purpose tests nor any significant body of domestic jurisprudential precedent or other guidance for applying comparable standards. This need for guidance inevitably raises the question of whether an advance ruling process could or should be initiated to implement a provision such as a treaty “main purpose” test, which is one way to deal with the uncertainty, albeit an expensive and administratively burdensome one for taxpayers and tax authorities alike.

74. Another important issue relating to the implementation of a main purpose test is the potential unilateral or bilateral invocation of the provision. For example, one could reasonably ask whether a source State should be allowed to apply the provision over the objection of a residence State. As drafted, the proposed provision leaves this issue open. By its terms, the provision would apply to deny benefits “if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the main purposes” of the arrangement or transaction in question, unless “it is established that granting that benefit in these circumstances would be in accordance with the object and
purpose of the relevant provisions of this Convention”. This leaves open the question of who will reasonably conclude (the source State alone? the competent authorities together?), and to whom it is established.

75. The Discussion Draft asserts that the proposed main purpose test is consistent with principles already stated in the Commentary on Article 1 of the Model Tax Convention, but in reality its formulation differs very materially. For example, paragraph 9.5 of that Commentary states as a guiding principle “that the benefits of a double taxation convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions” (emphasis added). The proposed main purpose test states that “a benefit under this Convention shall not be granted in respect of an item of income if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the main purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.”

76. This reformulation fundamentally shifts the emphasis of the provision as both a substantive and procedural matter, since it would allow the denial of a benefit, without regard to whether its granting would be in accordance with the object and purpose of the relevant provisions of the treaty, unless through the intervention of some unexplained procedure somebody was able to establish, presumably to the satisfaction of some unspecified person or persons (one or both tax authorities? a court?), that granting the benefit in the circumstances would be in accordance with the object and purpose of the treaty’s provisions. The way legal standards are expressed, and the implications their wording can have on the situs of burdens of proof, matter profoundly. The Discussion Draft’s proposed formulation differs substantially from the guiding principle in the existing Commentary, and it provides much less security for taxpayers that their proper entitlement to treaty benefits will be adequately protected.

77. If the provision’s premise is that it should prevent transactions having as one of their principal purposes obtaining a treaty benefit under circumstances that are inconsistent with the intent of the parties, it would seem reasonable to require both parties to agree that the result is inconsistent with their intent before the test could be applied. For example, some treaties have used a formulation of the test that requires both countries to agree to the existence of a tax avoidance purpose before the provision can be invoked to deny benefits. Other treaties have required that the source State at least notify and consult with the competent authority of the residence State before invoking the provision, or even that there be a full mutual agreement procedure, with the potential for arbitration, before the provision can be invoked definitively. These kinds of procedural safeguards are certainly more compatible with the notion that the provision is meant to be applied to cases where the treaty benefit is inconsistent with the intent of the parties than a procedure that allows either country to act wholly unilaterally.

78. Moreover, in order to avoid uncertainty that could drag on for years, it would be critical for an advance ruling procedure to be available in the country where the treaty benefit will be sought, so that
taxpayers could obtain certainty, within no more than 6 months after requesting such a ruling, as to whether the country intends to invoke the provision. A failure by that country to respond to the ruling request within the specified time would preclude the application of the provision. A taxpayer should be entitled to refer a negative ruling immediately to the other competent authority, along with the taxpayer’s defense, and if the latter did not concur with the first State within 3 months of the referral, the provision could not be invoked.

79. In summary, the IAPT recommends that the main purpose test provision be dropped from the Discussion Draft, particularly if the LOB provision is retained, but even if it is not. If the test is retained, it should be reformulated to apply to deny benefits only where both States agree that “a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions”. Moreover, it should be explicitly limited so as not to re-test issues that have already been tested under other treaty provisions, such as ownership under the LOB provision or conduit status under the beneficial owner conditions. The OECD should provide clear examples of why the test is needed as well as clear examples of when it should not be applied to circumstances where its application could realistically be in doubt. Finally, an advance ruling procedure should be available so that taxpayers could determine with certainty, within 6 months from filing a ruling request, whether a country intends to invoke the provision and within no more than 3 months thereafter whether the two competent authorities agree on the application of the provision.

5. Comments on Targeted Anti-Abuse Rules

80. The IAPT has a number of comments on the targeted anti-abuse rules described at paragraphs 34 et seq. of the Discussion Draft.

5.1 Proposed addition of minimum shareholding period to Article 10(2)

81. Paragraph 43 of the Discussion Draft proposes the addition of a minimum shareholding period to Article 10(2)(a) of the Model Tax Convention before a company can get the benefit of the direct investment dividend withholding rates on dividends (i.e., typically 5% or zero). The existing Commentary on Article 10 had suggested that States might want to consider different wording if they were concerned about manipulation of stock ownership percentages to qualify for the direct investment dividend rate (i.e., the Commentary suggestion was to add the words, “provided that this holding was not acquired primarily for the purpose of taking advantage of this provision”).

82. The IAPT views the Discussion Draft’s proposal as disproportionate to the problem. The blanket imposition of a holding period requirement as proposed by the Discussion Draft would unduly restrict benefits in cases which present no abuse and involve normal business arrangements. For example, suppose Company A1, resident in State A, acquires Company A2 also resident in State A, which has a long-standing, wholly owned subsidiary in State B for which the benefits of the 5% rate on dividends in the A-B Treaty have long been available. Company A1 wishes to streamline its holding structure by liquidating Company A2. Under the proposed provision, Company A1 would have to wait some
minimum number of months before it could receive a dividend from Company B at the 5% rate. This could act as a barrier to meeting routine commercial needs, such as timely funding dividends to public shareholders. Similar problems could arise if a Country A group wanted to streamline a multi-tier holding structure in Country B by eliminating the top Country B holding company – it might then have to wait some period of time before it could receive a dividend from the newly top-tier Country B company.

83. The IAPT therefore recommends that the OECD drop the proposed addition to Article 10(2). If the proposal is retained, the IAPT recommends that the required holding period be limited to a brief holding period (e.g., 2 months) so as to minimize potential disruption to normal parent-subsidiary dividend payments.

5.2 Proposed look-back period in Article 13(4)

84. The Discussion Draft proposes to introduce a look-back period into Article 13(4) to determine whether shares or other ownership interests being sold derived their value primarily from immovable property in the source State not only at the time of sale but also at any time during some period leading up to the sale. While the IAPT does not oppose such a change in principle, it notes that the addition may significantly complicate the analysis as to whether Article 13(4) will apply to a particular disposition to give taxing rights to the source State, which complication will increase the longer the look-back period specified. This added complication puts even more pressure on the need for the types of reasonable exceptions from Article 13(4) that can be found in the treaty practice of some countries or in the OECD Commentary (e.g., exempting sales by small minority shareholders or sales taking place through public trading on stock exchanges or over the counter). Such exceptions are justified taking into account a seller’s access (or lack thereof) to information needed to determine taxability, the likelihood of abuse by a seller, and the risk that a seller’s practical inability to establish the non-existence of a condition for taxability may cause many transactions to be inappropriately taxed.

5.3 Tie-breaker rule for determining the treaty residence of entities

85. Regarding the proposal to allow the competent authorities to resolve cases of entity dual residence on a case-by-case basis, the IAPT notes that such cases can and do arise outside the context of tax planning. We therefore suggest that the OECD explicitly acknowledge this fact, and that it clarify that either: (i) a request for a competent authority resolution pursuant to the proposed Article 4 language and Article 25(1) will be eligible for arbitration under Article 25(5); or (ii) the competent authorities shall endeavor to resolve the issue with a specified period after the request is made, not to exceed one year.

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5 We also note that a failure to provide adequate access to treaty benefits in such cases may raise questions within the EU as to violations of the freedom of establishment.
6. Comments on the interaction of treaties with domestic law anti-abuse provisions

86. The IAPT does not challenge the principle that domestic law anti-abuse rules can be consistent with treaties. Nevertheless, it believes that the extent to which they are consistent with treaties depends on whether their characteristics conform to certain basic principles already mentioned in the Commentary.

87. The Discussion Draft too loosely describes domestic law anti-abuse rules as having precedence over treaties. For example, domestic law thin capitalization rules can be inconsistent with the obligations in a treaty Nondiscrimination Article if they operate to impose non-arm’s length restrictions on the amount of deductible interest expense of a local entity. While the Discussion Draft seems to acknowledge that point at paragraph 60, it also states at paragraph 59 that “[t]he main objective of the work aimed at preventing the granting of treaty benefits with respect to these transactions [including “Thin capitalisation and other financing transactions that use tax deductions to lower borrowing costs”] is to ensure that treaties do not prevent the application of specific domestic law provisions that would prevent these transactions.” Allowing domestic law thin capitalization rules to take precedence over the Nondiscrimination Article’s treaty protection could cause States to inappropriately discriminate against foreign over local business owners, contrary to the fundamental purpose of the treaty.

88. The IAPT recommends that Commentary clarify that domestic law anti-abuse provisions can operate to deny treaty benefits only where those rules are based on standards already expressed in the Commentary, namely that they: (i) legitimately operate within general domestic law principles to determine the true facts on which tax liability arises, or (ii) have the effect of denying treaty benefits only where “a main purpose for entering into certain transactions or arrangements was to secure a more favorable tax position and obtaining that more favorable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions”. An overly broad assertion of the ability of domestic laws styled as “anti-abuse” provisions to take precedence over mutually agreed treaty provisions could easily lead to tremendous uncertainty and widespread unilateral treaty overrides.

89. The IAPT supports the suggestion that the principles regarding the interaction of treaties with specific domestic law anti-abuse rules enunciated in the UN Commentary reproduced at paragraph 65 of the Discussion Draft should be clarified in the OECD Commentary. It notes the statement at paragraph 66 that “specific treaty issues that may arise from the drafting of new domestic anti-abuse measures as a result of the work on other parts of the Action Plan should be dealt with in the context of the work on these other action items.” We hope, of course, that any such future work will take into account those principles as well as the results of the consultation on this Discussion Draft.

7. Comments on proposed clarification that tax treaties are not intended to be used to generate double non-taxation

90. The IAPT does not challenge the notion that countries do not enter into tax treaties with a general purpose to create opportunities for non-taxation or reduced taxation “through tax evasion or avoidance”. 
91. That being said, countries also do not expect that every item of income for which tax relief is provided by a source State will necessarily bear tax in the residence State. Therefore, in order for taxpayers to have any certainty in their ability to rely on treaties, they need to understand when a non-taxation or reduced taxation situation will be considered “tax avoidance” contrary to the purposes of the treaty.

92. For example, treaties routinely limit source States’ taxing rights over capital gains to some extent, and that treatment should not be considered unavailable if, as often happens, the residence State decides not to exercise its full taxing rights over its residents’ gains.

93. There are any number of other situations where treaties explicitly or implicitly provide relief from taxation in one country even though there may not be any risk of immediate double taxation, and there is widespread agreement that such situations are fully allowable. Some examples are:

- Payments that are exempt in the residence country under a territorial system of taxation
- Payments that are exempt in the residence country under a participation exemption regime
- Payments that are exempt in the residence country because derived by a tax exempt entity there (e.g., a charity, pension fund, or governmental entity)
- Payments that are exempt in the residence country because eligible for favorable treatment under a tax holiday or other targeted incentive provision there
- Payments that are not taxed in the residence country because the recipient has offsetting foreign tax credits
- Amounts that are not currently taxed in the residence country because the recipient has a net operating loss
- Amounts that are not currently taxed in the residence country because the recipient is subject to tax consolidation there with other affiliates
- Amounts that are not currently taxed in the residence country because not considered to have been triggered there under that country’s nonrecognition principles

94. If the OECD introduces Preamble language into the Model Tax Convention expressing the view that the parties do not intend to create “opportunities for non-taxation or reduced taxation through tax evasion or avoidance”, it should simultaneously acknowledge that many instances where non-taxation or reduced taxation results in whole or in part through treaty provisions do not constitute tax evasion or avoidance. It should also attempt to provide some guidance on what is meant by the reference to tax “avoidance” in this context, so that taxpayers, tax administrations, and courts will have some idea of how to distinguish acceptable from unacceptable cases. It is, after all, governments who negotiate the terms of tax treaties, and in the absence of other guidance taxpayers can only divine the governments’ intentions
through the mutually agreed text of the treaties themselves. If governments want taxpayers to look beyond the text to take into account some underlying purpose, those governments have an obligation to elucidate that purpose.

95. The OECD’s glossary of tax terms on its website explains “avoidance” as follows: “A term that is difficult to define but which is generally used to describe the arrangement of a taxpayer’s affairs that is intended to reduce his tax liability and that although the arrangement could be strictly legal it is usually in contradiction with the intent of the law it purports to follow.” This obviously leads to some circularity when one tries to apply the concept under the proposed Preamble language – it would effectively mean that the Preamble would be saying the parties have no intent to create opportunities for non-taxation or reduced taxation through arrangements that are in contradiction with their intent. If the OECD intends the Preamble language to be reliably used as an interpretation mechanism, it has an obligation to explain more clearly what the intended effect of the language is, and what standards are supposed to apply to distinguish acceptable from unacceptable double non-taxation.

96. Moreover, the general reference to an anti-treaty shopping purpose underlying treaties can create great uncertainty if the intention is to allow States to deny benefits on treaty shopping grounds outside the context of a comprehensive LOB article. If the intention not to allow treaty shopping is to be reflected in the Preamble, the OECD should provide Commentary clearly indicating that the LOB provision (and perhaps also the beneficial ownership requirements) are designed to address that concern, and that there are no residual cases of treaty shopping potentially subject to attack under some undefined parameters based on this casual reference in the Preamble.

97. On balance, and particularly taking into account the various anti-abuse provisions proposed for inclusion in the Model, the IAPT believes that the proposed Preamble language should be dropped on the grounds that it will lead to substantial uncertainty and potential disputes for legitimate commercial transactions and arrangements, without significantly improving the landscape for combatting abuse. Recognizing, however, that the BEPS Action Plan mandates inclusion of some form of language along these lines, the IAPT recommends that the parenthetical reference to treaty shopping be dropped and that the language be accompanied by Commentary language that acknowledges there are many instances of double non-taxation or reduced taxation that do not constitute tax evasion or avoidance, and that provides guidance on what standards are to apply to distinguish acceptable from unacceptable double non-taxation.

8. **Comments on tax policy considerations for tax treaty negotiations**

98. The IAPT strongly supports the initiative to lay out considerations countries should take into account in deciding whether to enter into, or to maintain, tax treaty relationships with other countries. We firmly believe that by refraining from entering into or maintaining treaty relationships in inappropriate circumstances, countries can take a lot of pressure off the perceived need for overly draconian anti-abuse measures in more appropriate treaty relationships.
99. The considerations set forth in the Discussion Draft all seem to be legitimate and reasonable factors to take into account. The OECD may wish to consider whether certain other factors should be taken into account, such as whether the treaty partner’s negotiating positions fall within or near internationally recognized norms, how reliable the treaty partner is in applying the treaty provisions in good faith, to what extent their procedural rules and practices accommodate or impede reasonable access to treaty benefits in legitimate cases, and to what extent they are committed to the goal of eliminating double taxation.
IAPT Comments on BEPS Action #6 (Prevent treaty abuse)

**Action 6 - Prevent treaty abuse**

Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. Work will also be done to clarify that tax treaties are not intended to be used to generate double non-taxation and to identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country. The work will be co-ordinated with the work on hybrids.

**Support for principle of limiting mutually unintended treaty benefits**

The IAPT supports the principle that governments should be able to limit the availability of treaty benefits in cases that fall outside the treaty partners’ mutually agreed parameters for those benefits. In its following comments, the IAPT makes suggestions on how that principle can most appropriately be implemented in practice.

**Preference for treaty rather than domestic law provisions**

The Alliance continues to believe, as indicated in an earlier communication to the OECD, that it is generally preferable for such restrictions to take the form of provisions in the treaty itself, rather than domestic law provisions, since the former present a greater likelihood of satisfying the mutual expectations of the treaty partners and of avoiding a proliferation of inconsistent standards.

**Preference for objective standards**

The Alliance also continues to believe that objective provisions, including comprehensive Limitation on Benefits (LOB) provisions, are clearer in their application and therefore provide greater certainty than many more subjective criteria, such as those that may be found in General Anti-Avoidance Rules or in “main purpose” tests. The experience of a country like the United States which has routinely included comprehensive LOB provisions in its treaties for the past three decades has shown that they can be quite effective in addressing many if not most of the concerns governments may have about the manner in which their treaties apply.

**Design features of LOB provisions**

On the assumption that the OECD will be analyzing the potential benefits of a standardized comprehensive LOB provision in the context of Action Item #6, the IAPT would like to suggest a number of considerations the OECD may want to take into account in evaluating design features of such a model provision, based on practical experience to date with provisions already in effect in bilateral treaties.
Most comprehensive LOB provisions include a series of “safe harbor”-type rules for various categories of taxpayers, followed by a residual “safety valve” clause for deserving taxpayers that do not fit within the safe harbors. The comments below address aspects of these typical provisions.

**Publicly traded company safe harbor.** It is common for LOB provisions to include a safe harbor for companies who principal class of shares is “regularly traded” or “substantially and regularly traded” on one or more “recognized stock exchanges”. The general principle underlying such safe harbors is presumably that publicly traded companies exist to conduct *bona fide* business activities and there is very little chance that they are being manipulated by their shareholders to operate primarily for treaty shopping purposes. The IAPT believes such safe harbors make sense. In designing publicly traded company safe harbors, the following points are worthy of consideration:

- **Definition of recognized stock exchange.** As capital markets become more and more integrated, companies are increasingly being traded on multiple exchanges around the world in order to better access capital from outside their home jurisdiction. Exchanges themselves are undergoing constant evolution, including both mergers and specialization for different market niches. Publicly traded company safe harbors should take these developments into account and allow for a broad and flexible definition of “recognized stock exchange”. Arbitrary limitations to home country exchanges or a limited number of third country exchanges and the absence of a flexible mechanism to update the list of recognized stock exchanges create unwarranted distortions in deserving companies’ access to treaty benefits.

- **Meaning of “regularly traded” or “substantially and regularly traded”**. It is helpful to define what is meant by requirements such as “regularly traded” or “substantially and regularly traded”. The definition should include guidance on the time period during which such trading must occur.

**Safe harbors for subsidiaries of publicly traded companies.** The IAPT has the following suggestions for safe harbors for subsidiaries of publicly traded companies:

- **Ownership percentage.** In order to take into account the not infrequent possibility that such subsidiaries may have some minority shareholders in addition to the foreign parent or may be vehicles for joint ventures between the publicly traded parent and another company, the IAPT recommends that such provisions apply to subsidiaries that are “at least 50 percent owned” by the publicly traded parent, rather than “more than 50 percent owned” or “100 percent owned”.

- **Cross-border subsidiaries.** Some safe harbor provisions for subsidiaries of publicly traded companies limit their coverage to subsidiaries whose publicly traded parent company is a resident of the same Contracting State as the subsidiary. The IAPT suggest that the safe harbor should also apply to a subsidiary resident in a Contracting State when its publicly traded parent is resident in the other Contracting State. This would not open the door to treaty-shopping by taxpayers based in third countries and would recognize the not infrequent need for treaty coverage of payments to subsidiaries resident in one of the Contracting States that derive income...
from engaging in normal commercial transactions with affiliates or other persons resident in the publicly traded parent company’s State.

- **Intermediary companies.** Some safe harbor provisions for subsidiaries of publicly traded companies require that any intermediary company between the publicly traded parent and the relevant subsidiary be resident in one of the two Contracting States. This makes the safe harbor unnecessarily useless to subsidiaries of groups which, for historical or other reasons, have multi-country ownership chains.

**Active trade or business safe harbors.** While this type of safe harbor is often characterized as one that compensates for some of the technical rigidities of other safe harbors, experience has shown that taxpayers often find this safe harbor very difficult to rely upon in practice due to the absence of clear guidance on issues such as:

- what constitutes an “active trade or business” (and whether a company must conduct that through its own employees);
- whether group financing activities can be considered an active trade or business;
- to what extent activities carried on by affiliates of the company seeking benefits can be attributed to that company for purposes of satisfying this safe harbor;
- what it means for income to be derived “in connection with, or incidental to” the active business in the treaty country, particularly in relation to income such as dividends, interest, and royalties;
- how similar or related the two businesses must be;
- how to determine whether the residence country business is “substantial” in relation to the source country business, including questions such as:
  - what percentage constitutes “substantial”; and
  - if a three-factor formula is used, how the factors are measured.

**Ownership / base erosion safe harbors.** Most comprehensive LOB provisions include a safe harbor for any entity which has some specified minimum percentage threshold of direct or indirect owners who are persons of one kind or another resident in one of the Contracting States and which does not use more than some specified percentage of its income to make deductible payments directly or indirectly to third
country residents.\textsuperscript{6} The IAPT would like to point out that, in practice, reliance on this type of safe harbor generally requires clarity about a number of issues, such as:

- whether non-qualifying intermediate owners defeat eligibility;
- whether the safe harbor can be used by entities based on the residence of the majority of their ultimate public shareholders (rather than of the publicly traded parent of the group);
- what the time period is for testing the ownership;
- what types of payments are taken into account in applying the base erosion test;
- what the standards are for determining whether such payments are “deductible”; and
- whether payments to related parties can ever be excluded from the base erosion calculation as allowable “arm’s length” payments; and
- what the time period is for testing the level of base erosion.

**Derivative benefits safe harbor.** The sample LOB provision found at paragraph 20 of the Commentary on Article 1 of the OECD Model Tax Convention does not include a so-called “derivative benefits” provision. In general, a derivative benefits test entitles certain companies that are residents of a Contracting State to treaty benefits if the owner of the company would have been entitled to the same benefit had the income in question flowed directly to that owner. Since the sample LOB provision was added to the Commentary in 2003, derivative benefit provisions have become much more common in treaty practice, reflecting the useful relief they provide from having to seek competent authority rulings for the high number of cases where a company has third country owners who are clearly not treaty shopping. The IAPT recommends that any model LOB provision to be draft by the OECD include a derivative benefits clause, and that the following considerations be taken into account in drafting such a provision:

- The provision should allow “good” derivative owners to be resident in any country which has a treaty with the source country which provides the requisite equivalent benefits, rather than restricting the eligible third countries to certain regions. The latter approach unfairly discriminates among treaty partners, places unnecessary administrative burdens on taxpayers and competent authorities, and does not reflect the increasing globalization of business structures.

\textsuperscript{6} See, e.g., paragraph 2(e) of the sample LOB provision found at paragraph 20 of the Commentary on Article 1 of the OECD Model Tax Convention.
• Where the derivative benefits provision includes a “rate comparison” requirement, it is critical to describe very clearly what the two rates are that are to be compared. The IAPT suggests that the appropriate rate comparison should focus on the rate being claimed by the actual company under its treaty with the source State and the rate that would be available to a hypothetical similarly situated third country company resident in the State where the derivative owner is resident under that State’s treaty with the source State.

**Discretionary grants of benefits.** Experience has shown that the competent authority personnel responsible for considering applications for discretionary grants of treaty benefits under LOB clauses that permit such grants benefit from having clear guidance from the treaty negotiators about the standards to be applied in such cases. While the various safe harbors described above provide clear examples of cases where the treaty negotiators have agreed that benefits should be allowed, discretionary grants of benefits should be considered potentially appropriate in a broader range of circumstances and not only, for example, those cases that “just miss” fitting into one or more safe harbors. For example, there are circumstances where businesses with long-standing structures that satisfy LOB provisions are sold and the acquirer group can no longer satisfy the LOB provisions although the intercompany transactions are unchanged. While it would appear that such circumstances are clear cases for discretionary relief, an overly narrow interpretation of the discretionary authority granted to the competent authority would risk a denial of benefits. In order to provide some certainty that discretionary authority will be exercised in a reasonable manner, it makes sense for the LOB provision to require a competent authority to whom an application for relief has been made to consult with the other competent authority on a timely basis before deciding to reject the application.

**Application of LOB provisions**

The IAPT has previously communicated suggestions to the OECD about the manner in which LOB provisions can most appropriately be applied in practice, but it takes the opportunity to reiterate those suggestions here:

While the Alliance believes that introduction of such a comprehensive LOB clause could be a reasonable measure to undertake to address governments’ concerns about treaty shopping, it also wishes to note several considerations relevant to its support for that recommendation…. First, such clauses are appropriate only where the countries using them accept that they address, in a generally exhaustive fashion, the anti-treaty-shopping concerns to which they are targeted, and that taxpayers will not face the difficulty that arrangements which satisfy the terms of those clauses and other applicable requirements of the treaty will nevertheless face challenges to treaty entitlement based on the application of General Anti-Avoidance Rules or similar anti-abuse principles to treaty-shopping concerns.

The effective operation of LOB clauses also requires that their provisions be clear to both taxpayers and tax administrators. For this purpose, and to avoid creating excessive administrative and compliance burdens, it is important to minimize the complexity of LOB clauses.
There is also a need to consider carefully the procedural application of such clauses. Especially if they are complex or ambiguous, such clauses could severely disrupt normal application of treaties. For example, they can work well in a system, such as that followed by the United States, which generally allows taxpayers to evaluate their own eligibility under the governing provisions and to self-certify their qualification for benefits, subject to review on audit. Under a different approach, where taxpayers would be required to affirmatively prove to the tax administration every element of a complex test before being able to claim benefits at all, the clauses could be much more disruptive to trade and investment decisions. Moreover, it is important for a general LOB clause to recognize that holding, financing, and investment functions represent normal and legitimate business activities which should not suffer blanket exclusions from treaty protection.

**Relationship between domestic law anti-abuse rules and treaty obligations**

Recognizing that States will not wish to rely exclusively on LOB provisions to address their concerns about potential treaty abuse, the IAPT wishes to offer some further comments about other options, including the use of domestic law anti-abuse rules. The Commentary on Article 1 of the OECD Model Tax Convention has been interpreted by some readers as giving countries unfettered authority to deny treaty benefits through application of domestic law rules styled as anti-abuse rules. While the IAPT does not challenge the principle that domestic law anti-abuse rules can be consistent with treaties, it believes that the extent to which they are consistent with treaties depends on whether their characteristics conform to certain basic principles already mentioned in the Commentary. To elucidate that point, the IAPT suggests that the OECD amend the Commentary to clarify that the use of domestic law anti-abuse rules to deny treaty benefits is consistent with treaty obligations only where those rules: (i) legitimately operate within general domestic law principles to determine the true facts on which tax liability arises,\(^7\) or (ii) have the effect of denying treaty benefits only where “a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions.”\(^8\)

**Relationship between domestic law anti-abuse provisions and MAP obligations**

In the course of the OECD’s multi-year examination of the treaty dispute resolution mechanism which concluded in 2007, the OECD focused on the issue that some States deny taxpayers the ability to initiate the mutual agreement procedure under paragraph 1 of Article 25 (Mutual Agreement Procedure) in cases where the transactions to which the request relates are regarded by that State as abusive. When the

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\(^7\) See paragraph 9.2 of the Commentary on Article 1 of the OECD Model Tax Convention.

\(^8\) See paragraph 9.5 of the Commentary on Article 1 of the OECD Model Tax Convention.
OECD enhanced the Commentary on Article 25 in 2008 to reflect the conclusions of its dispute resolution project, it added the following language to paragraph 26 of the Commentary in an attempt to clarify States’ obligations in this context:

Some States may deny the taxpayer the ability to initiate the mutual agreement procedure under paragraph 1 of Article 25 in cases where the transactions to which the request relates are regarded as abusive. This issue is closely related to the issue of “improper use of the Convention” discussed in paragraph 9.1 and the following paragraphs of the Commentary on Article 1. In the absence of a special provision, there is no general rule denying perceived abusive situations going to the mutual agreement procedure, however. The simple fact that a charge of tax is made under an avoidance provision of domestic law should not be a reason to deny access to mutual agreement. However, where serious violations of domestic laws resulting in significant penalties are involved, some States may wish to deny access to the mutual agreement procedure. The circumstances in which a State would deny access to the mutual agreement procedure should be made clear in the Convention.

The experience of business in the years since 2008 is that some countries continue to deny access to MAP in cases where treaty benefits are denied, based purely on allegations of violations of domestic anti-abuse rules. The IAPT recommends that the OECD take steps to reinforce the principle that access to MAP may not be denied based on a unilateral allegation of abuse in the absence of a specific treaty provision authorizing such denial. The IAPT suggests that such reinforcement may take the form of further enhancement of the Commentary, an initiative under the recently formed competent authorities’ group, or such other mechanism as the OECD may find effective.

Considerations relating to general anti-abuse or anti-avoidance rules (GAARs)

One mechanism which a number of States are implementing or considering and which could have implications for addressing potential treaty abuse is a domestic law general anti-abuse or anti-avoidance rule (GAAR). Our comments above relating to domestic rules in general apply equally to GAARs, and the IAPT does not favor the use of a GAAR as a mechanism to address treaty abuse. Recognizing, however, that some States are likely to view a GAAR as an attractive option, the IAPT notes that recent studies of the GAAR mechanism in a few States have produced useful insights into appropriate approaches to designing and implementing a GAAR, which could benefit other States considering this option:

- For example, in the United Kingdom, a GAAR Study Group led by Graham Aronson QC reached several key conclusions in its November 2011 report, including the following:
  - A “broad spectrum” GAAR would not be beneficial because it would “carry a real risk of undermining the ability of business and individuals to carry out sensible and responsible tax planning” and would require a comprehensive advance clearing system which would impose very substantial resource burdens on taxpayers and HMRC alike.”
A moderate rule targeted at abusive arrangements would be beneficial to the tax system – the target should be abnormal arrangements which go beyond reasonable tax planning and which are contrived to achieve an advantageous tax result.

A moderate rule should contain a series of safeguards to “ensure that the centre ground of responsible tax planning is effectively protected” – these are:

- an explicit protection for reasonable tax planning;
- An explicit protection for arrangements which are entered into without any intent to reduce tax;
- placing upon the tax administration the burden of proving that an arrangement is not reasonable tax planning;
- having an Advisory Panel, with relevant expertise and a majority of non-tax administration members, to advise whether the tax administration would be justified in seeking counteraction under the GAAR (and who would publish anonymized digests of its advice);
- giving taxpayer and the tax administration the right to refer to material or information which was publicly available when the tax planning arrangement was carried out; and
- requiring that potential application of the GAAR has to be authorized by senior officials within the tax administration.

Similarly, the October 1, 2012 report by the Expert Committee (chaired by Dr. Parthasarathi Shome) in India reached the following conclusions:

- Sufficient time should elapse between announcement of a GAAR and its entry into force to allow for appropriate training of tax officers in its application;
- The GAAR should only apply to arrangements which have the main purpose (and not one of the main purposes) of obtaining a tax benefit;
- The lack of “commercial substance”, which is a triggering factor for the GAAR, should be defined as an arrangement which does not have a significant effect upon the business risks, or net cash flows, of any party to the arrangement apart from any effect attributable to the tax benefit that would be obtained;
- The GAAR should be administered by a 5-member Approving Panel (including a retired High Court judge, 2 knowledgeable private sector members, and 2 Chief Commissioners of Income Tax;
- Where a treaty has anti-avoidance rules (e.g., LOB rules), the GAAR should not apply;
- Tax mitigation should be distinguished from tax avoidance;
- Guidance should give examples of various types of allowable tax mitigation (e.g., choosing between paying a dividend or buying back shares, setting up a branch or a subsidiary, funding through debt or equity, purchasing or leasing a capital asset);
- The GAAR should not be invoked in intra-group transactions where there is a tax benefit to one person but no overall tax savings to the group;
- The GAAR should apply only in cases of abusive, contrived and artificial arrangements;
- The GAAR should only apply above a minimum threshold of tax benefit;
- Where a specific anti-avoidance rule (SAAR) applies to a particular aspect / element, the GAAR should not apply;
- The assessing officer should provide a detailed reasoning in support of his invocation of the GAAR; and
- Taxpayers should be able to obtain an advance ruling within 6 months.

**Main purpose tests**

The IAPT is aware that some countries prefer to address potential treaty abuse by including so-called “main purpose” tests in their treaties. A typical main purpose provision reads: “The provisions of this Article shall not apply if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the rights in respect of which the income is paid to take advantage of this Article by means of that creation or assignment.”

The IAPT does not favor “main purpose” provisions as the preferred way to counter treaty abuse. The reasons for this relate to the potential level of uncertainty such provisions can cause and the extent to which they can chill legitimate commercial and investment transactions.

Main purpose tests raise two fundamental areas of uncertainty as a general matter. The first is the uncertainty of knowing whether a tax reduction purpose will be deemed in any particular case to be on a par with other important purposes for the existence and/or form of a transaction, such that it will be considered one of the principal purposes. Even on the assumption that the test would be triggered only where the tax reduction in question is inconsistent with the intent of the relevant benefit provision, notwithstanding the transaction’s literal satisfaction of the benefit provision’s conditions, the second area of uncertainty is having to determine whether the particular transaction’s tax reduction is inconsistent
with the provision’s intent. Both of these aspects involve subjective judgments and pose considerable risks of controversy.

Particularly in the context of bilateral tax treaties, the assessments required to apply a main purpose test provision pose significant difficulties. One reason for this is the general absence of guidance on the policy reasons underlying particular treaty provisions. While the OECD Commentaries and the explanatory materials prepared by some governments in the ratification process may provide some insight into the underlying policies, they do not reliably do so on a consistent basis. One can think of innumerable issues on which such materials tend not to provide significant policy guidance (e.g., why the ownership threshold for the direct investment dividend withholding rate is set at a particular level, why that withholding rate has been set at 0% or 5%, etc.). In many countries, no explanatory materials exist with respect to the policies underlying their treaties, and it is even rarer to find any materials that memorialize the joint understandings of the two Contracting States as to the underlying intent. Indeed, a particular point to note about the application of the main purpose standard in the treaty context is the particular difficulty of having to divine a particular treaty provision's underlying policy that is mutually accepted by both countries. This is especially difficult when one recognizes that the lines drawn in treaties are frequently the result of a compromise of the two governments’ competing policies.

For example, suppose two Contracting States amend their existing treaty to allow for greater taxing rights in the source jurisdiction, subject to a mutually agreed multi-year transition period during which the existing treaty’s benefits apply. If a new investment is made during the transition period for which treaty benefits are claimed, can those benefits be denied on the basis that one of the main purposes for making the investment was to claim the more generous benefits during that period? In a real life situation, business has seen a government make that argument, even though the intent of the other government in negotiating the transition period was to maximize benefits for its residents during that period.

Another source for uncertainty from the inclusion of a main purpose test in a treaty relates to the interaction between that test and other anti-abuse rules in the same treaty. In general, the issue here is whether a taxpayer that satisfies the conditions of a specific anti-abuse rule in the treaty, including any applicable LOB provision, is nevertheless still at risk as to that category of alleged abuse under the main purpose standard. Where a government has agreed to grant a particular treaty benefit and has further agreed to the terms of a specific anti-abuse rule concerning that benefit, the overlay of the main purpose test will create tremendous uncertainty if that government can invoke the test to challenge the taxpayer’s entitlement to the benefit on the grounds that the taxpayer has arranged its affairs to fall on the right side of the specific anti-abuse rule.

If a main purpose test were to be included in a treaty, a number of questions would arise concerning the procedural aspects of the test’s implementation. These questions relate to the conditions (if any) required to be fulfilled before the test can be invoked, the manner in which guidance about the application of the test will be made available, the standard of judicial review of any exercise of the test, and the unilateral or bilateral nature of its implementation. In situations where the test would be self-executing and could be applied by tax authorities without the issuance of specific guidance on particular transactions, there would
be tremendous pressure on the adequacy of the available general guidance on the circumstances and standards relevant to the test’s application. This is a particular problem in countries that do not have substantial experience in applying treaty main purpose tests nor any significant body of domestic jurisprudential precedent or other guidance for applying comparable standards. This need for guidance inevitably raises the question of whether an advance ruling process could or should be initiated to implement a provision such as a treaty “main purpose” test, which is one way to deal with the uncertainty, albeit an expensive and administratively burdensome one for taxpayers and tax authorities alike.

Another important issue relating to the implementation of a main purpose test is the potential unilateral or bilateral invocation of the provision. For example, one could reasonably ask whether a source State should be allowed to apply the provision over the objection of a residence State. If the provision’s premise is that it should prevent transactions having as one of their principal purposes obtaining a treaty benefit under circumstances that are inconsistent with the intent of the parties, it would seem reasonable to require both parties to agree that the result is inconsistent with their intent before the test could be applied. For example, some treaties have used a formulation of the test that requires both countries to agree to the existence of a tax avoidance purpose before the provision can be invoked to deny benefits. Other treaties have required that the source State at least notify and consult with the competent authority of the residence State before invoking the provision, or even that there be a full mutual agreement procedure before the provision can be invoked. These kinds of procedural safeguards are certainly more compatible with the notion that the provision is meant to be applied to cases where the treaty benefit is inconsistent with the intent of the parties than a procedure that allows either country to act wholly unilaterally.
Dear Sir, Madam,

The Taxes Committee of the International Bar Association (the IBA) has read with great interest your Focus Groups Public Discussion Draft on BEPS Action 6: Preventing the granting of treaty benefits in inappropriate circumstances (the Discussion Draft) with great interest. Under the consultation process included in the Action Plan on Base Erosion and Profit Shifting (the Action Plan), all stakeholders are invited to send comments on the Discussion Draft to the Focus Group of the OECD that has drafted the Discussion Draft. The Taxes Committee of the IBA welcomes this opportunity and is happy to provide the Focus Group with its comments in this letter.

1. Introduction and summary

Action 6 is intended to implement the OECD’s desire to end the granting of treaty benefits in inappropriate circumstances. The Taxes Committee of the IBA indicates its understanding for this development, but also wishes to raise its concerns about the effect of your recommendations. The combination of (i) adding a new understanding of the purposes of tax treaties; (ii) restricting the application of treaty benefits to residents/beneficial owners who meet the requirements of both a very extensive limitation on benefits test and a general anti-abuse provision (a main purpose test) and (iii) explicitly providing that tax treaties will not prevent countries from levying tax based on their domestic anti-abuse rules, will create an unacceptable level of uncertainty about the application of treaty benefits in a significant number of cases. The Taxes Committee of the IBA is concerned that the proposed measures will prevent the granting of treaty benefits, not only in certain inappropriate circumstances, but also in many bona fide situations. We expect that the extensive limitations on the application of treaty benefits will frustrate the main purpose of the tax treaties: to promote international investments by avoiding double taxation.

Below we have described our specific comments to the Discussion Draft by reference to the various paragraphs.

2. Paragraph 5 - 7, page 3.

The recommendations are aimed at “preventing the granting of treaty benefits in inappropriate circumstances”. We believe that the OECD should define, or at least try to describe in some detail, what is meant by “inappropriate circumstances”. If it is generally unclear to which circumstances the Discussion Draft relates, this will create uncertainty about the application of treaty benefits in many cases. In our view, it is not clear in several of the examples in the Discussion Draft, whether these constitute “inappropriate circumstances”. The same holds true for the term “treaty shopping”. Paragraph 7 defines “treaty shopping” as “a number of arrangements through which a person who is not a resident of a Contracting State may attempt to obtain benefits that a tax treaty grants to a resident of that State”. The members of the Taxes Committee of the IBA believe that a person may very well arrange his
matters in such a way that he can rightfully claim the benefits of the treaty (for example by actually moving to that State), without this resulting in “treaty shopping” or claiming treaty benefits in “inappropriate circumstances”. The origin of much of the uncertainty created by the recommendations of the Discussion Draft is due to the fact that the Discussion Draft remains vague on what is meant by “inappropriate circumstances” and “treaty shopping”.


As is described in the Discussion Draft, there are various ways to try to deal with the issue of treaty shopping and treaty abuse. One way would be to further update the concept of beneficial ownership. Although the term beneficial ownership is still the subject of considerable controversy as it still has not been fully developed, it is a term used in most countries and included in the OECD Model Convention and Commentary. The Taxes Committee believes that introducing concepts such as a limitation on benefits provision (LOB provision) and general anti-abuse provisions, which are relatively unknown in many countries (as they are used by a minority of jurisdictions only) and are not (and have never been) included in the OECD Model Convention, will, in itself, create much uncertainty. The proposed limitation on benefits tests (LOB tests) as well as the general anti-abuse provision (GAAR) involves interpretations of various relatively unknown terms. These are therefore not mechanical tests, with a predictable outcome. The Taxes Committee believes that the application of the LOB provision and GAAR will lead to more uncertainty about the application of treaty benefits, whereas the committee is not convinced that the introduction of these LOB tests and GAAR will prevent treaty abuse and treaty shopping more efficiently than updating the beneficial ownership concept.


In the view of the Taxes Committee, if an LOB provision will be implemented, it should include a derivative benefits clause. The reason is twofold.

First of all, an LOB provision without a derivative benefits clause will violate the non-discrimination clause of article 24(5) of the Model Convention. This can be explained by the following example. A company (X), resident in country A, is held by individual shareholders who are also resident of country A. X earns income from country B. Country A and B have concluded a treaty with the recommended LOB provision, without derivative benefits clause. X is entitled to the benefits of the A-B treaty, under the shareholders test. At some point in time, a shareholder who is resident in country C acquires the shares in X. A tax treaty is in effect between country C and B that provides for the same benefits as the A-B treaty. Assuming that X fails to qualify for the active business test (for example because its activities are not substantial in relation to the activities in country B), X will no longer be able to apply for the benefits of the A-B treaty, after the acquisition of its shares by country C resident shareholders. As a result, country B will withhold more tax and country A will not grant X the relief for double taxation as when X still qualified for the benefits of the A-B treaty. The A-C treaty includes an anti-discrimination provision in accordance with article 24 of the Model Convention.
The Taxes Committee believes that this difference in treatment will constitute discrimination against X, a company now held by shareholders who are resident in country C, as opposed to a company held by shareholders who are residing in country A. Such discrimination is forbidden by article 24(5) of the Model Convention. This forbidden discrimination may be avoided by including a broad derivative benefits clause.

The second reason for including a derivative benefits clause is that the Taxes Committee does not believe that including a derivative benefits clause leads to treaty abuse. In our view, the structure described in paragraph 15 of the Discussion Draft, illustrating the presumed abuse, is not an example of treaty abuse, but a matter of State T domestic tax laws, more specifically CFC provisions. The Taxes Committee’s view is that the provisions of a tax treaty should not be used to solve domestic tax issues of the treaty countries. In addition, this situation could also give rise to uncertainty about the application of the treaty as, in practice; it may not be that clear to what extent State R taxes the income and whether this is considered a “preferential rate” as compared to the “normal” taxation of such income in State T.

The Taxes Committee suggests that the derivative benefits test should not only provide that the source country taxation will be reduced in accordance with the treaty in case of an equivalent beneficiary, but also, ultimately, to the rate provided by the treaty between the country of the shareholder (not qualifying as an equivalent beneficiary) of the company and the source country, if this is higher than the rate provided for by the treaty between the country of residence of the company and the source country, but still lower than the source country’s domestic rate.

5. Paragraph 18 – 33; pages 10 – 14

The scope of the recommended GAAR is so broad and the wording of the proposed paragraph 6 is so vague, that the introduction of this provision will undoubtedly result in many uncertainties. It is unclear to the Taxes Committee what the value is of such a broad GAAR in addition to an extensive LOB provision. The example in paragraph 24 describes a situation where the treaty benefits are denied for payments received by a resident of a Contracting State (a bank), who is the beneficial owner of the income it earns and also meets one of the LOB tests, who enters into a transaction with the main purpose (or one of the main purposes) to provide to a resident of the third country the benefit of lower source taxation under a tax treaty. The Taxes Committee fails to see that such a transaction constitutes abuse of the treaty that should be prevented by the GAAR. The example seems to indicate that the bank is the beneficial owner of the income, in which case the benefits of the treaty would, of course, not be applicable based on that aspect.

An example of how broad the scope of this provision is and to how much uncertainty it will lead to is the Example C, on page 13. In this example, RCo, a company resident of State R, is in the business of producing electronic devices and it is considering establishing a manufacturing plant in a developing country in order to benefit from lower manufacturing costs.
It considers several countries and ultimately decides to build the plant in State S, as this is the only of the considered countries that has a treaty with State R. The conclusion of the Focus Group is that this is an example to which the GAAR would not apply, as the main purpose of building the plant in State S are related to the expansion of RCo’s business and the lower manufacturing costs of that country. Although the Taxes Committee agrees with the conclusion that this is not an example of treaty abuse, the Taxes Committee is not so certain that countries would not apply the proposed GAAR, as it is clear that one of the main purposes of making the investment in State S was to benefit from the R-S tax treaty. In our view this example indicates that implementing the recommended GAAR will lead to significant uncertainty.

In the view of the Taxes Committee the GAAR may also create issues for the paying persons or withholding agents, as it may not at all be clear to them what the purposes were for a certain recipient to receive a payment through a certain entity in a certain country. It should therefore be clarified that the paying person of the source state acting as withholding agent should not be held liable for assessing the existence of the requirements of the application of the treaty with regard to the recipient person. In this respect, it could be envisaged that the recipient person has to provide the paying person of the source state acting as withholding agent with a declaration attesting the existence of the requirements for the application of the treaty. Thus, the paying person would comply with its obligations as withholding agent by verifying formally that the requirements for the application of the treaty are met on the basis of the declaration of the recipient person. The reason for such clarification is to avoid additional burdens on the paying person as well as to avoid potential conflicts between the paying person and the recipient person on the basis of different interpretation of treaty rules or evaluation of the evidence aimed at proving the existence of the requirements for the application of the treaty. This comment applies, mutatis mutandis, also to the LOB provision as well as to specific anti-abuse provisions.

Moreover, the Taxes Committee suggest that the Focus Group take into consideration a different approach to this ‘one of the main purposes test’: this test could be implemented in the mutual agreement procedure paragraph of the LOB provision to clarify that even if a resident/beneficial owner does not qualify under any of the LOB tests, it will still qualify for the benefits of the treaty if it is clear that obtaining treaty benefits was not one of the main purposes for entering into a certain transaction or setting up a certain structure.

Finally, should the recommended GAAR be maintained in the final proposal, the Taxes Committee suggests to narrow its application to the case where obtaining the treaty benefit lacks significant non-tax reasons, thus allowing treaty benefits when the arrangement or transaction is supported by sound business reasons and even if one of the purposes is obtaining the treaty benefit.

The Taxes Committee expects that the recommendation that dual resident companies will not be able to benefit from any of the treaty benefits until it has been determined by the competent authorities, in which country such company is considered a resident for purposes of the treaty, will also lead to uncertainty about the application of treaty benefits. The recommended rule presumes that all cases of dual residency are related to treaty abuse. It is unclear to the Taxes Committee whether this presumption is based upon facts or guesswork. A mutual agreement procedure generally takes quite some time, during which the dual resident company cannot apply any treaty benefits, according to the recommended rule (unless agreed upon by the competent authorities, but this may take just as long).

The Taxes Committee requests the Focus Group to reconsider this recommendation, as the scope of also this rule is also too broad and will therefore create too much uncertainty about the application of the treaty benefits.


The Taxes Committee believes that countries should observe the provisions of the treaties they have concluded, in accordance with the Vienna Convention on the Law of Treaties. The OECD should encourage countries to do, rather than to recommend changes to the Model Convention to ensure the treaties do not prevent the application of domestic anti-abuse provisions. Also the scope of this provision is very broad, so this recommended provision will also result in uncertainty about the application of treaty benefits in a significant number of cases. The Taxes Committee believes that countries should include any general and specific anti-abuse rules to the extent possible in the treaty itself.


The Taxes Committee is concerned that the new understanding of the purpose of tax treaties (as embodied in the broad statements of purpose) will likely create additional major uncertainty in applying them.
International Chamber of Commerce
Comments to the OECD Discussion Draft on “Preventing Treaty Abuse”

General Comments

The International Chamber of Commerce (ICC) welcomes the opportunity to provide comments to the Discussion Draft regarding BEPS Action Point 6 on preventing the granting of treaty benefits in inappropriate circumstances. The aim of preventing the abuse of tax treaties through both treaty provisions and domestic law anti-abuse rules is fully supported by ICC. ICC has serious concerns, however, that the Discussion Draft is focusing only on combating treaty abuse without due regard for the impact on the vast majority of potential beneficiaries of income tax treaties that do not engage in abusive practices and who, in many cases will be deprived of the certainty and predictability that is the fundamental goal of tax treaties.

ICC is aware that it is very difficult to reach full consensus in the given timeframe of the BEPS project. However, complex issues require the time and care to work through the analysis and study the repercussions of any changes. Failure to take the time necessary to do this will result in faulty rules which will give a very hard time to businesses and will take years for governments to amend. Their impact on the global economy and the prospect of developing countries is not to be underestimated.

It seems that there is not enough time to resolve differences of opinion among the delegates. In order to really come to a sound proposal, governments urgently need more time to discuss the very complex tax issues they are dealing with. Given the short comment periods, it is impossible for business to give the careful thought necessary to identify and comment on all the issues in each of these proposals. Our following remarks are therefore aimed at a high level summary of our concerns and suggestions.

Comments on the Discussion Draft

Where it is clear that a transaction is upheld by a proper analysis of functions carried out, risks taken and assets used and adequate substance is present, it should be clear that there is no question of abusive behavior, or trying to gain access to a tax treaty where there should not be. Business must be able to organize their affairs in a way that is commercially optimal and concentrate their activities in their global value chain as they see fit, as long as adequate
substance is attributed to these activities and the accompanying transactions are according to the arm’s length standards. This is vital to strengthening the integrity of the tax system, furthering a global level playing field and, at the same time, improving certainty for international business to foster cross border investments and trade. ICC, therefore, makes the following recommendations:

- Reject the overly restrictive standards in the proposed Entitlement to Benefits (ETB) article that is patterned after the current U.S. Limitation on Benefits article and adhere more closely (with modifications discussed below) to the version that already appears in the Commentaries;

- Reject subjective main purpose or general anti-avoidance treaty solutions; they are not predictable enough creating unacceptable levels of uncertainty thereby creating unnecessary obstacles for international trade and business. There is no compelling reason to also subject transactions that pass the LOB-tests to a main purpose test as well. Only in extraordinary and specific circumstances – specifically when there is no other provision applicable that could target abuse – can recourse to a main purpose test be acceptable;

- Provide that, if the decision is made to retain a main purpose test, enterprises that meet any of the other criteria for eligibility for the benefits of the treaty under the Entitlement to Benefits article should be presumed not to fail the main purpose test unless the relevant Competent Authority establishes by clear and convincing evidence that the test should apply;

- In the course of endorsing effective anti-abuse measures, provide a clear mandate for countries to adhere to the fundamental precept already recognized in the Commentaries that, consistent with the goal of promoting bi-lateral trade and investment through establishing rules that provide the greatest degree of certainty and predictability for bona fide beneficiaries of tax treaties, rules that create subjectivity and uncertainty, or that rely on cumbersome pre-clearance procedures straining the resources of tax administrators are to be avoided; and

- Consider adding a mechanism for a home country tax administration of a Multinational Enterprise group to certify the non-abusive practice of such group, as confirmed in bilateral APAs or other agreements, which will facilitate Competent Authority processes for such a group.
Dear Sir/Madam

Thank you for inviting comments on the OECD public discussion draft on BEPS Action 6 relating to preventing the granting of treaty benefits in inappropriate circumstances.

The International Underwriting Association of London (IUA) represents international and wholesale insurance and reinsurance companies operating in or through London. Its purpose is to promote and enhance the business environment for its members. We estimate that premium income for the London company market in 2012 was £24.225bn.

Overview comments

The IUA acknowledges that treaty abuse is a legitimate OECD concern and supports measures to eliminate that abuse. However, we note that any such measures should be proportionate to the scale of the perceived issues and should not add uncertainty to the international tax treaty framework.

In particular, the primary purpose of double tax treaties must be preserved: treaties are entered into to promote international trade by protecting against double taxation. Treaties aim to provide certainty of tax treatment for cross-border trade and investment where two states might tax the same income.

Any abuse of a treaty resulting in benefits obtained in an unintended manner should properly be addressed by treaty provisions which remove the treaty benefit in such situations. However, providing the treaty benefits negotiated and agreed between the two states must remain the primary purpose of a treaty. Accordingly, anti-abuse provisions must not have the unintended effect of denying benefits that are intended to be provided under a treaty. There should not be an excessive administrative burden on the taxpayer in determining whether treaty benefits apply in situations where no abuse is planned.

A distinction should be made between anti-abuse and anti-avoidance. The words 'abuse' and 'evasion' should be used in the context of inappropriate use of a treaty, but 'avoidance' should be acknowledged as describing planning within relevant legal parameters. There needs to be a clear statement of what is considered to be 'abuse'.
The IUA considers that excessive complexity is introduced by the different layers of rules that are proposed, including a limitation-on-benefits provision, a general anti-avoidance rule and specific anti-avoidance rules. The IUA is concerned that that level of complexity will increase the costs of compliance and may lead to uncertainty in interpreting the treaty provisions. The Model Convention should allow states to choose the approach to be adopted: limitation on benefits or general anti-avoidance rule, but not both.

We would note also that for the most part other issues brought up in the discussion draft relate to items that properly should be handled in other workstreams and that these should be handled in a co-ordinated and harmonised way.

**Detailed comments**

We comment on the proposals in the same order as is followed in the Discussion Draft.

**A. TREATY PROVISIONS AND/OR DOMESTIC RULES TO PREVENT THE GRANTING OF TREATY BENEFITS IN INAPPROPRIATE CIRCUMSTANCES**

1. Cases where a person tries to circumvent limitations provided by the treaty itself

   **a) Treaty shopping**

   Paragraph 9 recommends the inclusion in the title and preamble of tax treaties a clear statement that Contracting States wish to prevent tax avoidance and intend to avoid creating opportunities for treaty shopping. We comment on that in Section B.

   **Limitation on benefits provisions**

   Paragraph 13 refers to a derivative benefits provision. We do not believe that it is appropriate for treaty provisions to attempt to address all possible scenarios and therefore do not consider that a derivative benefits provision is necessary. In fact, there are many situations in which the proper response of a taxpayer may well be to consider its internal ownership structures and the dividend issue which you outline in paragraph 14 is just such a situation.

   **b) Other situations where a person seeks to circumvent treaty limitations**

   The Discussion Draft also sets out a number of other situations in which it states that specific treaty anti-abuse rules may be useful and those situations are:

   - splitting-up of contracts: the Discussion Draft concludes, correctly in our opinion, that this is more properly dealt with in the prevention of artificial avoidance of PE status workstream;

   - hiring-out of labour cases: the Draft concludes, correctly in our opinion, that existing convention commentary is perfectly adequate;
transactions intended to avoid dividend characterisation: the Draft concludes, correctly in our opinion, that this is more properly dealt with in the hybrid mismatches workstream;

dividend transfer transactions: the Discussion Draft proposes a holding period for shares before the reduced dividend withholding tax rates under a convention can apply. We note that that may have an impact on situations where a new company joins a group or where there is a non-tax reason, for example a local regulatory reason, why a transaction must be concluded on a certain date. Such situations may lead to a denial of treaty benefits. Any minimum holding period for artificial increases of ownership needs to be distinguished from bona fide commercial transactions. If a minimum holding period must be included, we suggest this should be not longer than three months.

Paragraph 42 refers to when dividends "become legally available" and paragraph 43 to "the time of the payment" of the dividend. There should be consistency between those two times;

transactions that circumvent the application of Article 13(4): we accept that the proposals in paragraphs 47 to 49 are proportionate;

tie-breaker rules for determining the treaty residence of dual resident persons other than individuals: the proposals for the competent authorities of the Contracting States to resolve cases of corporate dual residence by mutual agreement introduce a high level of uncertainty and potentially subjectivity on the part of tax authorities. The existing version provides clarity and the IUA would prefer to see that version remain. An anti-abuse overlay here may address situations which cause concern.

anti-abuse rule for permanent establishments situated in third states: the inclusion of a triangular clause should be proportionate. The IUA's particular concern is that the introduction of a specific anti-abuse provision here implies that such situations are typically abusive. Many IUA members operate in many jurisdictions through a branch structure, as that brings capital and regulatory efficiency. It is a business model commonly adopted in the insurance industry. We would therefore prefer any test to acknowledge the commercial reasons for operating in the third state. For example, the active conduct of a trade or business in the third state should be recognised as a commercial reason and examples of such situations, updated for current business models, should be provided. Any test introduced should be based on whether a structure is artificial. In addition, we consider that an effective rate of tax test can give rise to uncertainty year on year

2. Cases where a person tries to circumvent limitations provided by the treaty itself

The Discussion Draft highlights in this section a number of avoidance strategies that are facilitated by treaty arrangements rather than caused by them. As a side issue, we believe that transfer mispricing, unless in innocent error, will already be contrary
to law, while the other strategies highlighted are, as noted at paragraph 58, quite properly addressed in other BEPS workstreams, including that on transfer pricing.

The main point that the discussion draft brings out in this section is that tax treaties should not prevent the application of domestic law that would prevent abusive transactions and the fundamental proposal to address this appears to be a savings clause. We have already noted above that states are not compelled to give treaty benefits in abusive circumstances, but we recognise that the proposed savings clauses included at paragraph 70 are proportionate and appropriate.

**B. CLARIFICATION THAT TAX TREATIES ARE NOT INTENDED TO BE USED TO GENERATE DOUBLE NON-TAXATION**

As we noted above, paragraph 9 recommends the inclusion in the title and preamble of tax treaties a clear statement that Contracting States wish to prevent tax avoidance and intend to avoid creating opportunities for treaty shopping and the proposed wording is included at Section B of the Discussion Draft. We agree that this clarification is helpful and agree that the proposed wording in paragraphs 75 and 77 is appropriate.

**C. TAX POLICY CONSIDERATIONS THAT, IN GENERAL, COUNTRIES SHOULD CONSIDER BEFORE DECIDING TO ENTER INTO A TAX TREATY WITH ANOTHER COUNTRY**

We consider that the proposed wording at paragraph 81 for a new section in the Introduction to the OECD Model Convention is a perfectly fair rehearsal of appropriate tax policy considerations.

Yours faithfully

Nick Lowe
Director of Government Affairs
Dear Pascal,

The Investment Company Institute (ICI)¹ and ICI Global² are concerned that the Base Erosion and Profit Shifting (BEPS) Action 6 Public Discussion Draft (hereafter the Action 6 draft)³ does not reflect expressly the OECD’s extensive multi-year consideration of treaty eligibility for investors in collective investment vehicles (CIVs). The CIVs at issue are widely-held, diversified, and subject to investor-protection regulation in the country in which the CIV is established.

The OECD’s consideration of CIVs involved a Government-business consultation established in 2006 by the OECD’s Committee on Fiscal Affairs (CFA) as the Informal Consultative Group on the Taxation of Collective Investment Vehicles and Procedures for Tax Relief for Cross-Border Investors (ICG).⁴ The CIV Report that resulted from the ICG’s work was endorsed by the CFA in April 2010.⁵

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¹ ICI is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (“ETFs”), and unit investment trusts (“UITs”). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $16.8 trillion and serve over 90 million shareholders.

² ICI Global is a global fund trade organization based in London; members include regulated U.S. and non-U.S. based funds publicly offered to investors in jurisdictions worldwide. ICI Global seeks to advance the common interests and to promote public understanding of global investment funds, their managers, and investors. Members of ICI Global manage total assets of $1.4 trillion in non-U.S. funds.


⁴ The ICG included representatives from 15 Governments, as well as the European Commission. The National Government representatives were from Austria, Canada, France, Germany, Ireland, Italy, Japan, Luxembourg, the Netherlands, Norway, Spain, Switzerland, the United Kingdom, the United States, and the People’s Republic of China.
The 2010 Update to the OECD Model Tax Convention Article 1 Commentary,\(^6\) which adopts the Report’s conclusions, addresses expressly governments’ concerns about treaty shopping opportunities through CIVs. While the Action 6 draft makes no mention of CIVs or the conclusions endorsed by the CFA, the draft presumably is not intended to reverse the OECD’s considered conclusions regarding CIV treaty benefits.

Consequently, we recommend that a specific reference to the CIV Report approved by the CFA, and the relevant paragraphs added to the Article 1 Commentary, be provided in the final Action 6 Report. This reference would state that paragraphs 6.8 through 6.34 of the Article 1 Commentary provide the relevant Action 6 guidance for CIVs; such a reference would eliminate any confusion that otherwise might arise regarding the application to CIVs of a limitation on benefits (LOB) clause or a general anti-abuse rule. As paragraph 8 of the Article 6 draft discusses already various contexts in which the OECD has examined treaty shopping issues, this paragraph would be an appropriate place to provide the recommended clarity.

Our recommendation – which is fully consistent with sound tax policy – effectively would preserve the 2010 CFA-approved procedures for determining treaty eligibility for CIVs and their investors.

**Support for OECD’s BEPS Initiative**

The compelling need to address on a coordinated basis various important tax concerns is obvious. The OECD’s considerable expertise in tax matters, its ability to reach out beyond its membership for input, and its long-standing practice of consulting with business make it the logical choice for addressing BEPS issues.

Treaty shopping can be a serious problem. The CIV Report recognized this problem and provided practical and reliable approaches for applying an LOB clause to CIVs. Importantly, the CIV Report, and the changes to the OECD Commentary, were crafted after the LOB clause (that has been incorporated in the Action 6 draft) was included in the US Model. Thus, the CIV Report properly is viewed as clarifying the application to CIVs of the LOB clause included in the Action 6 draft.

We recognize that the OECD has been given a mandate by the G20 to address all BEPS issues within an extraordinarily short time frame. We also recognize that this short time frame provides limited opportunity for business input and for the Secretariat to respond

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to every business comment received. Despite the short time frames, it nevertheless is imperative that the final product balance appropriately all competing considerations.
The CIV Report

We submit that the CIV Report and the changes made to the Article 1 Commentary balance appropriately all relevant considerations of Governments and business. This thoughtful approach for applying an LOB clause to CIVs should be reflected expressly in the Final Report on BEPS Action 6.

The CIV Report was developed with strong support from the global CIV community. During the first consultation with business, at a Working Party 1 meeting on 17 February 2005, industry representatives from ten leading CIV jurisdictions\(^7\) participated. When the next meeting to discuss CIV issues with business was held at the OECD on 1-2 February 2006, over 115 individuals representing 29 countries’ tax authorities and numerous CIV industries participated. The ICG subsequently established to consider these issues included 28 business representatives from eleven countries.\(^8\)

The ICG that was established in 2006 analyzed treaty eligibility issues and potential treaty shopping concerns. The business delegates worked closely with the OECD and Governments to craft appropriate responses to these issues and concerns. The consensus report prepared by the ICG\(^9\) was released in January 2009 for extensive public consultation before being endorsed by the CFA, in final form, in April 2010. The consultation was extensive. The conclusions are sound.

The CIVs that are the subject of the CIV Report, as noted above, are widely-held, diversified, and subject to investor-protection regulation in the country in which the CIV is established.\(^10\) In general, these CIVs have many thousands, sometimes hundreds of thousands, of investors; most of these investors have relatively small accounts. These investors, as the CIV Report explains, lack the financial incentive individually to incur the substantial costs to claim the treaty benefits attributable to the small amounts they have invested. For the CIV, however, it typically is cost effective to make appropriate claims for investor treaty relief.

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\(^7\) These jurisdictions were Belgium, Canada, France, Germany, Ireland, Italy, Luxembourg, Switzerland, the United Kingdom, and the United States. An observer from a pan-European industry association attended as well.

\(^8\) Several representatives from Japan, as well as the ten countries represented at the 2005 meeting, participated in the ICG’s business delegation.


\(^10\) The CIV Report, in paragraph 4, stated specifically that the ICG did not address private equity funds, hedge funds or trusts or other entities that are not widely held, diversified and subject to investor-protection regulation in the country in which the entity is established.
Special consideration was given by the OECD to CIV treaty eligibility issues for several reasons. First, some source-country Governments were concerned that clear rules were needed to determine when CIVs could claim treaty relief (either in their own right or on behalf of their investors); potential treaty shopping considerations were an element of this concern. Second, some CIVs that are treaty entitled in their own right were concerned that they effectively could not receive treaty relief. Third, CIVs that are not treaty entitled in their own right were concerned that they could not satisfy requirements for proving the treaty eligibility of their investors given the highly intermediated nature of most CIVs’ distribution networks. Finally, some residence-country Governments were concerned that, if CIV investors were not receiving treaty relief to which they are entitled, these investors would claim credits against their residence-country tax for both the foreign taxes that should have been withheld as well as those that should have been recovered; the effect of claiming credits for these excess foreign taxes would be to transfer tax revenues from the investors’ residence countries to a source country. All of these potentially-competing concerns were addressed, to everyone’s satisfaction, by the CIV Report.11

The CIV Report effectively acknowledges that Governments may take different approaches to CIV treaty eligibility, and the procedures for establishing the tax residence of a CIV’s investors, depending on the structure of the CIV and the manner in which it is distributed. Some CIVs can be treated as treaty eligible in their own right, the CIV Report states, because – under the relevant long-standing legal standard – they are persons, residents, and the beneficial owners of their income. The only constraint on treaty eligibility for these CIVs might be the need to satisfy an LOB clause. Other CIVs, the CIV Report states, can be treated as treaty eligible only to the extent that their underlying investors are treaty eligible – either directly or as equivalent beneficiaries under a treaty between the investor’s residence country (which is not the residence country of the CIV itself) and the source country. Finally, other CIVs can be treated as transparent, the CIV Report states, so that their investors (such as pension funds) can claim treaty relief (including treaty exemptions) in their own right.

Importantly, as noted above, the CIV Report also acknowledges that CIVs typically do not know their investors; the majority of CIV interests typically will be held by many securities brokers or other intermediaries holding the interests in a nominee (or “street name”) account for their customers. Because intermediaries consider the identities of their customers (the fund’s underlying investors) to be a valuable commercial (proprietary) asset, detailed information about these investors’ identities typically is not shared with potential competitors. Consequently, the CIV Report states, “it would be impractical for the CIV to collect such information from the relevant intermediaries on a

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11 See, e.g., paragraph 6.27 of the Commentary to Article 1 which explains that “the purely proportionate approach set out in paragraphs 6.21 through 6.26 protects against treaty shopping.”
daily basis. Accordingly, Contracting States should be willing to accept practical and reliable approaches that do not require such daily testing.”

The CIV Report then describes various approaches that Governments can take to satisfy themselves that a CIV is owned by treaty-eligible investors. In many countries, the CIV Report notes, the CIV industry is largely domestic, with an overwhelming percentage of investors resident in the country in which the CIV is established. In this situation, “it may be appropriate . . . to assume that a CIV is owned by the residents of the State in which it is established if the CIV has limited distribution of its shares or units to the State in which the CIV is established or to other States that provide for similar benefits in their treaties with the source State.” In other situations, the CIV Report states, CIVs generally should be required to determine the treaty eligibility of their investors only once per year. If particular circumstances cause a Government to conclude that annual determinations are inadequate, the CIV Report concludes, more frequent testing (but no more frequently than quarterly) could be required.

**The Consequences to CIVs of a Strict Application of BEPS Action 6 Public Discussion Draft**

Strict application to CIVs of the Action 6 draft (and, in particular, the LOB clause of the 2006 Model US Tax Convention) effectively could reverse the carefully considered and appropriately balanced approach of the CIV Report. This report, as noted above, was published *after* the US Model and was endorsed unanimously by the Government officials who were members of the ICG.

For a CIV to determine whether more than 50% of its interests are held by persons who are resident in a treaty-partner country for more than 183 days, the CIV *strictly speaking* could be required to *prove* the tax residence of *every* underlying investor *every* day. Because this information is not commercially available, no CIV – and no investor in a CIV – *ever* could receive treaty benefits.

The net effect of applying strictly the Action 6 draft to CIVs, therefore, would *not* be elimination of treaty *shopping*; instead, the effect would be elimination of treaty *relief* negotiated previously, and intentionally, by the investors’ residence countries.

We assume, as noted above, that the absence of an express reference in the Article 6 draft to the CIV Report is an unfortunate result of the time pressures imposed on the OECD by

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12 Paragraph 6.29 of the Commentary to Article 1 (emphasis added).
13 Paragraph 6.30 of the Commentary to Article 1.
14 Paragraph 6.31 of the Commentary to Article 1.
the G20. Regardless of the reason for the uncertainty, clarifying guidance should be provided immediately.

Perhaps the easiest way to resolve this matter is to note, in the introduction to the BEPS Action 6 Final Report,\(^{15}\) that it is not intended to address situations – such as the treaty eligibility of CIVs and their investors – that already have been considered fully by the OECD. A specific reference to the CIV Report approved by the CFA, and the relevant paragraphs (6.8 through 6.34) added to the Article 1 Commentary, should be provided. This reference would state that paragraphs 6.8 through 6.34 provide the relevant Action 6 guidance for CIVs; such a reference would eliminate any confusion that otherwise might arise regarding the application to CIVs of an LOB clause or a general anti-abuse rule.

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This issue is critically important to the global CIV industry – which invests over US$ 30 trillion\(^{16}\) for CIV investors. Our recommendation – which is fully consistent with sound tax policy – also is critically important to ensuring that the many years of dedicated effort by the OECD, Government officials, and industry experts is not reversed – unintentionally or otherwise – for the sake of meeting a G20-imposed deadline.

Please feel free to contact me (at lawson@ici.org or 001-202-326-5832) at your convenience if you would like to discuss this issue further or if we can provide you with any additional information.

Sincerely,

[Signature]

Keith Lawson
Senior Counsel – Tax Law

cc: Grace Perez-Navarro
Deputy Director
CTPA, OECD

Marlies de Ruiter
Head of Division
CTPA/OECD

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\(^{15}\) Paragraph 8 of the Action 6 draft, as noted above, would be an appropriate place for this discussion.

8 April 2014

Tax Treaties, Transfer Pricing and Financial Transactions Division
Centre for Tax Policy and Administration
Organisation for Economic Co-operation and Development

By email: taxtreaties@oecd.org

Dear Sir or Madam

OECD DISCUSSION DRAFT ON BEPS ACTION 6

IMA1 is concerned that the recommendations of the discussion draft on BEPS Action 6 will jeopardise the ability for collective investment vehicles (CIVs) to access treaty benefits. We recognise the importance of combating treaty abuse and treaty shopping, and we also support the broader objectives of the BEPS Action Plan. However, we urge the OECD to consider the impact on CIVs of the recommendations, and take into account the findings of the 2010 OECD report: The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles (the CIV Report).

Over $30 trillion of net assets are held by CIVs globally2. This represents over 40% of Gross World Product3. At least 39% of the world’s equity CIVs invest cross border and for UK CIVs the figure is closer to 50% for UK CIVs. CIVs are a vital instrument of choice throughout the world for many pension funds and also smaller private savers.

CIVs represent a key source of investment capital, and the ability of CIVs to access the protection afforded to investors by double tax treaties is vital to ensuring that CIVs remain a viable product for saving and investment, and that capital invested through CIVs is available for cross border investment and the long-term financing of economies.

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1 IMA represents the asset management industry operating in the UK. Our Members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of around $5.4 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles.

2 International Investment Funds Association International Data Exchange – 2013: Q4

The purpose and advantages of investment through a CIV were recognised by the OECD in the CIV report in April 2010. This report also looked at ways to prevent CIVs from being used for treaty shopping. Many countries were involved in the development of this report and it received strong support from business representatives.

As well as addressing the technical challenges of interpreting tax treaties for CIVs, the report recognises that it is vital to preserve the principle of neutrality for investment held through CIVs with respect to direct investment. Tax neutrality, along with the obvious benefits of diversification of risk, and economies of scale provided by CIVs, provides access to capital markets to smaller investors, and investors from smaller and developing countries. Unless CIVs can readily access treaty benefits, tax neutrality will be compromised and investors will suffer double taxation.

**Limitation on benefits**

The second recommendation to prevent treaty shopping in paragraph 9 of the discussion draft on BEPS Action 6 is to include in tax treaties a limitation-on-benefits (LOB) provision. Paragraph 6.29 of the Commentary on Article 1 of the Model Tax Convention recognises the difficulties in applying a limitation on benefits provision to CIVs, because of the regular changes in ownership and the intermediated distribution of CIVs.

The BEPS proposal effectively recognises the difficulties that arise from frequent changes in ownership of listed entities insofar as treaty benefits are preserved for entities that are regularly traded on a recognised stock exchange, without regard for the residence of underlying owners. However mutual funds that are not regularly traded face the same difficulties and we believe that distinguishing between listed and non-listed CIVs could represent a significant and unwarranted distortion.

Listed and traded companies represent a low risk of being used for treaty shopping because shareholders are generally not able to exercise control over the company. This is even truer of widely held CIVs, whether listed or not, and we believe the same treatment should be afforded to CIVs.

The OECD Common Reporting Standard (CRS) on Automatic Exchange of Information, recognises the comparability of listed and non-listed funds in its work on the CRS and applies the same standards of investor identification to both.

**Automatic Exchange of Information**

Although the practical difficulties of identifying underlying investors remain, we recognise that there have been significant policy developments with regard to investor information reporting, most importantly the OECD CRS. As an industry we have embraced the need for visibility of the identity of investors and recognised the benefits of this, not only in combating tax evasion, but also for other purposes that include obtaining treaty benefits.

The CRS provides a common framework for obtaining information on investors in CIVs which can be developed into a coherent policy on how CIVs should be granted treaty benefits without facilitating treaty shopping. The OECD is already looking at how this can be achieved by examining how its previous work on TRACE can be adapted and incorporated into the framework of the CRS.

The Action Point 6 recommendations threaten to override the significant and positive body of work on CIVs, carried out over many years. Instead we believe that there are
already sufficient common elements, and a workable structure to develop easily a coherent policy on treaty access of CIVs. This can be achieved using the findings of the CIV report, and facilitated by the growing matrix of information provided by the CRS. We urge the OECD to continue its excellent work in these areas, and provide more time for developing sound policy that would not compromise the access to financial products and capital markets for investors through CIVs.

**Derivative benefits**

Para 55 (within section 4.2 that deals with the potential for treaty shopping) of the CIV Report states the following:

“In the case of CIVs, an anti-treaty shopping provision generally would seek to determine whether a CIV is being used for treaty shopping by determining whether the owners, or a specific proportion of the owners, of interests in the CIV are residents of the Contracting State in which the CIV is organised or, in some cases, whether the owners of interests in the CIV would have been entitled to equivalent benefits had they invested directly. The latter approach would help to ensure that investors who would have been entitled to benefits with respect to income derived from the source State had they received the income directly are not put in a worse position by investing through a CIV located in a third country. The approach thus serves the goals of neutrality as between direct investments and investments through a CIV. It also decreases the risk of double taxation as between the source State and the State of residence of the investor, to the extent that there is a tax treaty between them. It is beneficial for investors, particularly those from small countries, who will consequently enjoy a greater choice of investment vehicles. It also increases economies of scale, which are a primary economic benefit of investing through CIVs. Finally, adopting this approach substantially simplifies compliance procedures.”

The CIV Report thus recognises that, where a LOB applies to a treaty, neutrality of treatment for investors in CIVs can only be achieved through a comprehensive derivative benefits provision and that this neutrality protects small investors and investors from small and developing countries. We believe that, if the OECD incorporates a LOB provision in the Model Convention (or countries apply a LOB provision to existing treaties), this should include a derivative benefits provision that, at least insofar as concerns CIVs are widely held entities that are regulated in their country of residence, does not apply only to entities controlled by seven or fewer persons.

Such a derivative benefits clause could be both effective in combating treaty shopping through CIVs, and administrable for CIVs only if a framework for identification of investors is developed pursuant to existing work on the CRS and TRACE. This would involve the passing of aggregate data on investor residence (compiled for CRS purposes) back through a distribution chain to the CIV or custodian making treaty claims on its behalf.

This coherent and effective framework can be created readily, but until then, the existing commentary to Article 1 of the Model Convention in 6.29-6.31 is the only way in which CIVs might be able to comply with a LOB provision in treaties.
EU Treaty

Although we recognise that the legal framework of the EU is not relevant to many OECD members, we note that the EU treaty might prevent an EU Member State from discriminating between a CIV whose investors are domestic, and a CIV whose investors are resident in another EU member state (and that this would be the case whether or not the CIV is resident in an EU member state). Changes to treaties would be even more difficult to manage if there is a risk that they will not to be widely adopted, or that they may be challenged in court by taxpayers.

Summary of recommendations

1) We urge the OECD to consider including in the definition of “qualifying person” a CIV where the CIV is widely held and regulated in its country of residence on the grounds that a widely held and regulated CIV presents a low risk of being used for treaty shopping.

2) We urge the OECD to continue work to adapt the TRACE implementation package so that it can be incorporated into the current work on CRS.

This can deliver a framework for effective and coherent sharing of aggregate information collected pursuant to the CRS. In due course this will facilitate the administration of LOB provisions in treaties by CIVs and further prevents CIVs from being used for treaty shopping.

3) We believe that any LOB clause adopted by the BEPS proposals should at least include a derivative benefits provisions that applies to widely held and regulated funds, which present a low risk of treaty shopping.

4) Until a framework for aggregate information sharing can be developed, the OECD should uphold the existing approach to CIVs in the commentary to Article 1 of the Model Convention.

Finally, I would like to thank for the opportunity to comment on the discussion draft and we appreciate the considerable efforts that have been made to develop these proposals in a very short timeframe. We hope to be able to continue to contribute to the consultation and I am available at your convenience to discuss anything in this letter at jmorley-smith@investmentuk.org or on +44 (0)20 7831 0898.

Yours faithfully,

Jorge Morley-Smith
Director, Tax

Cc. Mike Williams, HM Treasury
Tom Matthews, HM Revenue & Customs
Dear Sir or Madam,

Public discussion draft - BEPS Action 6: Preventing the granting of treaty benefits in inappropriate circumstances ("the draft on BEPS Action 6")
Response from the Irish Funds Industry Association ("IFIA")

The Irish Funds Industry Association (IFIA) is the industry association for the international investment fund community in Ireland, representing custodians, administrators, managers, transfer agents and professional advisory firms. Ireland is a leading centre for the domicile and administration of collective investment vehicles ("CIVs"), with industry companies providing services to CIVs with assets totalling in excess of €2.7 trillion.

We wish to outline the very real concerns of the IFIA in the specific context of the draft discussion document on BEPS Action 6. The proposals included in the document could unintentionally have a major impact on treaty access for CIVs, particularly funds distributed across borders and create double taxation for investors in CIVs. If implemented as proposed, these provisions could effectively remove all treaty access for the vast majority of CIVs. The concern arises with regard to CIVs that are widely-held, diversified, and subject to regulation in the countries in which the CIVs are established.

Summary of Recommendations

We make the following recommendations in respect of the draft on BEPS Action 6:

(a) Confirmation in the draft discussion document that it is not intended to address any perceived issues with CIVs, including an extension of the definition of “qualified person” in the proposed “Limitation on Benefits” provision to include widely held and regulated CIVs, and

(b) Recognition in the draft discussion document that the general anti-abuse rule ("GAAR") should be constructed in a way to provide certainty for CIVs in a manner consistent with the findings of the 2010 OECD reporting on treaty benefits for CIVs ("CIV Report").
BEPS Action Plan - Purpose

We understand that the main aim of the BEPS action plan is to address gaps and opportunities opened up for multi-national enterprises (“MNEs”) to artificially shift profits out of countries where they are earned resulting in double non-taxation or unduly low taxation. One of the key actions highlighted in the BEPS action plan is preventing treaty abuse (Action 6) by preventing the granting of treaty benefits in inappropriate circumstances.

CIVs are designed for public participation and regulated to allow investors invest money alongside other investors in order to benefit from lower costs, professional investment management, economies of scale and asset/risk diversification. CIVs are regulated entities governed by both regulations (including investor-protection rules) and the investment prospectus dictating the nature of investment activities that can be undertaken. They are independent from their investors (“unitholders”) and control cannot be exercised by the unitholders. As a result, regulated CIVs by their nature are not facilitators or conduits for base erosion and profit shifting by MNEs. Indeed, CIVs are a significant source of cross-border investment capital which double taxation treaties are intended to protect.

In this regard, CIVs should be excluded from the scope of the draft on BEPS Action 6 as it is inappropriate to include CIVs within the remit of specific actions aimed at MNE’s. If there are residual concerns with OECD Members that MNE’s could utilise CIVs to claim treaty benefits in inappropriate circumstances, the application of a General Anti-Abuse Rule (“GAAR”) which provides certainty (i.e. is not vague or subjective) and recognises the principles of the CIV Report could be a tool at the disposal of tax authorities to counteract such circumstances.

The OECD Report on CIVs and Treaty Benefits

As you will be aware, the issue of treaty access for CIVs was considered in great detail by the OECD in recent years. The report1 of the review group (“CIV Report”), ‘the granting of treaty benefits with respect to the income of collective investment vehicles’, was adopted by the OECD Committee on Fiscal Affairs on 23 April 2010. While a number of approaches were considered, the favoured approach was, inter alia, to ensure CIVs could utilise CIVs to claim treaty benefits in inappropriate circumstances, the application of a General Anti-Abuse Rule (“GAAR”) which provides certainty (i.e. is not vague or subjective) and recognises the principles of the CIV Report could be a tool at the disposal of tax authorities to counteract such circumstances.

The CIV Report recognised the benefits of investing through CIVs and, in particular, the benefits to small investors including:

“CIVs allow small investors to gain the benefits of economies of scale even if they have relatively little invested. They provide access to a number of markets that might be closed to the small investor. These benefits are provided in a form that is highly liquid, as securities issued by a CIV may be redeemed on a frequent (daily, weekly or monthly) basis at net asset value (“NAV”) or can be transferred with minimal restrictions. CIVs also allow for highly efficient reinvestment of income. Distributions on portfolio securities held by the CIV can be reinvested by the CIV. It would be difficult for individual investors to reinvest small distributions on an efficient basis. In addition, investors in CIVs benefit from the market experience and

1 The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles”
insights of professional money managers…. Governments have long recognised the importance of CIVs as a complement to other savings vehicles in terms of facilitating retirement security. In many countries, participants in defined contribution retirement plans invest primarily in CIVs…. With ageing populations in many countries, CIVs will become increasingly important”.

The report also noted that:

“The global CIV market is one in which the CIV and a significant portion of its investors are located in different countries. The global CIV can be much more efficient – it can benefit from the economies of scale described above to a greater extent than smaller CIVs”.

It noted the difficulties encountered by CIVs:

“Difficulties in claiming treaty benefits at the time payment is made, and delays in payment of refunds, reduce the return to any investor unless, in the case of a refund, it is accompanied by interest to compensate for the delay. There are added dimensions to such difficulties and delays when the investor is a CIV. Investors in CIVs may change daily, making it extremely difficult, if not impossible, to track particular income streams to particular investors. For example, an investor could hold shares in a CIV on 15 June, when the CIV receives a dividend. If the investor redeems or sells those shares on 1 July, the investor generally will recognise a gain or loss. To the extent that the CIV is required to allocate income to particular investors, the remaining or future investors in the CIV generally would be credited with the dividend, even if they did not own shares in the CIV at the time the dividend was received. The difficulty in tracing of course also is compounded by the fact that interests in CIVs frequently are held through layers of intermediaries. In those cases, the CIV’s records will show the names of the intermediaries through which the investors hold their interests in the CIV, rather than the names of the investors themselves”.

In addition, the OECD Model Tax Convention Article 1 Commentary² was updated in 2010, adopting the CIV Report’s conclusions, as well as addressing governments’ concerns about treaty shopping opportunities through CIVs.

The IFIA welcomed the results of the CIV Report which was completed on foot of full and detailed consideration by the relevant parties of the facts and considerations specific to this industry. Therefore, it is imperative that the current OECD review which is not focused on CIVs, or on the asset management industry should not adversely affect the very specific conclusions reached in the CIV Report.

In addition, the TRACE (Treaty Relief and Compliance Enhancement) Implementation Package³ (“IP”) set out a series of practical procedures implementing the conclusions of the CIV Report. We would also recommend that OECD continues its work on adapting TRACE for the purposes of the Common Reporting Standard and ensure that the measures are adopted by the OECD Members.

‘Limitation-on-Benefits’ Provisions

In particular, one of the mechanisms that has been suggested in the draft on BEPS Action 6 as a means to prevent the granting of treaty benefits in inappropriate circumstances is the adoption of Limitation-on-

³ The TRACE Implementation Package was approved by the Council of Fiscal Affairs in January 2014 http://www.oecd.org/ctp/exchange-of-tax-information/TRACE_Implementation_Package_Website.pdf
Benefits (“LoB”) provisions as a standard in treaties. LoB clauses are currently only used by a very limited number of countries in treaty provisions (notably the US) and have evolved over time. They are a mechanism for preventing treaty abuse but can have unintentional negative consequences for CIVs and, in particular, CIVs distributed across borders (cross border fund distribution is key objective of the UCITS\(^4\) and AIFM\(^5\) directives). If the proposed LoB were to be applied to CIVs, this would potentially drive the market to domestically distributed product, which would lead to market and product inefficiencies, lessen investor choice and drive up costs for investors, such as pension funds.

Whilst the provision contains a facility to seek relief in such circumstances where treaty abuse is not in point, the process for seeking such relief can be uncertain and very time consuming as it is determined on a case by case basis by the competent authorities. Therefore, in the first instance, it is critical that the access to treaties by CIVs should not be considered an inappropriate situation for granting treaty benefits and, secondly, if LoB provisions or any similar provisions are put forward as a mechanism for dealing with treaty abuse the position of CIVs should be specifically recognised/excluded and it should be ensured that CIVs are not inadvertently precluded from accessing treaties.

In this regard, we would recommend that CIVs are explicitly added to the definition of “qualified persons” in the proposed LoB provisions.

**General Anti-Abuse Rule (“GAAR”)**

The draft discussion document includes a GAAR the purpose of which is to deny the benefit of a tax convention where one of the main purposes of an arrangement or transaction that has been entered into is to obtain a more favourable tax treatment. While a GAAR can be used as a tool by tax authorities to counteract situations involving the granting of treaty benefits in inappropriate situations, it is key that:

1. The GAAR rule in the discussion document should recognise the principles of the CIV Report,
2. There should be certainty around the parameters and application of the GAAR removing any vagueness and subjectivity on its interpretation and/or application to CIVs, and
3. There should be a specific recognition that investors utilising unconnected widely held CIVs for professional investment management should not be considered entering into a transaction one of the main purposes of which is to secure a benefit under a tax treaty.

**Impact for CIV’s**

This is an issue of fundamental importance for CIVs as withholding taxes on income and capital gains are a “drag” on fund performance and ultimately on investor returns (investors, as recognised in the 2010 OECD report, are in the main residents of OECD member countries with entitlement to treaty benefits under local treaty networks). The lack of treaty access will create double taxation for investors.

It should be noted that small open fund centres, which service cross border investor needs would be materially adversely affected by the application of the proposals in the draft on BEPS Action 6 to CIVs, as

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\(^5\) The Alternative Investment Fund Managers Directive 2011/61/EU
compared with their counterparts in larger jurisdictions such as the UK and the US, which predominantly service a local/domestic investor base and would not necessarily be impacted as much by the application of a LoB regime. Indeed their large domestic markets would permit them to attract significant cross-border investors while at the same time still satisfying the LoB provision.

In addition, personal saving schemes and occupational pension funds have long been recognised by Governments as key to facilitating retirement security for their citizens. The role of CIVs is critical to saving plans and pension funds to create efficiencies, and in providing access to regulated professional asset management, risk diversification and flexibility of choice of product risk profile to citizens as they reach retirement age. The denial of treaty benefits for CIVs resulting from the proposed LoB provisions would directly impact the accumulation of such long term retirement savings due to over taxation adversely impacting the policy goals of many governments.

In the context of OECD Members that are EU Member States, it should also be noted that these proposed changes would introduce a real and permanent disincentive to the establishment of cross-border funds, something the EU UCITS legislation has been seeking to encourage for many years. In addition, double taxation for investors creates a discriminatory outcome and goes against EU principles on free movement of capital.

CIVs and Tax Transparency

We also wish to note that as CIVs are within the scope of US FATCA and the broader remit of OECD proposals on a Common Reporting Standard for automatic exchange of information there will be granular transparency to Governments in respect of investments by residents (including MNEs) in offshore financial products.

This issue is critically important to both the IFIA and the global CIV industry. Our recommendations are consistent with the substantial work done previously by both governments and industry on the subject of treaty benefits for CIVs. We would welcome the opportunity to discuss further or we can provide you with any additional information that may be of assistance.

Yours sincerely,

PAT LARDNER
Chief Executive

Cc: Mr Gary Tobin, Principal Officer, Business Tax Policy Team, Department of Finance, Government Buildings, Upper Merrion St, Dublin 2
Mr Eamonn O’Dea, Assistant Secretary, Office of the Revenue Commissioners, Corporate Business and International Division, Stamping Building, Dublin Castle, Dublin 2
Irish Tax Institute

Response to OECD Discussion Draft: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

April 2014
OECD Discussion Draft:  
Preventing the Granting of Treaty Benefits in Inappropriate Circumstances  

Irish Tax Institute Response

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About the Irish Tax Institute

The Irish Tax Institute is the leading representative and educational body for Ireland’s AITI Chartered Tax Advisers (CTA) and is the only professional body exclusively dedicated to tax. Our members provide tax expertise to thousands of businesses and individuals in Ireland and internationally. In addition many hold senior roles within professional service firms, global companies, Government, Revenue and state bodies.

The Institute is the leading provider of tax qualifications in Ireland, educating the finest minds in tax and business for over thirty years. Our AITI Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice.

A respected body on tax policy and administration, the Institute engages at the most senior levels across Government, business and state organisations. Representing the views and expertise of its members, it plays an important role in the fiscal and tax administrative discussions and decisions in Ireland and in the EU.
1. Executive Summary

Bilateral tax treaties are an important and well established feature of the international tax system. As international trade has expanded, the number of tax treaties globally has continued to grow, with more than 3,000 tax treaties now in existence worldwide.

Tax treaties play a vital role in encouraging and facilitating international and multinational trade. Well designed and properly functioning treaties will provide:

- protection for businesses against the risk of double taxation arising; and
- certainty for both business and Contracting States as to the tax treatment that applies to a range of cross border activities.

The Introduction to the OECD Model Tax Convention confirms this key objective:

“It has long been recognised among member countries of the OECD that it is desirable to clarify, standardise, and confirm the fiscal situation of taxpayers who are engaged in commercial, industrial, financial or any other activities in other countries through the application by all countries of common solutions to identical cases of double taxation.”

In developing its Model Tax Convention, the OECD has played a vital role in the establishment of a strong global tax treaty network. Whilst, fully appreciating the objectives of the OECD in tackling Base Erosion and Profit Shifting (BEPS), it is important that any changes made to tax treaties as part of this BEPS project do not put at risk the certainty within the treaty framework that currently exists and that is vital for continued strong international growth.

The Discussion Draft advocates a new form of combined test for tax treaties, comprising both

(i) a limitation-on-benefits (LOB) clause; and
(ii) a ‘main purpose’ general anti-abuse test.

This combination of tests raises a number of issues which are of concern to the Irish Tax Institute. We believe the tests will result in increased uncertainty for international businesses as to:

- Their entitlement to the benefits of double tax treaties; and
- The application of the treaty provisions to their business activities.

(i) LOB clause

The LOB clause proposed in the Discussion Draft contains both ownership and activity elements and derives from a model generated in, and suitable for, the US economy. Ownership conditions, by their nature, will be inherently more difficult to
fulfil for companies in small open economies with high volumes of international trade, in jurisdictions with smaller capital markets and where cross border ownership of entities is more common, such as in the EU. Furthermore, the activities test envisaged in the LOB clause is subjective, based on established US jurisprudence and likely to create uncertainty in interpretation across Contracting States which have limited experience in the application of LOB.

Critically, if an LOB clause is ultimately adopted, it is essential that a “Derivative Benefits” provision is included. This is to provide some protection against the LOB applying in an unduly restrictive manner in circumstances where there is no treaty shopping at issue. Further explanation on this matter is contained below.

(ii) “Main purpose” test

This test is framed so that if “one of the main purposes” of any arrangement or transaction is to obtain a treaty benefit, the benefit is thereby denied. This is a very widely drawn test that would lead to uncertainty for businesses seeking to conduct international activity. In order to obtain any form of certainty, businesses will have to seek Competent Authority rulings in many instances – leading to an increase in the compliance burden on business and additional cost and delay for Contracting States.

(iii) Use of a combined test

Paragraphs (i) and (ii) above outline our specific concerns with each of the two tests. However, the combination of the tests will further add to the complexity and uncertainty as to how they will apply. We are particularly concerned about the adverse impact this uncertainty will have upon international trade.

We therefore recommend that the OECD study in detail the impact of the proposed measures on international trade flows.

(iv) Importance of consultation on the Commentary to the Model Tax Convention

The new approach outlined in the Draft represents a fundamental shift in the way tax treaties will have to be interpreted. There could well be disagreement as to interpretation of the clauses between jurisdictions which must be avoided if international trade is to be encouraged. In this environment, the role of the Commentary to the OECD Model Tax Convention is vital to help minimise confusion, explain the intentions of the OECD and assist tax authorities and businesses in interpreting the provisions.

The Commentary should be made available for public consultation prior to being finalised.

There follows a more detailed explanation of the Institute’s concerns on the two tests contained in the OECD Paper.
2. Limitation-on-Benefits (LOB) clause

Ownership and the Importance of a Derivative Benefits clause

The ownership element of the LOB test as set out in the Draft, requires a corporate taxpayer to be owned predominantly by eligible persons resident in that Contracting State in order to qualify for treaty benefits. The reason is to prevent treaty shopping. However, this imposes an unduly narrow ownership test and in smaller countries, with less developed capital markets, companies could be denied treaty access because they have sourced capital from investors resident in countries outside the Contracting State. It is important that any LOB clause takes into account the way international business is currently financed and will be financed in future.

Certain types of business (such as collective investment vehicles) would be particularly affected by a LOB. For example, within the European Union, investors from multiple EU jurisdictions are facilitated to invest in single collective investment vehicles in one jurisdiction. This can result in cost savings from economies of scale and this consolidation helps to increase the efficiency of the EU’s capital markets. Notwithstanding that investors would be entitled to access treaty benefits if investing directly, if they invest through a collective investment vehicle they would find themselves unable to access treaties because the investment funds will typically be unable to meet the ownership requirement in the LOB clause.

The OECD’s paper “The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles”\(^1\) recognises the importance of collective investment vehicles. The paper also highlights that such entities “require certainty regarding their qualification for treaty benefits”. The position of collective investment vehicles should be specifically recognised such that they are excluded from the scope of LOB provisions and it should be ensured that CIVs are not inadvertently precluded from accessing treaties.

A ‘Derivative Benefits’ clause could safeguard in part against the LOB test working in an unduly restrictive manner in circumstances where there is no treaty shopping at issue.

Contracting States which are EU Member States must adhere to EU freedoms on movement of capital and establishment and cannot restrict treaty access to businesses owned predominantly by local residents. The absence of a Derivative Benefits clause risks conflict with these fundamental EU Freedoms.

The existence of a Derivative Benefits clause is therefore critical, but the drafting of that clause is equally important.

These are the key elements that the Institute would like to see considered in drafting such a clause:

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\(^1\) This paper was adopted by the OECD Committee on Fiscal Affairs on 23 April 2010. Available at http://www.oecd.org/tax/treaties/45359261.pdf
Ownership by ‘equivalent beneficiaries’ should be taken into account, where similar benefits are provided under another treaty.

There should not be a requirement that each intermediary company in the ownership structure is an equivalent beneficiary. This would involve a degree of unwarranted complexity and impose duplicative effort on both taxpayers and taxing authorities.

As noted above, account needs to be taken of EU law and Freedoms for taxpayers and transactions within the EU.

The ‘base erosion test’ should not prevent taxpayers from making payments to persons who are entitled to ‘equivalent treaty benefits’. Furthermore, any ‘base erosion’ measures must reflect the operation of the EU as a single market recognising that EU resident taxpayers should be free to make payments to other EU residents on equivalent terms to those made to local residents.

A substance element should be considered, in order to protect genuine commercial structures where ownership or income requirements are not met under a proposed Derivatives Benefits clause.

There is a concern raised in the Discussion Draft that a Derivative Benefits clause may facilitate treaty benefits being granted in limited “base eroding situations”. We believe that any such concerns would be adequately addressed through the other BEPS Action Points and these concerns should not prevent the inclusion of the clause in the LOB test.

**The “substantial activity” test**

Under the proposed LOB clause, a company which would not meet the ownership criteria would still be entitled to treaty access if it met the Substantial Activity test set out in paragraph 3.

(i) *The subjective nature of the test*

The subjective nature of this test is likely to give rise to significant uncertainty in its application across multiple jurisdictions and to restrict the ability of taxpayers to use tax treaties. The US has built up significant jurisprudence on the meaning and interpretation of this test. Given the very disparate nature of judicial systems around the world it would be difficult to apply this jurisprudence elsewhere.

The result is likely to be disagreement on interpretation between tax authorities in many situations leading to a substantial increase in the number of ruling requests made by businesses.

(ii) *The absence of a safe harbour provision*

A number of existing tax treaties with an LOB clause, currently include ‘safe harbour’ provisions which allow for greater certainty as to the application of the treaty. Any proposed standard LOB clause should include safe harbour provisions to reduce some of the uncertainty for business in the application of such measures.
**Quoted companies**

The proposed LOB clause provides that listed companies could qualify for treaty access if they are quoted on a stock exchange in the country in which they are resident. This exception is very narrow as many companies typically opt to list in other jurisdictions in order to gain access to larger capital markets. Existing tax treaties containing LOB clauses, including the Ireland/US treaty, recognise this fact and allow companies listed on any “recognised stock exchange” to qualify for treaty access.

3. **‘Main Purpose’ general anti-abuse clause**

A taxpayer who meets the LOB test is still required to meet an additional ‘main purpose’ general anti-abuse test under the proposals outlined in the Draft. Paragraph 31 expressly provides that obtaining treaty access does not have to be the dominant purpose of any transactions or arrangements for treaty benefits to be denied. Even if obtaining treaty access is one of the main purposes for an arrangement, treaty access may be denied. A ‘dominant purpose’ test would be more proportionate to ensure that legitimate transactions are not unduly denied access to tax treaty benefits.

The proposed ‘main purpose’ test is by its nature subjective and difficult to interpret. Different jurisdictions, with different legal traditions, are likely to apply a variety of interpretations to this test. This will result in significant additional uncertainty for taxpayers as to whether a treaty is applicable in a large number of cases.

The considerable risk of uncertainty posed by a ‘main purpose’ test has been recognised in the US. In 1999, the US Senate reviewed a proposed draft text of a US income tax treaty with Italy which contained wording similar to the test in the current proposals. The Senate Committee commented that:

"The new main purpose tests in the proposed treaty are subjective, vague and add uncertainty to the treaty. It is unclear how the provisions are to be applied. In addition, the provisions lack conformity with other U.S. tax treaties. This uncertainty could create difficulties for legitimate business transactions, and can hinder a taxpayer's ability to rely on the treaty."^2

At a very minimum, detailed guidance would be required to assist tax authorities and taxpayers in interpreting this test. However, given the subjectivity inherent in a 'main purpose' test, such guidance may not adequately reduce the level of uncertainty.

4. **Conclusion**

The OECD’s efforts to prevent instances of double non-taxation should not result in increased double taxation or in increased uncertainty for taxpayers. Any changes to tax treaties must be capable of being administered effectively in practice in a clear and

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^2 Senate Executive Report 106-8 (1999)
consistent manner. The significant benefits of an accessible and well functioning tax treaty network in facilitating international and multinational trade must be preserved.
Comments on Discussion draft on
Action 6 (Prevent Treaty Abuse) of the BEPS Action Plan

The following are the comments of the Accounting & Tax Committee of the Japan Foreign Trade Council, Inc. (JFTC) in response to the invitation to public comments by the OECD regarding the “Discussion draft on Preventing The Granting of Treaty Benefits in Inappropriate Circumstances”.

The JFTC is a trade-industry association with Japanese trading companies and trading organizations as its core members. One of the main activities of JFTC’s Accounting & Tax Committee is to submit specific policy proposals and requests concerning tax matters. Member companies of the JFTC Accounting & Tax Committee are listed at the end of this document.

Overall Comments

1. One of the main purposes of tax treaties is to establish rules of taxation between two states in order to provide relief from international double taxation when a resident of one of the Contracting States earns income through business operations, investment or other activities undertaken in the other Contracting State (source country), and to thereby encourage economic exchange between the Contracting States. Therefore, we support measures for denying benefits of tax treaties to treaty shopping, and artificial transactions and arrangements aimed solely at securing benefits of a tax treaty. We also support provisions explicitly stating that tax treaties are not intended for use in generating double non-taxation.

2. However, excessively stringent anti-avoidance rules written into tax treaties and domestic laws may result in unfair treatment of substantive transactions and investments, which should be avoided. Furthermore, taking into consideration the balance between taxpayer’s administrative burden related to confirmation and interpretation of anti-avoidance rules and usefulness of such rules, it is our view that the necessity of including multiple anti-avoidance rules should be carefully examined.

3. Failure to clearly define “treaty abuse” will destabilize the applications of treaties, which may obstruct economic activities of enterprises. In addition, an enterprise planning to expand its business internationally will as a matter of course take into consideration the presence or absence of tax
treaties, the content of such treaties and the tax systems in target countries. Such a course of action should not be considered to constitute treaty abuse.

4. Tax treaties are not solely responsible for problems of double non-taxation, which also occur when entities take advantage of gaps that exist between tax treaties and domestic laws. In view of this fact, it would be desirable to synchronize treaty revisions based on Action Plan 6 with the enactment of domestic laws. Moreover, such revisions should be applicable exclusively to future transactions and arrangements, and explicit provisions should be included stating that revisions are not retroactively applicable to transactions and arrangements undertaken in the past.

Specific Comments

Paragraph 11.
1. We strongly request that the adoption of the LoB provision should not cause an increase in double taxation cases by varying tax authorities’ fact-finding/practices and blurring the applicability of tax treaties. The texts of tax treaties in force containing the LoB provision are supplemented with concrete explanations. In light of this fact, we believe that the Commentary should include adequate guidelines and specific criteria. For example, concrete explanations are especially needed for the following items:

- Definition of “trade or business” in the context of “active conduct of a trade or business.”
- Detailed calculation method for “Indirect Ownership” (concept of control in accounting principles or simple multiplication)
- Scope of “indirect payment” in the context of paragraph 2 e) ii) of the proposed LoB provision
- Specific items to be included in the “criteria for determination by competent authorities” in paragraph 4 of the proposed LoB provision (This paragraph is intended to play a safe-harbor type function in addition to paragraph 2 and 3. However, predictability for taxpayers will be low unless the criteria are specifically identified.)

2. In addition, to enable the taxpayers’ predictability, a well-established advanced ruling system to assess the applicability of the treaty benefits should be developed and guidance on such a system should be provided in the Commentary. While the existence of a reliable administrative procedures and strong independent judicial system will help to assure taxpayers that the anti-abuse provisions will be applied objectively, the current Discussion Draft does not stress the importance of such well-established tax administrative procedures and judicial system. We believe it would
not be the right approach to implement anti-abuse provisions without considering such issues at the same time.

3. The LoB provision is a measure to determine whether a person is eligible to be granted the treaty benefits based on a formal mechanism without considering the bona fide business purposes and, therefore, the treaty benefits should not be denied simply because a person does not satisfy certain criteria provided in the proposed LoB provision, which results in a situation where “double taxation” is created. It is our view that, in determining whether a person is a “qualified person”, a substance over form approach should be taken.

4. Based on the purpose of tax treaties which is to encourage economic exchange between the Contracting States, LoB provision should apply to specific items in the treaty rather than apply comprehensively. Specifically in relation to withholding taxes on dividend payments provided under treaties, we believe that it is irrelevant to the BEPS Action Plan which essentially targets double non-taxation. Instead, it creates the risk of resulting in double taxation. Therefore, unless the dividend payments are deductible at the source country, it would be a reasonable approach that the eligibility to treaty benefits in withholding tax rates on dividend payments should not be determined based on whether the recipient is a qualified person as envisaged in the LoB provision, but rather should be based on whether the recipient is the beneficial owner with certain economic substance that has been discussed by OECD. Under such an approach, detailed guidelines and illustrations should be provided in the Commentary so that the tax administration could determine in which cases a person would qualify for the beneficial owner and would have certain economic substance.

5. If the LoB provision were to be adopted, and if required documentations and detailed procedures are to be determined in domestic laws, in order for LoB provision to be applied, in certain instances, such as in countries requiring advance application or cases involving tax refund procedures, it could place an undue burden on taxpayers or withholding tax obligors. Moreover, we contend that obtaining treaty benefits should not require an entity, for example, to acquire a tax identification number and to file tax returns in the source countries. To avoid such outcome, we request that the introduction of a common OECD format and procedures be considered for the application of LoB provision.

6. When determining the existence of an “active conduct of a trade or business” for the purpose of paragraph 3 of the proposed LoB provision, it would be reasonable that such determination is made on the basis of all group members in that Contracting State, rather than on a stand-alone basis of an individual member. Multinational enterprises (MNEs) would face many different types of risks and often try to mitigate these risks by quarantining each risk in each company separately established in the same country. This may lead to the conclusion, when considered on a stand-alone basis, that
each company does not have sufficient economic substance. However this is not true when the activities of the group members in that Contracting State are considered collectively. Such companies are often established with business reasons such as protecting the commercial activities from collateral risk and/or to conduct each business operation with a unique function efficiently and effectively. Therefore, even if each company has specific trade or investment activities separately, as long as the group companies are engaged in the active conduct of a trade or business as a whole group in the same country, the companies should be treated as qualified persons that satisfy the active business test in paragraphs 3 of the proposed LoB provision. To illustrate this point, the following example is provided, for which a supplemental explanation should be provided in the Commentary of OECD Model Tax Convention.

7. Assumptions

In both Case A and Case B, the MNE’s business activities in State R are essentially the same. The only difference between Case A and Case B is that, in Case A, two separate entities are established, whereas in Case B two divisions are established.

<table>
<thead>
<tr>
<th>Case A</th>
<th>Case B</th>
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<tbody>
<tr>
<td>✓ Sub1, Sub2 and Sub3 are subsidiaries owned, directly or indirectly by Parent.</td>
<td>✓ Sub1 and Sub2 are subsidiaries owned, directly or indirectly by Parent.</td>
</tr>
<tr>
<td>✓ Parent wishes to mitigate any legal risk posed to Sub2 and Sub 3 by the activities of related parties and therefore establishes Sub1 that is a legally separate entity.</td>
<td>✓ Parent wishes to mitigate any legal risk posed to Sub2 by the activities of related parties and therefore establishes Sub1 as a legally separate entity.</td>
</tr>
<tr>
<td>✓ Sub1 invests in Sub3 and manages the investment.</td>
<td>✓ Sub1 has Division1 as an investment division and Division 2 as a trading division.</td>
</tr>
<tr>
<td>✓ Sub2 and Sub3 are engaged in the active conduct of domestic and cross-border trade or business in State R and in State S, respectively.</td>
<td>✓ Sub1 invests in Sub2 and Division 1 of Sub1 manages the investment.</td>
</tr>
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</table>

8. In Case A, under the proposed LoB provision as proposed, Sub1 may not be considered to be a qualified person who engages in the active conduct of trade or
business in State R. However, Sub1 was established for the legitimate business purpose of risk mitigation and not to obtain particular tax advantages. As such, it would be inappropriate to consider the status of Sub1 without considering the fact that Sub1 is established as a legally separate entity in order to mitigate the risks inherent in the activities of Sub2. Therefore, Sub1 and Sub2 should be treated as qualified persons conducting active business on a group basis when assessing the eligibility of the treaty benefits. Obviously, in Case B, since Sub1 is engaged in the active conduct of trade or business in State R, Sub1 shall be a qualified person for treaty benefits purposes. In both cases, business operations in State R are essentially the same and therefore we believe the conclusion of the applicability of the treaty benefits should be the same. Therefore both Sub1 and Sub2 in State R should be treated as qualified persons that are engaged in the active conduct of trade or business in State R on a group basis.

9. While, in the above example, the two subsidiaries in State R are established for the purposes of risk mitigation. There are various other cases where a separate legal entity must be established due to business reasons as being illustrated below:

10. Example 1: For the purposes of the intended investment, the legal/financial system of State S may be insufficiently developed; State S may impose strict or unstable restrictions on foreign trade/investment; and/or State S may restrict foreign exchange operations. In the case where finance is required to facilitate the investment in Sub3, third party finance institutions may be unwilling to provide finance to Sub3 in State S (also they may be unwilling to provide finance to Sub2 in State R or Parent in State T to protect the debt collection risks from the other risks inherent in Parent and Sub2’s activities) and would require that the borrowing entity is established in a more stable jurisdiction (e.g., if State R has stable legal and financial system, such an entity would be established in State R, not in State S).

11. Example 2: Where the Parent enters into a joint venture arrangement with a third party, for the reasons stated in Example 1 (e.g., the legal system of State S may be insufficiently developed), the establishment of the joint venture investment vehicle in the State S may increase the risk for investment and business operations. Therefore, in such a case, the investment company would be established in a country with more stable and developed system (in State R in this example) and would be managing the investment jointly with the business partner. The joint venture partner may require the Parent to establish a new legally separate joint venture company in State R to avoid above risks.

12. In both of the above examples, Sub1 would be established in State R for valid commercial purposes and not with the intended purpose of base erosion or profit shifting. Hence, tax treaties should not limit access to treaty benefits.

Paragraph 13
We find “at least 95 percent” ownership ratio by “equivalent beneficiaries” to be extremely high. It is desirable to lower this ratio to no more than “at least 75 percent.” Furthermore, to be deemed an equivalent beneficiary, it is stated
in the paragraph that maximum tax rate applied to payments from the source country to the third country must be equal to or higher than the maximum tax rate applied to payments from the source country to the resident country. If this condition is not met, the beneficiary is not deemed a derivative beneficiary, and the domestic tax rate of the source country is applied. Assume that the domestic tax rate of the source country is higher than the tax rate of the tax treaty between the source country and the third country. Given that the equivalent beneficiary provision is a type of bona fide provision, this case would yield an unreasonable outcome. Therefore, in such instances, instead of applying the domestic tax rate, the tax rate of the tax treaty between the source country and the third country should be applied. For example, this treatment is accepted in the technical explanations of the US-UK Tax Treaty, and should be appended to the OECD Model Tax Convention.

**Paragraph 17**
1. It is unclear what the reason is for determining that there is BEPS in the case illustrated in paragraph 15. In the case where the Parent transfers the IP to OPCO2 for commercial reasons other than tax (for example, State R is more appropriate country to hold IP from the view point of protection of IP rights), it is not reasonable to conclude that there is BEPS simply because the withholding tax in State S has decreased.

2. Determining the granting of treaty benefits based on the existence and contents of preferential tax systems in the State of residence is an excessively restrictive anti-avoidance rule. We understand that the case is intended to address the possibility of base erosion from State T to State R. However, this is an issue of taxing rights between States T and R, and should not affect the withholding tax rate in State S. Moreover, as stated above, even if the withholding tax rate in State S is to be affected by this case, instead of applying the domestic tax rate of State S, the tax rate as determined in the tax treaty between States S and R should be applied.

3. Even if assets were to be moved for the purpose of benefiting from the preferential rates that would be applied in State R, it cannot be said that this constitutes BEPS if the domestic laws of State T contain provisions for taxing asset transfer from State T to State R at appropriate market value.

**Paragraph 19**
1. In cases where the reasonable application of the treaty benefits is denied by the paragraph 6 of the Article X, even though there is a legitimate business reason in place, it would significantly impair predictability of taxpayers and may also result in double taxation, contrarily to the primary aim of the tax treaties. In this regard, such a proposed main purpose test or the GAAR should be applied rigidly and restrictively, and we request clarification and rigidity of the applicable requirements for such a test.
2. It is unreasonable to deny the application of the treaty benefits, where commercial reason is the primary purpose of the transaction and the existence or contents of the tax treaty is one of the considerations. Moreover, in the case when taxpayers are able to explain that there is legitimate commercial reason for the transaction to occur, it should be clearly stated in the Commentary that the application of the treaty benefits should not be denied, regardless of the applicability of LoB provision.

3. Regarding “where one of the main purposes... is to secure a benefit under a tax treaty and obtaining that benefit”, the burden of proof should rest strictly with the tax authorities. Even if the burden of proof were to lie effectively with the taxpayer, the withholding person would be unable to explain the commercial reason for the investment structure. Consequently, in practice, explanations would have to be given to the “tax authorities of the source country” by the “the recipient of the income who is a resident in the other country”. This would constitute cross-border inquiry and inspection. Furthermore, assuming the income is not attributable to a permanent establishment located in the source country, this would also be problematic from the perspective of infringement of the sovereignty of the country of residence.

4. Adopting the main purpose test without appropriately resolving the above problems would significantly undermine the predictability of taxpayers and would also involve practical problems. Therefore, we contend that the main purpose test should not be included in tax treaties unless above issues are resolved.

**Paragraph 29**
This paragraph states that tax authorities can determine one of the main purposes of any person concerned with an arrangement or transaction is to obtain benefits under the treaty after an objective analysis of the relevant facts and circumstances, without conclusive proof of the intent of the person. We have a concern that tax authorities may determine one of the main purposes of an arrangement in an arbitrary manner without clear criteria of objective analysis and the application of the treaty can be excessively restricted. We request an explicit statement that disregarding of the purposes of transactions which taxpayers insist must be strictly prohibited without the existence of clear provisions in relevant treaties or regulations.

**Paragraph 33**
1. It is not clear on what criteria the four cases illustrated in this paragraph are concluded as the cases to which paragraph 6 of the Article X is applied or the cases which are not. In the cases to which paragraph 6 is applied, only the tax purposes of a taxpayer are stated and it is not clear what other non-tax purposes the taxpayer has. In fact, it is rare for taxpayers not to consider tax issues at all. Tax issues are one of the important factors to be considered in addition to business purposes. However, the illustrated cases do not explain which of non-tax purposes or tax purposes are the main purposes of
the taxpayer. We request that tax authorities should respect taxpayers’ views, in case taxpayers prove that one of the main purposes of the arrangement is not for tax purposes, without the existence of clear provisions in relevant treaties or regulations.

2. In Example C, the advantages of low labor cost and benefits derived from the tax treaty are not quantified. Quantification and proof are difficult and will place excessive burdens on taxpayers. Therefore, taxpayers should not be required to produce quantitative information.

3. In Example D, the grounds for not applying the main purpose test are ambiguous. That is, it remains unclear whether the reason is that the intent of tax treaties is to encourage cross-border investment, or that the majority of investors in RCo are residents of State R. Exemption from taxation to dividends in the source country stated in bilateral tax treaties is intended to encourage the mutual acceptance of investments, and its intention is irrelevant to the discussions of base erosion. If in Example D, the domestic laws of State R and State X include provisions for the exemption from taxation of dividend income, this case should not be subject to the main purpose test.

**Paragraph 43**
The minimum shareholding period requirement for the application of reduced tax rates on dividends should not become an undue obstacle to economic activities. For granting this benefit, it is desirable for the minimum holding period to be at least six months prior to the receipt of dividends.

**Paragraph 46**
With regard to paragraph 46 and paragraph 49, we are concerned that unless commercial reasons are also taken fully into consideration, unilateral decisions on taxation may become rampant.

**Paragraph 49**
With regard to Article 13(4), the proposed amendment would require that determinations be made on the shares of real-estate related companies at any time during a certain period as opposed to at the time of the alienation only. We are concerned that this would place undue burdens on taxpayers, depending on the length of the certain period. Therefore, we request that due attention be paid to administrative burdens in amending Article 13(4).

**Paragraph 53**
Under the situation where a person is a resident of both Contracting States, i.e. where both tax authorities in two jurisdictions insist on residency and taxation on a same entity, it may take a long time for the tax authorities to reach agreement if the only remedial action available is the MAP process. In this regard, the solutions to accelerate the MAP process and to enhance the possibility to reach agreement (e.g. utilization of Arbitration, setting the deadline for reaching to the agreement in MAP process) should also be considered.
In addition, if the dual resident person is required to pay taxes in two or more jurisdictions during the MAP process, it will be subject to unreasonable tax burdens until the agreement is concluded. To resolve such double taxation, it should be allowed that such dual resident person will pay taxes in only one jurisdiction (e.g. where its headquarters are situated), until the agreement is concluded between the two tax authorities.

**Paragraph 57**

We are not opposed to explicitly including a saving clause for the purpose of clearly indicating the order of precedence of anti-abuse rules contained in tax treaties and domestic laws. However, when a tax treaty contains an anti-abuse provision that does not exist in domestic laws, the question arises as to whether such a provision can be used as the sole basis for the disallowance of tax benefits. In response to this question, an explicit provision should be included stating that it is difficult to directly apply such a provision appearing in a tax treaty.

**Paragraph 70**

Where the general or specific anti-abuse rules under domestic tax laws in two or more jurisdictions are applied on a same transaction or entity (e.g. CFC rules in two jurisdictions are applied on a same entity), double or multiple taxation may arise on such transaction or entity. In order to resolve such double taxation as a result of conflict of anti-abuse rules in multiple jurisdictions, certain adjustments or tie-breaker arrangements/mechanism should be introduced under the Treaties.

**Paragraph 81**

Tax policy 15.3 states that a large number of double taxation cases arise in the resident countries and in the source countries can be eliminated through the relief of double taxation stated in the domestic laws. However, domestic relief systems such as foreign income exemption system or foreign tax credit system in some cases limits the scope of such relief to taxation rights of the source country only to the extent that the resident country considers reasonable, thus there is a risk that double taxation may not be completely eliminated. Conclusion of tax treaties is crucial to eliminate double taxation. Countries should try to conclude tax treaties with other countries which have different views of taxation rights in order to eliminate double taxation.
Japan Foreign Trade Council, Inc.

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Dear Sir or Madam,

**OECD DISCUSSION DRAFT ON ACTION 6 (Prevent Treaty Abuse) of the BEPS Action Plan**

Following the publication of the above discussion draft on 14 March 2014, Jupiter has been in active discussion with both the Investment Management Association (the “IMA”) in the UK and the European Fund and Asset Management Association (“EFAMA”) with respect to the potential impact on the International Fund industry. We understand that both the IMA and EFAMA will be making representations on this subject directly to the OECD, and we have separately given our comments to those organisations and lent our support to their representations.

Jupiter Fund Management plc. is a focused, active fund manager with a well-known brand and an established track record, seeking to add value for clients through the delivery of investment outperformance over the medium to long term. We focus primarily on managing equity investments on behalf of retail, institutional and private client investors across a wide range of products including UK and offshore mutual funds, segregated mandates and investment trusts. As at 31 December 2013, our AUM was £31.7bn, of which over 12% was derived from non-UK resident investors. The geography of our invested assets shows over 60% invested in offshore (non-UK) products.

We are concerned that the discussion draft as it is currently written will severely limit the basis on which Collective Investment Vehicles (“CIV”s) access treaty benefits. The 2010 OECD report *The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles* (The “CIV report”) recognised the importance of preserving the principle of neutrality for investments held through CIVs with respect to direct investment. It is critically important that tax neutrality is available for CIVs in order for investors to avoid double taxation and for those investors to continue to benefit from the diversification of risk and economies of scale that CIVs offer. Given the increasingly cross-border investment into regulated fund structures within Europe, it would appear inequitable to limit treaty benefits to a fund merely as a result of unit holders being based in a different territory, particularly where such an investor would be able to access treaty benefits if investing in their own name. Such a restriction seems to unfairly penalise smaller investors and would seem to us to be a disproportionate consequence of the proposals within the discussion draft.
I would like to stress the following key points which are addressed in the IMA response:

1. BEPS Action 6 paragraph 9 refers to a “limitation-on-benefits” provision and the difficulty in applying such a provision to listed entities with frequent changes in ownership. However, mutual funds which are not listed face the same difficulties. Distinguishing between listed and unlisted funds would cause a significant and unwarranted distortion in the CIV market. Please also note that the OECD Common Reporting Standard (“CRS”) makes no such distinction between listed and unlisted entities.

2. The OECD CRS could provide a framework for obtaining information on investors in CIVs which I believe could then be developed into a policy on how CIVs can maintain treaty access without facilitating treaty shopping.

3. The CIV report (para 55) states that investors should be entitled to “equivalent benefits had they invested directly” and “not put in a worse position by investing through a CIV located in a third country”. The CIV report recognises that neutrality for investors can only be achieved through a comprehensive derivative benefits provision. Such a clause would be effective for combating treaty shopping and, if further developments are made pursuant to the OECD CRS, it should be possible for CIVs to identify investors for these purposes in due course.

4. The EU legal framework is relevant for many OECD members. We are concerned that the EU Treaty might prevent an EU member state from discriminating between a CIV whose investors are domestic and those whose investors are resident in another EU member state.

Recommendation

Given that the Treaty Relief and Compliance Enhancement (‘TRACE’) initiative has not been implemented, the proposals under BEPS Action 6 would unintentionally prevent an already treaty entitled CIV from qualifying for those benefits in the future and also undermine the basic goal of OECD member countries to extend treaty benefits to CIVs that are not currently entitled. We recommend that any changes enacted as a result of the BEPS Action 6 are explicitly stated to not apply to CIVs, and that treaty access for CIVs is dealt with more appropriately under the TRACE initiative.

I would like to thank you for the opportunity to comment on this discussion draft. I am available for further discussion on any of the above points if it would be helpful at sfilbee@jupiter-group.co.uk or +44 (0)20 7314 4833.

Yours faithfully

Sarah Filbee ACA CTA
Senior Product Tax Manager

**General Comments**

1. A tax treaty allocates taxing rights and grants the residents various benefits, such as relief or exemption from source taxation, with a view to eliminating double taxation and thereby facilitating economic exchange between the contracting states. In this context, "benefits" are the result of such allocation of taxing rights and do not mean "preferential tax treatment". We believe that benefits of a tax treaty should be given to bona fide commercial arrangements of taxpayers.

2. On the other hand, it is only fair to deny such benefits to treaty-shopping situations, a typical example of which is a transaction that was conducted through a company with no business substance for the sole purpose of obtaining treaty benefits.

3. Action 6 of the Action Plan on Base Erosion and Profit Shifting (“BEPS”) calls for the OECD to “develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances” and to “clarify that tax treaties are not intended to be used to generate double non-taxation.” Keidanren supports these initiatives.

4. When establishing concrete rules for preventing tax avoidance, due consideration should be given to ensure that the new rules will not hamper normal business activities and not impose excessive compliance burden on taxpayers. Such consideration should also be given when creating rules related to the other Actions.

**Specific Issues**

**A. Entitlement-to-Benefits Provisions**

5. The Public Discussion Draft proposes that, to address treaty-shopping situations, the OECD Model Tax Convention (“Model Convention”) be revised to add entitlement-to-benefits provisions that consist of limitation-on-benefits provisions (“LOB provisions”) and main-purpose test provisions (“MPT provisions”).
6. As some countries have already concluded tax treaties that have both or either of LOB and MPT provisions, we have no objection to the introduction of entitlement-to-benefits provisions per se.

7. However, in view of the purpose of preventing treaty shopping by some entities, it seems somewhat excessive for the Model Convention to stipulate that both LOB and MPT provisions be included in tax treaties in principle. We believe that the Model Convention should be revised in a manner that allows a country to choose either LOB or MPT provisions for its tax treaties, though there is no need to go so far as to preclude the country’s adopting both.

**LOB Provisions (paragraph 11-17)**

8. In general, it is desirable that LOB provisions be clearly and succinctly set forth. Article X, paragraph 3 of the Model Convention allows residents of a contracting state to qualify for treaty relief where the resident is engaged in the active conduct of a trade or business (other than making or managing investments for the resident’s account—excluding banking, insurance or securities activities carried on by a bank, insurance company or registered securities dealer). We believe that such rule should be applied to other industries where the taxpayer has genuine economic substance, and that testing should be done at a group level rather than on a separate company basis.

9. Also, Article X, paragraph 4 of the Model Convention (determination by competent authority) should allow the granting of treaty benefits when the establishment, acquisition, or maintenance of the resident in question and the conduct of its operations have been made for business purposes.

10. When introducing LOB provisions, it is desirable that the OECD create a standardized format of procedures for certificates of residence and other documentation, from the perspective of reducing administrative burdens on taxpayers and standardizing enforcement practices among countries.

11. We support the inclusion of derivative benefits provisions as part of the LOB provisions in the Model Convention. With regard to the example given in paragraph 15 of the Public Discussion Draft, we think that the case cannot necessarily be determined to constitute BEPS if the conduct in question was made for business purposes.

**MPT Provisions (paragraph 18-33)**

12. When introducing MPT provisions, their application should be restricted to limited situations so that the vast majority of companies engaged in normal business activities will remain unaffected. In addition, clear operational guidelines must be developed and shared among countries to provide greater foreseeability for taxpayers.
13. In particular, conditions applicable to the MPT provisions needs to be defined by positive facts so as not to leave room for arbitrary administration. Countries should understand that in general, it is quite difficult to make the main purpose clear.

14. The definition “one of the main purposes” proposed in the MPT provision of the Public Discussion Draft is too wide in scope. It is a highly common practice for a company expanding its business overseas to take into account the taxation systems of individual countries including the existence and contents of their tax treaties. Viewing such practice as constituting treaty abuse is simply inconceivable. At least, the definition “one of the main purposes” should be changed to “the main purpose.”

15. Similarly, reconsideration should be given to the phrases “need not be the sole or dominant purpose” and "sufficient that at least one of the main purposes was to obtain the benefit" in paragraph 31 of the Public Discussion Draft.

16. Paragraph 33 of the Public Discussion Draft invites comments on specific examples that illustrate cases in which the MPT provisions should and should not apply. With regard to this matter, as suggested in paragraph 32, the OECD should first establish the principle that the MPT provisions do not apply to a transaction or arrangement that was made for business purposes even if made also in consideration of a tax treaty.

17. Below are our views on Examples A through D in paragraph 33 of the Public Discussion Draft presented by the OECD to seek comments.

Examples A and B

18. In each of these two examples, the conclusion is that, in the absence of other facts and circumstances showing otherwise, MPT provisions apply. However, in other words, this conclusion implies that MPT provisions do not apply if T Co.’s assignment of the right and provision of the usufruct to R Co. had business substance.

Examples C and D

19. We agree with the conclusions that the MPT provisions do not apply to either case. Especially in example C, it is obvious that there is a genuine business purpose to establish a new plant. The OECD needs to clarify in the Commentary to the Model Convention that these cases do not constitute treaty abuse.

20. As to the relationship between LOB and MPT provisions, paragraph 23 of the Public Discussion Draft states that, even if a person is entitled to benefits under Article X, paragraphs 1 to 5 (LOB provisions) of the Model Convention, that does not mean those benefits cannot be denied under paragraph 6 (MPT provision) of said Article. We ask for clarification concerning a case in which a transaction conducted by a resident—who satisfies Article 4 of the Model Convention and has been determined not to be treaty abusive—is judged to be abusive under Article X, paragraph 6 of the Model Convention.
B. Minimum Shareholding Period to Qualify for Relief or Exemption from Source Taxation of Dividends (paragraph 43)

21. A period of six months seems appropriate and desirable as the length of the minimum shareholding period to qualify for relief or exemption from source taxation of dividends.

C. Source Taxation of Dividends Paid by Intermediary Entities (Paragraph 44-46)

22. The Public Discussion Draft proposes to introduce anti-abuse rules to deal with cases where certain intermediary entities established in the State of source are used to take advantage of the treaty provisions that lower the source taxation of dividends. However, we believe that investing in intermediary entities per se does not necessarily constitute treaty abuse. There should remain a business purpose exception so as not to hinder genuine business activities.

D. Determining the State of Residence of Dual-Resident Persons (Paragraph 53)

23. Regarding the tie-breaker rule related to a dual-resident person, it is proposed that Article 4, paragraph 3 of the Model Convention be revised to read that “the competent authorities of the Contracting States shall endeavor to determine . . . the Contracting State of which such person shall be deemed to be a resident” (italics added). Still, we believe a framework needs to be established to ensure the determination of the state of residence in such a case. Any agreements reached between contracting states should be swiftly notified to taxpayers.

Sincerely,

Subcommittee on Taxation
KEIDANREN
Memorandum

To OECD, Centre for Tax Policy and Administration, Tax Treaties, Transfer Pricing and Financial Transactions Division

From Anne Quenedey

Date 9 April 2014

Subject Comments on the Public Discussion Draft entitled “BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances”

Dear Madam,

We are pleased to respond to the OECD request to send comments on the Public Discussion Draft entitled “BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances” dated 14 March 2014 (hereafter referred to as the “Draft”).

First of all, we are thankful to the OECD for initiating an international and public discussion on ways to modify existing tax rules to prevent the granting of treaty benefits in inappropriate circumstances.

We agree that treaty abuse is an important source of BEPS concerns. In that context, we welcome the work that has been done by the OECD to take into consideration the concerns from the business community. This effort must be encouraged and strengthened.

1 Preliminary comments

The purpose of BEPS Action 6 is

- "to address treaty-shopping situations";
- "as well as other cases of treaty abuse, which may give rise to double non-taxation".

However, BEPS Action 6 should not be more than that. It should be clearly stated that BEPS Action 6 cannot be a threat against cross border commercial transactions and security of these transactions. As stated in the Draft itself, “a general objective of tax conventions is to encourage cross-border investment”.

The original purpose of the tax conventions is to eliminate situations of double taxation by
allocating or reducing taxing rights between the source State and the State of residence. Although we agree that the removal of the benefits of the tax conventions in case of abusive situations is an important issue, this should not, therefore, lead to lose sight of the original purpose of tax conventions.

2 Cases where a person tries to circumvent limitations provided by the treaty itself

2.1 Treaty shopping

(a) Limitation-on-benefits provision

Limitation-on-benefits provision (hereafter referred to as “LOB”) describes entities which can benefit from the tax conventions through a list of situations that clearly comes from a domestic law history (the US tax law history essentially).

Taxation when doing business in more than one country is globally the result of going through domestic laws and international rules. Usually, the domestic and inbound/outbound tax rules applicable are homogeneous in order to create a global, comprehensive and normal level of taxation.

The aim is to avoid too heavy taxation resulting from a mismatch between two consecutive levels of taxation or non-taxation resulting from loopholes in the legislation.

This mechanism needs that the split into categories and the identification of the different entities and situations at domestic level and at international level be compatible.

The LOB system would create a criteria of identification of qualifying entities which is too far from our domestic law and from many domestic laws. It is also impossible by construction to be compatible with various domestic legislations (except if they are all similar, which is not possible without challenging the sovereignty of the States).

It is therefore not a satisfying methodology from a technical standpoint.

Furthermore, we do not think that the LOB provision is compatible with European law (non-discrimination provisions in particular).

We believe that the adding of a LOB provision in tax treaties would be incompatible with domestic laws and would overreach the main purpose of such tax treaties.

Indeed, a LOB provision would de facto require that the States adapt their domestic rules. For example, we should probably change our domestic rules before adding a LOB provision in tax treaties signed by France providing with a specific treatment for persons constituted and operated exclusively for religious purposes (see paragraph 2. d) i) of the LOB provision model provided in the Draft).

(b) Rules aimed at arrangements one of the main purposes of which is to obtain treaty benefits

The rule provided in paragraph 18 of the Draft cannot have a too broad scope and be too tricky to apply.

What it is important is to have a rule which is efficient and in order to be efficient, such rule must be (i) legal and (ii) easy to understand and to apply.
(i) Legal

The rule must be compatible with the laws of the signatory States, these laws being not only the tax laws but all the laws of the State and in particular the constitutional laws of the State.

For example, in France, the Conseil Constitutionnel in a recent decision dated December 29, 2013 has stated that the proposed definition of the abuse of law, contained in the draft Finance Law for 2014, was incompatible with the French Constitution. The draft Finance Law was proposing to replace the pre-existing definition which refers to transactions that have an exclusive tax motivation by a new definition which would refer to transactions that would have a principal tax motivation. The decision of the Conseil Constitutionnel has invalidated this proposal on the ground that the proposed definition was too ambiguous and unclear and that such definition would trigger a risk of arbitrary application of the law by tax authorities.

This legal constraint must be taken into account at the level of each potential signatory State if we want to have a truly general and universal rule.

(ii) Easy to understand and to apply

When the Draft makes reference to treaty abuses, the scope of what is abusive and what is not should be clearly delimited. In particular, general terminology such as “one of the main purposes” should be prohibited since it could lead to uncertainties and misinterpretations.

Paragraph 29 of the Draft states also that: “It is not necessary to find conclusive proof of the intent of a person concerned with an arrangement or transaction, but it must be reasonable to conclude, after an objective analysis of the relevant facts and circumstances, that one of the main purposes of the arrangement or transaction was to obtain the benefits of the tax convention”.

It means that a situation that a tax authority may consider as doable for tax reasons could be considered as abusive without conclusive proofs. We believe that this is contrary to a fair exercise by the States of their taxation empowerment. The finding of proofs of the intent cannot be considered as a non-compulsory element of demonstration.

2.2 Other situations where a person seeks to circumvent treaty limitations

(a) Dividend transfer transactions

Paragraph 43 of the Draft proposes to include in subparagraph a) of Article 10(2) of the OECD Model Tax Convention a minimum shareholding period in order for taxpayers to access the lower rate of withholding tax applicable to dividends in the source State.

We suggest that such minimum shareholding period be equal to a twelve month period of time, provided that the mere commitment by taxpayers to hold the shares for the required period of time would enable them to benefit from the lower rate of withholding tax if the holding period is not met at the time of the distribution. This aims to avoid refund systems that are time-consuming and burdensome both from a tax authorities perspective and a taxpayers perspective.
(b) Anti-abuse rule for permanent establishments situated in third States

Paragraph 56 of the Draft proposes to include a new paragraph to Article 1 of the Model Tax Convention to deal with "triangular cases where income attributable to the permanent establishment in a third State is subject to low taxation".

As indicated in our comments relating to the LOB provision, we do not believe that the adding of new provisions inspired from a domestic law history (the US tax law history essentially) is a satisfying methodology from a technical standpoint. This would be incompatible with many other domestic laws and would overreach the main purpose of the tax conventions.

***

We are at the disposal of the Tax Treaty, Transfer Pricing and Financial Transactions Division of the OECD in order to contribute further.

Very truly yours,

Anne Quenedey,
Partner
9 April 2014

Dear Sir/Madam

Response to OECD discussion draft on BEPS action 6: Preventing the granting of treaty benefits in inappropriate circumstances

KPMG LLP, the KPMG Member Firm in the UK, are pleased to provide our comments on the above Discussion Draft.

We support the aims of the Draft and agree that it should be made clear that while treaties exist for the elimination of double taxation this should be done without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance.

Our main recommendation is that the proposed limitation of benefits (LOB) clause should not be adopted on a mandatory basis as we consider this creates undue complexity and uncertainty, can deny legitimate companies treaty benefits and is unnecessary with the general anti-abuse clause. While we support the general anti-abuse clause we consider that it is necessary that there is detailed guidance as to how it applies.

1) LOB clause

We understand that it is policy of some countries, in particular the US, always to insist on having an LOB clause in treaties. For the reasons set out below we consider an LOB clause is not the best way of preventing treaty shopping. Recognising some countries will always require one, we recommend that it should be option only; that way individual states are free to apply it or not.

Experience has shown that it can be very complicated to apply the provision and can create a considerable compliance burden. There are a number of cases where companies will be denied benefits under the formulaic test. This is particularly relevant for privately held companies, private equity and other forms of collective investment vehicles. A company may be legitimately established in one country but have a range of private investors more than 50% of whom are not resident in that country. It would be denied treaty benefits unless an agreement...
was reached by the competent authorities under paragraph 5. Experience, however, has shown that it can be very difficult to obtain such agreement. Where such treaty benefits have been granted under such a clause it has taken several years to negotiate the position creating uncertainty for the companies involved.

Similar issues are likely to be experienced by fund complexes set up in countries such as Ireland or Luxembourg where the majority of the investors will not be local residents. Funds are set up in these countries to take advantage of specific fund taxation rules – effectively designed to ensure that investments through a fund do not suffer an additional layer of taxation – and their existence should not be considered as treaty shopping.

Consideration therefore needs to be given as to how the LOB clause can be amended so as not to exclude collective investment vehicles.

There are also certain commercially used structures which may fail the strict LOB test. One of these is the dual listed company structure where two parent companies are listed in different countries but effectively form one group via various contractual and voting arrangements. In some cases a trust is established to hold a special share in each quoted parent company in order to equalise voting. Such arrangements could lead to a group - which is in reality publicly traded - failing the publicly traded test.

We note that where there are intermediary holding companies in a structure, the tests in paragraph 2 c) ii) and e) only apply where all intermediate companies are resident in one of the contracting states. Therefore if five resident individuals of State A hold a company which is resident in State B (BCo) which in turn holds ACo which is resident in State A, ACo could be denied benefits under a treaty with third state, State C. There is no policy reason for denying benefits in such a situation where all the countries involved have implemented treaties with either the proposed LOB clause or the general anti-abuse clause and so we recommend removing this condition so that the intermediate companies do not have to be resident in one of the contracting states.

Similarly if Company A holds Company B which holds Company C and they are all resident in different states, Company B cannot obtain benefits under a treaty with State C under paragraphs 2 c) ii) or e). For this reason we support the inclusion on the derivative benefits test in any LOB clause. This test should not open the gates to treaty abuse because of the existence of the general anti-abuse clause.

At a conceptual level we consider the LOB approach is flawed as it is an all or nothing test. As stated above it can deny benefits to a legitimate company whereas if a company satisfies the rules the LOB clause does not then prevent such a company entering into abusive transactions.

Finally, as suggested above, provided that the general anti-abuse clause functions properly there is no need for a LOB clause as well.
2) New article X Para 6: general anti-abuse clause

We agree with the proposed general anti-abuse clause but consider that it should be made clear in the guidance that obtaining a benefit is only one of the main purposes of an arrangement or transaction where it is reasonable to conclude that the transaction would not have been entered into absent the treaty benefits. Examples A and B in Para 33 set out scenarios where it is suggested that the transaction would not have been entered into without the treaty benefit applying and on this basis we agree with the examples.

However, assume the fact pattern in Example A was slightly different and TCo required financing and there were commercial reasons for entering into the repo over the shares of SCo. In such a case, entering into the transaction with a financial institution in State R has a commercial purpose and is not driven by treaty shopping. The fact that the treaty enhances the financial transaction should not in itself trigger the anti-abuse clause as the transaction would have been done even if the treaty benefit did not exist. If State S has wider concerns about such transactions, this should be reflected in domestic law.

The anti-abuse clause does not apply where “it is established that granting that benefit in these circumstances would be in accordance with the object and the purpose of the relevant provisions of this Convention”. We consider that examples are required to demonstrate when a benefit is so granted. For example in Example C the facts state RCo chooses State S to make its investment because of the existence of a tax treaty. Therefore it could be said that obtaining treaty benefit is one of the main purposes of investing in that country as opposed to another country. The example should make it clear that the provision does not apply in such a situation for two reasons. First it is clear that the investment would have been made in any case and the treaty relief is an added benefit – i.e. obtaining the benefit is not one of the main purposes of the arrangement or transaction. Furthermore provided that the business established in State S has genuine substance any treaty benefits obtained are those intended by the Convention.

Clearly the answer would be different if the establishment in State C lacked genuine substance. In this case it could be reasonably concluded that obtaining treaty benefits was one of the main purposes of the arrangement and that any benefits obtained would not be in accordance with the object and purpose of the convention.

Such guidance will be particularly important when looking at the establishment of holding or finance companies where one of the major considerations as regards location may well be access to a treaty network. It should be clear that where there is appropriate substance – i.e. the holding or treasury activities is actually carried on in the relevant state – the anti-abuse clause is not relevant.

3) Dividend transfer transactions

We consider that any holding period required to prevent manipulation of the threshold for obtaining reduced withholding taxes is kept to a minimum, say three months. Furthermore, the
rule should follow the application of the EU Parent Subsidiary Directive so that the recipient of the income is entitled to treaty benefits if the holding period is fulfilled after the date of payment and not just before. To require it to be filled before any payment is received could interfere with legitimate commercial transactions.

4) **Transactions that rely on the tie-breaker rule for determining the treaty residence of dual-resident other than individuals**

We disagree with the view expressed by some countries set out in Para 52 that dual-resident companies are often involved in tax avoidance arrangements. In modern multi-nationals where board members may be located in different jurisdictions there is clearly a risk of a company being resident both in a country where it is incorporated and in the country where board decisions are taken. Leaving the decision to competent authority creates uncertainty. We therefore recommend that the tie-breaker clause awards residence to the country where the effective management takes place. If countries are concerned that dual-residency can be used for tax avoidance purposes we consider the better solution is that adopted by the UK – i.e. there should be a domestic rule which states that where a company is treated as being resident in another state for treaty purposes it ceases to be resident in the first state for all domestic purposes.

5) **Anti-abuse for PE situated in a third state**

We consider that it is not appropriate to deal with such situations within treaties and it could lead to anomalies. For example a UK company may decide to set up a bona fide treasury operation in Ireland. If it does this through an Irish company the benefits of Ireland’s tax treaties would apply. If it did it through a branch the anti-PE rule would be triggered. We consider that abusive situations are better addressed through domestic rules such as CFC rules (we note the UK applies CFC rules to branches) or where relevant through anti-hybrid rules.

6) **Abuse of domestic law using Treaty benefits**

We agree with the proposals set out here but we consider that it should be made clear that when local laws apply, double taxation is not created. In other words where one state denies a deduction there should be a compensating adjustment in the other state.

7) **Section B: Clarification that tax treaties are not intended to generate double-taxation**

We agree with the recommendations in this section but note that guidance should make it clear that treaties should not create opportunities for non-taxation through evasion or avoidance. Where none or reduced taxation results from explicit domestic policy this should not be overridden by treaties. For example, where the investor country provides a general exemption for dividends and where the investee country allows a deduction for preference dividends, treaties should not automatically override such policy decisions.
8) **Section C: Tax policy considerations that in general countries should consider before deciding to enter into a tax treaty with another country**

We recommend that guidance should confirm that making use of specific incentives of one country which are designed to attract certain business activity does not constitute avoidance and should not be overridden by treaty.

Yours faithfully

Chris Morgan
Partner
SUBMISSION OF THE

Law Society of Ireland

OECD BEPS ACTION 6 PUBLIC DISCUSSION DRAFT

To: Tax Treaties, Transfer Pricing and Financial Transactions Division
   BEPS Action 6
   OECD/CTPA

8 April 2014
This submission is made on behalf of the Tax Committee Law Society of Ireland, the professional body representing lawyers qualified as solicitors in Ireland.

1. **Background & Context**

1.1 We refer to the Public Discussion Draft entitled ‘BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances’ released by the OECD on 14 March 2014 (the “Discussion Draft”). The Discussion Draft proposes to introduce a number of provisions designed to prevent treaty abuse into tax treaties entered into by OECD countries. It also sets out tax policy considerations that ought to be considered by OECD countries before entering into tax treaties.

1.2 We believe that the proposal in the Discussion Draft to introduce limitation on benefits (“LoB”) provisions into tax treaties generally would:

- result in a number of illogical outcomes arising from the move to make an LoB clause a multi-lateral matter in bilateral treaties;
- put businesses operating in smaller OECD countries at a disadvantage to those operating in larger OECD countries;
- potentially place businesses operating in non-OECD countries at an advantage over those operating in OECD countries; and
- potentially be illegal under EU law.

1.3 We consider that the general anti-avoidance provision proposed in the Discussion Draft is a more appropriate approach to dealing with treaty abuse concerns than the LoB provisions. Alternatively the LoB provisions could be modified so that they operate effectively by accepting that businesses that are owned by OECD residents or are OECD listed should be able to benefit from all tax treaties between OECD countries in the same way as businesses that operate within a single OECD country are.

2. **Proposed LoB Test**

2.1 Most companies would have to qualify for treaty benefits under the proposed LoB test under the following sub-paragraph of draft Article X(2):

\[ \text{c) a company, if:} \]

\[ \text{i) the principal class of its shares (and any disproportionate class of shares) is regularly traded on one or more recognized stock exchanges, and either:} \]

\[ \text{A) its principal class of shares is primarily traded on one or more recognized stock exchanges located in the Contracting State of which the company is a resident; or} \]

\[ \text{B) the company’s primary place of management and control is in the Contracting State of which it is a resident; or} \]
ii) at least 50 percent of the aggregate voting power and value of the shares (and at least 50 percent of any disproportionate class of shares) in the company is owned directly or indirectly by five or fewer companies entitled to benefits under subdivision i) of this subparagraph, provided that, in the case of indirect ownership, each intermediate owner is a resident of either Contracting State;

3. **Example of Application of Proposed LoB Test**

3.1 Suppose Company Z follows the following development path:

   (i) Company Z is formed and funded by individuals resident in State A (a small OECD country) so it is resident in State A;

   (ii) Company Z develops and does business with a small number of residents of other countries;

   (iii) To further develop its business it wishes to raise private equity/venture capital funding, but cannot do this in State A as the private equity/venture capital providers in that state are not appropriate or do not have the capital to provide the funding. Accordingly it raises the funding from venture capital or private equity managers located in State B (a large OECD country) with capital from a large number of investors across a number of OECD countries;

   (iv) Subsequently, Company Z wishes to raise equity finance on the most appropriate stock exchange. Company Z IPOs on a stock exchange in State B and remains resident in State A; and

   (v) Company Z seeks the best global talent and relies on modern communication technology, so its executives are disbursed among a number of countries.

   At all times, apart from scaling up, the business and tax position of Company Z remains the same.

3.2 **Issues**

   (a) While in stage (i), the LoB provisions are not relevant to Company Z.

   (b) At stage (ii), the LoB provisions are not relevant as Company Z is only funded and operated out of State A.

   (c) At stage (iii), Company Z will have issues when it seeks to rely on State A’s treaties with any state other than State B as paragraph 2(c)(ii) will likely exclude it since it will be majority owned by residents of State B or the other OECD countries in which the investors are located (see paragraph 4.1(a) below).

   (d) At stage (iv), due to its listing on a Stock Exchange in State B, Company Z will have issues when it seeks to rely on State A’s treaties with any state other than State B since its shares will not be traded on a ‘recognized stock exchange’ for the purposes of those treaties (paragraph 2(c)(i)) (see paragraph 4.1(b) below).
At stage (v), Company Z may not even be able to benefit from the treaty with State B if it is impossible to determine its “primary place of management and control” due to the dispersion of its executives (i.e. failing paragraph 2(c)(i)(B)) (see paragraph 4.1(c) below).

4. Problems raised by the Proposed LoB Test

4.1 Business Operating on a Multi-Lateral Basis

(a) Paragraph 2(c)(ii) - Private Equity / Venture Capital

Private equity or venture capital managers are concentrated in certain of the larger OECD countries and, in particular, industry specific private equity or venture capital providers may be resident in a very limited number of jurisdictions. If a company resident in an OECD country (particularly a small state with limited local capital available or a small scale venture capital/private equity pool of capital) needs to raise capital to expand, it is likely to raise it from a venture capital/private equity provider outside its home state which is likely to be in another OECD country. This is likely to result in the company being precluded from benefiting from tax treaties with any OECD countries, other than the one between its state of residence and the state where it raised the capital. This is because it would be unlisted and majority owned by the venture capital/private equity fund so it can only rely on paragraph 2(c)(ii) of the LoB test for that treaty but no others.

As the capital is provided by a number of investors to reduce concentration risk for them, it is unlikely to be 50% owned by 5 or fewer companies. Accordingly, it would be reliant on the goodwill of the other contracting state to agree that Article X(4) of the LoB provisions applies which is a wholly untenable position as it creates a significant legal doubt in a normal business situation.

The fact of its ownership has no impact on its tax position in its state of residence so the result is an odd outcome.

(b) Paragraph 2(c)(i) - Listing

Stock exchanges are consolidating globally and regionally as capital is attracted to the most diverse pool of potential issuers and issuers move to the deepest pool of capital. Globalisation drives market efficiency in this case. Accordingly, companies do not necessarily raise capital on exchanges located in their state of residence, as these may lack material liquidity or capital capacity. Increasingly capital is raised on exchanges that are most suited to the business they are undertaking (e.g. NASDAQ for technology companies, Toronto stock exchanges for mining and natural resource companies) and/or where preferable pricing is available. If a company resident in an OECD country decides to raise capital on an OECD stock exchange outside its own country to expand, it will be precluded from benefiting from tax treaties with any OECD country other that the treaty between the state of its residence and the state in which it is listed. This is because it immediately fails paragraph 2(c)(i) of the LoB test.

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1 The company would also likely fail the derivative benefits test as it may not be possible to trace the ultimate ownership of 95% of its shares through private equity venture capital funds.
The choice of listing in the optimum OECD stock exchange for that company – a purely commercial matter – results in an adverse tax consequence.

(c) Paragraph 2(c)(i)(B) - Executive Management

With advances in communication, many multinational companies are often operated from several headquarters or none where the headquarters is “virtual”. This is often driven by the desire to be close to customers and markets as well as to access the best human talent worldwide. These arrangements may make it difficult to establish where the "primary place of management and control" is for that company. Therefore, even if a company is resident in a state and seeking to rely on the treaty with another OECD country on whose stock exchange it is listed, it may be precluded from doing so if its executives are disbursed in a number of jurisdictions other than its state of residence (i.e. failing paragraph 2(c)(i)(B)). This is despite the fact that all parts of the organisation are remunerated on arm’s length terms and taxed accordingly.

(d) Paragraph 3 – Active Conduct of a Trade or Business

It is not feasible for a company to have only the Active Conduct of a Trade or Business test to rely on to obtain treaty benefits. For example as Company Z develops in our example, the test is uncertain and a company would have difficulty in verifying that it meets the relevant criteria from year to year.

If the test in paragraph 3 is to be interpreted in line with the US Model Technical Explanation the following issues arise:

(i) "trade or business" is not defined and the meaning under the laws of the Contracting State in which the item of income is derived is to be ascribed to it; this means that a company could be carrying on a trade or business for the purposes of one treaty but not for the purposes of another treaty depending on how the laws of the relevant jurisdictions interpret ‘trade or business’;

(ii) a company that functions solely as a headquarters company will not be considered to be engaged in an active trade or business so a holding company which does not have trading subsidiaries in its state of residence can never qualify under this test;

(iii) where more than one trade or business is conducted in the state of source, it is necessary to identify the trade or business to which an item of income is attributable; and

(iv) where income is received from related parties, a further condition is imposed which requires that the trade or business carried on in the state of residence must be "substantial" in relation to the activity in the state of source; the substantiability test is generally a facts and circumstances test which takes into account the comparative sizes of the businesses in each state (often measured by reference to, inter alia, asset values, gross income and payroll expenses in each state although the relevant factors vary between US treaties) with 'due regard' to the relative sizes of the economies in the two states; these factors vary over time and it is difficult for a company to have any certainty that it meets the substantiability requirement at any
given point in time. For example, in recent years we have seen fluctuations in the size of countries’ GDP due to the financial crisis. This of itself could cause a company to fail or pass the Active Conduct of a Trade or Business test from year to year. Finally, currency movements would also need to be factored in and these can vary widely. The practical issues with this test seem to be significant and a company could pass or fail this test from year to year without any change in their tax position.

Between OECD countries, this test should not be applied on the basis that all OECD countries will ultimately implement the various elements of the BEPS project. This means that there will no longer be base erosion or profit shifting and that activity will be aligned with substance. If it is not, other parts of BEPS come into operation.

Also, the EU single market has as one of its aims the freedom for companies to establish their operations on a cross border basis within the EU as they see fit without restriction. Clearly this provision will drive corporates to localise their activities in the country in which the top company is resident and discourage them from establishing operations in other EU member states. This would be the case for a company that only operates within the EU. As with many of the other outcomes of the proposed LoB clause, this breaches EU law.

(e) Summary

In summary the proposed LoB provisions may work acceptably for companies that operate, raise finance and recruit executive talent only in the OECD country in which they are resident. Where such companies operate, raise finance and recruit executive talent in other OECD countries, there are potentially serious issues with the LoB provisions.

4.2 Collective Investment Vehicles (CIV’s)

We consider that LoB provisions are not appropriate for CIVs and could effectively prevent cross-border CIVs from availing of the benefits of double treaties.

The issue of treaty access for CIVs was considered in detail by the OECD recently, culminating in the 2010 report from the OECD Committee on Fiscal Affairs which indicated a favoured approach of CIVs being granted access to treaties by being treated as a resident of a contracting state and the beneficial owner of its income. The introduction of an LoB provision would be likely to discriminate against small OECD states with a developed cross border CIV industry in favour of CIVs established in large OECD states targeted at domestic markets. A general anti-avoidance provision would be more appropriate for CIVs.

4.3 Large OECD Country Preference

The LoB provisions discriminate against small OECD countries as they are unlikely to have deep capital markets, major/specialised stock exchanges and/or the best global talent. Accordingly, the Discussion Draft could be viewed as attempting to limit the size to which companies in small OECD countries can grow unless they move their place of tax residence to a large country.

The LoB provisions operate to discourage OECD resident companies from expanding and trading within the OECD which is contrary to OECD principles.
4.4 Non-OECD Country Preference

Furthermore the LoB provisions may actually benefit companies resident in non-OECD countries which have treaties with an OECD country. For example, a company resident in State 1 (a non-OECD country), which is owned by residents of State 1, would be able to benefit from any treaty containing LoB provisions to which State 1 is a party. Company Z referred to in our example at 3 above, has difficulty accessing treaties with OECD states from stage (iii) of its development onwards, even though at all times it is funded by OECD residents, listed in the OECD and operated out of OECD countries only.

4.5 EU Law

The single market within Europe guarantees certain fundamental freedoms. These include the free movement of capital and workers and the freedom to provide services. Any restriction on these fundamental freedoms within the EU is illegal unless it can be justified.

In terms of EU freedoms, it is immediately clear that the effective restriction which the LoB provisions place on the jurisdiction in which a company can raise its capital is illegal as it discriminates between member states of the EU. In addition, because free movement of capital also applies to third countries any restriction on raising capital in other jurisdictions is likely also to be illegal as a matter of EU law. The requirement that the executive grouping must be located in the country of residence also may be illegal as a matter of free movement of workers under the EU treaties. Workers should not be forced to move from one country to another simply by tax rules. Finally, the proposal restricts the ability of stock exchanges outside the home jurisdiction from offering their services as facilitators of the provision of capital. For example, if the London Stock Exchange’s ability to provide its intermediary service of facilitating a non-UK company in raising capital is restricted by the LoB clause of a tax treaty, then there is a restriction on the freedom to provide services within the EU.

It is unlikely that this result could be justified as the LoB operates in this way whether tax avoidance is present or not. We would suggest that a general anti-avoidance rule such as the proposed Article X(6) on “Entitlement to Benefits” would better achieve the objective of preventing treaty abuse and so could potentially be justified as a matter of EU law.

5. Derivative Benefits Test

We refer to the example set out at paragraph 15 of the Discussion Draft. Existing OECD Commentary provides that tax treaties are intended to prevent tax avoidance and this is clear from the preamble to such treaties. In addition if, in that example, State R follows OECD principles and the EU Code of Practice on Unfair Tax Competition, it should not provide for preferential tax rates. If it did, despite OECD and EU principles, the structure described could be defeated by the application of any of:

- a general anti-avoidance rule such as the proposed Article X(6) on “Entitlement to Benefits” as its main purpose is to obtain a tax benefit;
• transfer pricing rules in State T; or
• CFC rules in State T.

There are compelling reasons to include a derivative benefits clause in any LoB proposal. Citing a single example of a structure that can be defeated by many existing rules (including an approach that is superior from a policy perspective (the proposed Article X(6) on “Entitlement to Benefits”)) as a reason to exclude a derivative benefits test does not seem to be good policy-making.

Also a normal group company structure would be adversely affected by excluding a derivative benefits test. For example, if Company Z incorporated a subsidiary in another OECD country, that subsidiary would have considerable difficulty in accessing the benefits of treaty benefits as the latter part of Paragraph 2(c)(ii) would not be satisfied. This is clearly a restriction of the EU law freedom of establishment where Company Z and its subsidiary are both formed in EU member states, and would likely be illegal. The latter part of Paragraph 2(c)(ii) should refer to intermediate owners being resident in an OECD country or at a minimum, in treaties to which EU member states are a party, it should refer to owners resident in an EU member state.

6. Submitted views

We consider that the LoB proposal should be dropped and a general anti-avoidance provision (such as the proposed Article X(6) on “Entitlement to Benefits”) should be adopted. This is because we consider that the existing initiatives of the OECD allied with such a general anti-avoidance clause would resolve all material issues in this context.

Should the OECD accept the LoB proposal, the definitions of “primary place of management and control” and “recognized stock exchange” in each treaty should respectively refer to the control not residing outside OECD countries and include a comprehensive list of OECD stock exchanges. Subparagraphs 2(c)(i)(A) & (B) and 2(c)(ii) of Article X should also refer to any and all OECD countries to provide fairness between OECD countries. This is because the proposed draft LoB fails to take account of the multilateral environment in which multinational business operates and consequently discriminates against small OECD countries. Any proposed LoB provisions should accept that it is normal for multinational companies to choose to list in one OECD country but to be resident in another OECD country. It should also be perfectly acceptable for a company to manage its operations (through its primary place of management and control) in any OECD country without affecting its right to access treaties. Of course the country in which such control is exercised would have taxing rights as a matter of its domestic law and the OECD treaty network. This is an entirely different point from the ability to access treaties.

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4 April 2014

Comments on the Public Discussion Draft on BEPS Action 6: preventing the granting of treaty benefits in inappropriate circumstances

Dear Mr Saint-Amans,

We hereby provide you with our comments on the Public Discussion Draft on BEPS Action 6: preventing the granting of treaty benefits in inappropriate circumstances, issued on 14 March 2014 (“Discussion Draft”). We have limited our comments to the most material issues identified.

As a first item in the three-pronged approach to counter treaty shopping, the Discussion Draft proposes to replace the Title and Preamble of the OECD Model Convention (“OECD MC”) by including a clear statement that Contracting States wish to prevent tax avoidance and intend to avoid creating opportunities for treaty shopping. The Discussion Draft and the proposed supplementary Commentary leave no doubt as regards the intention thereof. By altering the OECD MC’s Title and Preamble, the OECD envisages to have individual double tax conventions (“DTC(s)”) – that have adopted the altered wording - applied and interpreted in the light of the proclaimed purpose of avoiding tax avoidance and treaty shopping. Article 31, §1 of the Vienna Convention on the Law of Treaties (“VLCT”) indeed requires the purpose of treaties being taken into account when interpreting a (tax) treaty. However, the OECD should clarify that such a statement in principle does not suffice. The purpose of a treaty is only one factor that should be taken into account in the interpretative process. Absent operative provisions dealing with avoidance and treaty shopping (e.g. a general anti-avoidance rule), the (vague) statement in the Title and Preamble is probably not justified and, consequently, the ordinary meaning of treaty terms and the context should likely be given more weight.

A similar conclusion can be drawn as regards the clarification that tax treaties are not intended to be used to generate double non-taxation. The General Report of the 2004 IFA Congress convincingly demonstrated that tax treaties do not serve a general purpose of preventing double non-taxation and that they allocate taxing rights among Contracting States without requiring the State to which such rights are conferred to actually exercise them. Consequently, specific treaty provisions (e.g. subject to tax rules) are required to counter situations of double non-taxation. The Discussion Draft does not propose to alter the OECD MC’s operative provisions (e.g. Article 23 OECD MC), but merely intends to include a reference to the prevention of double non-taxation in the preamble of the OECD MC. Therefore, it could be submitted that the prevention of double non-taxation is, even after amending the wording of the preamble, not a purpose of a tax treaty. This conclusion is implicitly confirmed in footnote 2

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1 As also suggested in the Discussion Draft, cf. infra.
of the Discussion Draft. There, it is implied that countries that make a conscious decision not to exercise taxing rights allocated to them by a tax treaty – being the prime reason for double non-taxation - is not covered by the Discussion Draft and a fortiori the notion of “tax treaty abuse”.

The Discussion Draft also proposes to include a general anti-avoidance rule (“GAAR”) in the OECD MC. Further to the GAAR, treaty benefits would not be granted “if it is reasonable to conclude (...) that obtaining that benefit was one of the main purposes” of any arrangement resulting in that benefit, “unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions” of the treaty. The Discussion Draft (§20) states that the GAAR mirrors the guidance already provided in the current version of the Commentary on Article 1 (incl. the “Guiding Principle” of §9.5). Two major observations are relevant in this respect.

**Primo**, the proposed accompanying Commentary clarifies that, for tax treaty abuse to be present, it suffices that obtaining a tax treaty benefit was “at least one of the main purposes was to obtain that benefit”. This is arguably too broad. The OECD (explicitly) accepts that a general objective of Contracting States entering into tax conventions is to encourage cross-border investment. In doing so, it (implicitly) acknowledges that tax constraints hamper international economic activity. In light thereof, it seems intellectually inconsistent to sustain that a mere tax consideration (“at least one of the main purposes”) could fall foul of the GAAR. Example C of §33 of the Discussion Draft de facto makes clear that the “one of the main purposes” criterion is too broad: whereas the inference in this example is that obtaining treaty benefits is one of the main objectives of the alternative adopted, it is argued in the Discussion Draft that the GAAR is not violated. In order to do away this inconsistency and the legal uncertainty it entails, the definition of tax treaty abuse should be altered: only taxpayer behaviour that is *solely or predominantly* inspired by obtaining treaty benefits and which does not, or only very marginally, contribute to the development of cross-border activity should be considered “abuse” of a tax treaty. DTCs are, first and foremost, economic treaties designed to foster cross-border trade and investment. An investor faced with an investment decision will always take into account the tax implications of his decision. However, if a genuine economic objective is being pursued, benefits of the treaty should be granted even if there is a tax motive.

**Secundo**, the proposed GAAR does not merely mirror the Guiding Principle embedded in §9.5 of the Commentary on Article 1. The Guiding Principle is consistently interpreted as containing two elements which must be present simultaneously for an arrangement to be considered abusive: a subjective element (“a main purpose of a transaction or arrangement is to secure a benefit under a tax treaty”) and an objective element (“obtaining that benefit in these circumstances would be contrary to the object and purpose of the relevant treaty provisions”). Although the current Commentary remains silent on the issue, it is clear that the tax administration of the Contracting State that wants to deny the treaty benefits currently carries the burden of proving that a particular arrangement satisfies both criteria. It is observed that the Discussion Draft’s GAAR now intends to (partially) reverse the burden of proof, viz. in respect of the objective element: it is now up to the taxpayer to sustain that granting treaty benefits would be in accordance with the object and purpose of the relevant treaty provisions. It is therefore submitted that the Discussion Draft is inconspicuously lowering the “treaty abuse” threshold. In light thereof, the present authors wonder about the (added) value of the current introduction to the Guiding Principle that “(...) it should not be lightly assumed that a taxpayer is entering into (...) abusive transactions”.

The Discussion Draft also proposes to include a limitation on benefits (“LOB”) provision in the OECD MC, on top of the aforementioned GAAR. The Discussion Draft expressly envisages to have the GAAR apply in addition to the LOB clause: the fact that a taxpayer passes the LOB test does not

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2 See also Example C of §33 of the Discussion Draft.
3 We will not comment on the fact that inclusion of such a provision would likely run counter certain States’ treaty policy considerations.
imply that benefits cannot be denied to him under the GAAR (§23). However, this general statement should be qualified. The LOB clause may be considered a *lex specialis* to the GAAR. Consequently, once a purported abusive arrangement passes the LOB test, the GAAR should only apply to the extent the allegedly abusive behaviour is completely out of the scope of the type(s) of treaty abuse the LOB clause intends to counter. While it is true that the LOB test primarily focuses on ownership-related abuses, whereas the GAAR rather deals with abuse in more general, transactional terms, a certain overlap cannot be excluded, in particular in light of the fact that the LOB clause covers the benefits of every provision of the DTC. Therefore, the statement in §23 of the Discussion Draft is oversimplified.

The LOB clause, the GAAR and the change of the OECD MC’s title and preamble (“the three-pronged approach”) all intend to counter treaty shopping or situations in which taxpayers try to circumvent limitations provided by the treaty itself. The Discussion Draft (§5) delineates these situations from cases where taxpayers rely on DTCs to circumvent provisions of domestic tax law. The OECD intends to tackle the latter kind of situations by including a so-called “savings clause” in the OECD MC. This clause would provide that a tax treaty does not restrict the right of Contracting States to tax their own residents (save for some explicit exceptions) - a principle which the OECD currently sees confirmed in §6.1 and §23 of the Commentary to Article 1. The suggestion to include a savings clause is odd, for two reasons. First, it is rather inconsistent to argue in §68-69 of the Discussion Draft that treaties should not be interpreted as limiting the taxing rights of Contracting States vis-à-vis their own residents, while at the same time including an explicit provision preserving the same right. Second, the Discussion Draft seems to depart from the current OECD position that anti-avoidance rules “are part of the basic domestic rules set by domestic tax laws for determining which facts give rise to a tax liability [and are] not addressed in tax treaties”, further to which these rules do in principle not conflict with tax treaty obligations. This position is explicitly reiterated for CFC rules and (to an extent) for thin capitalisation rules. By proposing to include a savings clause to preserve the application of said rules, the Discussion Draft seems to return to the 1977 position or at least invite the (*a contrario*) argument that these rules currently do conflict with tax treaty obligations, absent preserving provisions.

As a final remark, it could be questioned whether the Discussion Draft has paid sufficient attention to the EU law dimension. The GAAR, the LOB clause and some specific anti-avoidance rules proposed in the Discussion Draft (*e.g.* the low-taxed branch rule of §56) may all result in a denial of tax treaty benefits and, consequently, in a *prima facie* prohibited restriction of the fundamental freedoms of the TFEU. Such restrictions can only be justified by the need to prevent tax avoidance if the anti-avoidance rules at stake are specifically aimed at countering “wholly artificial arrangements aimed solely at escaping national tax normally due”. An EU law issue may arise if the rules proposed in the Discussion Draft would prove to impose a lower “abuse” threshold than this EU standard. The LOB clause and special anti-avoidance rules both apply in an objective, all-or-nothing fashion, regardless of whether there are tax motives underlying. The proposed GAAR - by employing a “one of the main purposes” test - uses a rather low abuse threshold. Consequently, serious doubts can be raised on the EU law compatibility of said proposed provisions.

We hope that these comments will be taken into consideration when the OECD finalises its work on Action 6 of the BEPS Action Plan on tax treaty abuse.

Please do not hesitate to contact us should you have any questions in relation to the above.

Yours sincerely,

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This Paper sets out our comments on the Public Discussion Draft issued on 14 March 2014.

GENERAL COMMENTS

1 In responding to the treaty abuses identified in the Discussion Draft, the proposed measures inevitably impose restrictions on treaty benefits. It is important that these restrictions do not have a material adverse effect on genuine cross-border economic activity. In this respect, we are concerned that the general approach is unduly restrictive. The proposed limitation-on-benefits provision in particular is too narrowly focused on entities controlled by residents of one or other of the contracting states. This will clearly be inappropriate in some circumstances, for example, where the contracting state is a member of the EU, but it also has potentially damaging effects on others, for example, in the area of widely held investment funds which will often use companies that qualify for treaty benefits primarily in order to simply the process of making claims for benefits under (what would otherwise be) numerous treaties.

2 The anti-abuse provisions referred to in the document tend to place a greater degree of discretion in the conferring both of treaty benefits on revenue authorities. This will inevitably create uncertainty for taxpayers. These provisions should be counter-balanced by clear and enforceable procedures through which taxpayers can obtain resolution of such issues which is binding on contracting states.

SPECIFIC COMMENTS

Limitation-on-benefits

3 As a general point, we are concerned that the proposed limitation-on-benefit provision is too narrowly focused. The requirements for beneficial ownership of interests in entities to be held by residents of one of the Contracting States are too restrictive. They will cause particular difficulties for companies owned ultimately by widely-held investment funds, where the investors will typically be established in many jurisdictions. Unless specific provision is made in the limitation-on-benefits provision for vehicles owned by such funds to be treated as qualified persons, they will have to rely on the more general provisions in paragraph 3 and 4 of the draft provision. These are inherently uncertainty. The result will be that for many investors that uncertainty may cause them not to invest in the fund in particular if they would otherwise be confident of obtaining treaty benefits if they were to invest directly.

4 Paragraph 11. The limitation on benefits provision will need to deal with circumstances where one of the contracting states is a member of the EU. In such cases, some of the provisions will need to be adjusted to permit, for example, the issue of shares on a stock exchange in another Member State and indirect ownership through companies which are residents of other EU Member States.

5 Paragraph 13. The Discussion Draft discusses whether or not any limitation-on-benefits provision should contain a “derivative benefits” provision. In our view, if a limitation-on-benefits provision is included, a derivative benefits provision should be included as well. The Discussion Draft includes an example of such a provision. This provision turns on the definition of an “equivalent beneficiary”. An equivalent beneficiary is essentially a resident of another State which would be entitled to benefit itself under a comprehensive treaty between that other State and the State from which benefits are claimed who, additionally in the cases of income falling within the dividends, interests and royalties, would be entitled to receive such income subject to withholding at a rate which is at least as low as that applicable under the treaty in question. We think that this definition is too narrow.

- A company which would otherwise be an equivalent beneficiary will not be so if the rate of withholding tax specified in the relevant treaty with its home state and the source state is marginally higher. In such a case it is unlikely that the group structure has been adopted purely to obtain the...
benefit of the treaty. It would be more appropriate for the provisions to operate so that relief is only allowed at the rate to which the equivalent beneficiary would be entitled under the applicable treaty with its home state.

- The provision only applies if, in a case of indirect ownership, “each intermediate owner is itself an equivalent beneficiary”. Again, one company in the chain it is entitled to treaty relief at a marginally higher rate will disqualify the treaty claim. Again, this seems disproportionate.

The restricted nature of the derivative benefits provision will force taxpayers that wish to obtain treaty benefits to rely on the residual provisions in paragraph 3 and 4. These are inherently uncertain and, where they depend upon agreement with competent authorities, will result in delays in obtaining relief.

Paragraphs 15 and 16 refer to an example in which intellectual property is transferred to a company in a third state in order to obtain the benefit of a treaty. The example given is not a good one. In the example, both of the relevant treaties, the treaty between State T and State S and the treaty between State R and State S, provide that royalties can only be taxed in the state of residence. So this is not a case of treaty abuse. The group has not obtained a treaty benefit as a result of the structure. If this is an abusive transaction, it is because of the diversion of income from State T to State R. The appropriate means of addressing any abuse in this case is for State T to tax the profits of Opco 2 under its CFC rules if it thinks that the transfer of the IP to Opco 2 is abusive.

Rules aimed at arrangements are of the main purposes of which to obtain treaty benefits.

Paragraph 18 proposes the incorporation of a more general anti-avoidance rule within the Model Tax Convention. This type of motive-based test is common in UK tax legislation. A general anti-avoidance rule of this kind is inevitably open to interpretation and there will be a significant risk of Contracting States applying differing interpretations to the same set of facts. For this reason, it will be important that any such provision is supported by extensive guidance and examples in the Commentary.

Paragraph 27. We did not find the example in this case particularly helpful. It would be helpful if the example could address other issues which may arise. For example, would the conclusion be any different if the original loan was refinanced? In that case, there would be a general in commercial transaction between RCo and SCo which it might be said the treaty was intended to benefit. Does it make any difference if RCo was funded at the time of the acquisition of SCo to lend funds to SCo to repay the original debt so that TCo was never a party to the loan? Would it make any difference if RCo is the group’s finance company so it makes the loans on that basis?

Paragraph 28. The Discussion Draft proceeds on the assumption that any agreement or transaction which is structured to obtain the benefit of a treaty is abusive and should fall foul of the provision. We do not think that this the correct approach. Many transactions and arrangements will be structured in order to obtain treaty benefits. But that does not mean that they are particularly colourable: it simply means that steps have been taken in order to fulfil the conditions set out in the treaty. The critical distinction is between transactions and arrangements which obtain benefits which are within the object and purpose of the treaty and those which are not. The Commentary needs to distinguish more adequately between these two categories and identify the basis on which that distinction will be made. In our view, it should require some degree of artificiality, and the Commentary should address the circumstances in which the transaction or arrangement will be regarded as artificial.

The wording of the new provision places the onus on the taxpayer to prove that a treaty benefit that is obtained is not in accordance with the object and purpose of the treaty. In our view, that is a difficult burden for the taxpayer to overcome. It would be more appropriate if the onus was placed on revenue authorities to show that benefits obtained are not in accordance with the purposes of the convention. This could be achieved by deleting the words at the end of the proposed new rule beginning with “unless it is established …” and replacing them with “where it is established that granting that benefit in these circumstances would not be in accordance with the object and purpose of the relevant provisions of this Convention”.

We find the examples given in paragraph 33 unhelpful. As a general rule, they fail to demonstrate where the line should be drawn between transactions which are within the object and purpose of the Convention and those which are not. Many more examples will be required with much more detailed explanation of the basis on which the condition is reached.
We have particular concerns with Example B. The example suggests that the fact that RCo pays an amount equal to the net present value of the dividends on the preferred shares is an indicator of an abusive transaction. We do not agree. We also do not necessarily agree that the bare facts as stated justify the conclusion. It might be equally reasonable to conclude that the transaction is just a financing arrangement under which TCo sells and existing income stream for a capital sum. It may well be that TCo is paying tax in State T on the full value of the capital sum as income whereas it paid tax on the dividends with credit for the withholding tax. TCo may need the capital immediately and selling the income stream is one simple means of raising that capital. The fact that RCo obtained the benefit of treaty relief may allow RCo to pay more than in a financial institution established in another state, but that is simply a factor of treaty negotiations between State R and State S.

Other situations where a person seeks to circumvent treaty limitations

Tie-breaker rule for determining the treaty residence of dual-resident persons

We are concerned that this proposal will inevitably lead to more cases of double-taxation. There are many cases – in particular where a country treats companies as resident merely by reference to place of incorporation – that companies can be or become resident for tax purposes in more than one jurisdiction. Those circumstances are not confined to tax avoidance cases. The solution – to deny benefits to all dual resident companies unless there is agreement between the competent authorities of both Contracting States – seems disproportionate. This is particularly so given that the competent authorities are under no obligation to resolve the question as to residence under the terms of the new Article 4 (3) but merely to “endeavour to determine” the residence of a dual resident company for treaty purposes. We think that this is inadequate. Our preference would be to retain the previous tie-breaker provision or, if not, to provide some means of effective resolution on which companies can rely.

Anti-abuse rule for permanent establishments situated in third states

We understand that Contracting States may well take the view that treaty benefits should not be afforded to a company resident in the other Contracting State which operates through a branch in a third state to which the income is attributable and where the taxation of the profits of the branch benefit from some preferential treatment. But it will not always be the case that such circumstances represent treaty abuse. For example, if the state of source has an equivalent double-tax treaty with the state in which the permanent establishment is located, there would appear to be no relevant abuse.
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Dear Sirs,

BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances – Public Consultation

We refer to the Public discussion draft BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances published on 14 March 2014, on which public comments are expected by 9 April 2014.

1. It is with particular pleasure that we would like to bring to your attention our observations, comments and possible suggestions to the above-mentioned draft (the “Draft”). In the following paragraphs we would like to offer some general remarks on the Draft as well as our point of view on certain selected topics, such as the proposal to introduce a “limitation-on-benefits” clause (the “LOB Clause”), the “entitlement to benefits” clause and the anti-abuse rule for permanent establishments situated in low-tax jurisdictions.

A. General remarks

2. Considering that Action Plan 6 is aimed at developing model treaty provisions able to prevent the granting of treaty benefits in circumstances where abuse may be identified (and is not avoided by already existing rules and principles), we would like to underline that many treaty shopping situations and abusive schemes may already be tackled under some existing and well-elaborated concepts such as the “arm’s length principle” and “beneficial ownership”.

2.1. Both the authoritative statement of the arm’s length principle included in Article 9(1) of the Model and the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (paragraph 1.8) emphasise that the arm’s length principle “[...] avoids the creation of tax advantages or disadvantages that would otherwise distort the relative competitive positions of either type of entity” [emphasis added]. One could therefore already rely on such principle to govern situations where there are intercompany transactions having an “abusive feature”. In our view, this is also the case in some of the
examples provided by the Draft that could be simply solved through a strict application of such principle (i.e. example at paragraph 15 – discussed below in more detail) without the need to make recourse to new specific provisions.

2.2. In addition to the arm’s length principle, the beneficial ownership concept, together with its Commentary (see earlier specific reports)\(^1\) are able to protect in many cases the fair application of treaties and limit the uncontrolled granting of treaty benefits in inappropriate circumstances (i.e. examples such as those presented in the Draft at paragraphs 24 and 27 can be targeted by a strict application of the beneficial ownership concept with no need to introduce additional specific provisions).

3. In our view, the above considerations should not be ignored because, specifically, some of the provisions that are proposed by the Draft may have a dramatic impact on the application of tax treaties and, in certain instances, cause serious application issues and problems of compatibility with existing national and supranational law.

3.1. For instance, paragraph 18 of the Draft contains a proposed LOB Clause and a more general way to address treaty avoidance cases (through the “entitlement to benefits” clause, a s.c. GAAR), including treaty shopping situations not covered by the specific LOB Clause. The GAAR at stake is indicated as “article X, § 6” in the Draft and we will preliminarily offer in the following paragraphs some comments of a more general and systematic nature, leaving to paragraphs B. and C. below some more detailed and further comments.

3.2. Furthermore, neither the proposed rules nor the related Commentary (which will affect the interpretation and/or application of the provision) seem to consider the possible impact of the proposed provision on existing supranational rules and principles that bind several groups of member countries. This is for instance the case for EU law and, in particular, the impact of the case law of the Court of Justice of the European Union (“ECJ”) dealing with the definition of “abuse” in the field of direct taxation. According to established case law of the ECJ:

[A] national measure restricting freedom of establishment may be justified where it specifically targets wholly artificial arrangements designed to circumvent the legislation of the Member State concerned (see, to that effect, Case C 264/96 ICI [1998] ECR I 4695, paragraph 26; Marks & Spencer, paragraph 57; Cadbury Schweppes and Cadbury Schweppes Overseas, paragraph 51; and Test Claimants in the Thin Cap Group Litigation, paragraph 72).

The same principle has later been affirmed by the ECJ with regard to the free movement of capital in *Itelcar* (Case C-282/12) whereby the ECJ declared in paragraph 34 that:

According to settled case-law, a national measure restricting the free movement of capital may be justified where it specifically targets wholly artificial arrangements which do not reflect economic reality and the sole purpose of which is to avoid the tax normally payable on the profits generated by activities carried out on the national territory (see, to that effect, Case C524/04 Test Claimants in the Thin Cap Group Litigation [2007] ECR I 2107, paragraphs 72 and 74, and Case C182/08 Glaxo Wellcome [2009] ECR I 8591, paragraph 89).

3.3. The current version of the proposed LOB Clause and GAAR and of their commentary (once adopted in a tax treaty and applied/interpreted by an EU Member State) could raise issues of compatibility with EU law insofar as it involves the application of a treaty between EU Member States or between an EU Member State and a third State (with regard only to free movement of capital under Art. 63 of the Treaty on the Functioning of the European Union) (see, inter alia, Saint-Gobain, Gilly). To this regard and based on the general considerations offered above, we believe that particular attention should be given to the interaction between the GAAR drafted along the wording proposed in the Draft and existing supranational systems of law (such as EU law).

B. The limitation-on-benefits provision and the “derivative benefits” provision

4. The introduction of an LOB Clause is per se to be considered a rational and consistent way to equip double tax treaties with a mechanism preventing undesired treaty shopping conducts and thus, in most cases, abuse of treaty benefits. While we believe that such a clause, although being complex in its practical application, could significantly improve the application mechanism of the treaties and prevention of tax abuse (also based on the extensive and experienced application of such clause especially in US tax treaty practice), we wish to focus attention on the fact that in several circumstances the effect of a mechanical application of the limitation-on-benefits tests could lead to the paradoxical and unfair result that persons which are resident of a State are prevented from the entitlement of treaty benefits even if nothing in their conduct is addressed to obtain the benefits of the treaty as one of its principal purposes.

5. In this respect, the introduction of paragraph 4 within the proposed LOB Clause is crucial. Such provision would indeed give access to a competent authority’s evaluation of each single case to identify whether, even if in the absence of the condition to pass the tests encompassed in the LOB Clause, the treaty benefits could nonetheless be granted if it is determined that the conduct of such person did not have, as one of its principal purposes, the inappropriate achievement of benefits under the treaty. The provision as currently worded, however, would leave the affected person subject to the “broad discretion” of the competent authority of the State of source (only).

6. If so worded, such provision may risk to be ineffective since (a) the view of the competent authority of the State of source would likely be one-sided, thus exposing the person to the risk of a double taxation if the State of residence does
not then share the views of the State of source’s competent authority and (b) the absence of an obligation for the competent authority to arrive at a binding result could leave the affected person with an unresolved issue. On this basis, in our view, it is of the utmost importance that paragraph 4 be amended to allow that such competent authority analysis is dealt with under a mutual agreement in accordance with Article 25 of the OECD Model Tax Convention, i.e. with the involvement of the competent authority of the State of residence of the affected person and with the applicability of paragraph 5 of Article 25 (and therefore with the possibility to obtain certainty of an outcome of the competent authority’s analysis through the arbitration procedure). Clearly, by referring to paragraph 5, appropriate adjustments should be made in order to ensure that the procedure can be applied with particular respect to the specific cases covered by the LOB Clause and can be pursued by taxpayers also on an advance basis (and therefore even in the lack of the conditions contained under paragraph 5(a)).

7. Looking at the LOB Clause, as already mentioned above, it has been argued that such a provision could be seen as an infringement of EU law where it is included in double tax treaties in force between EU Member States. The infringement would regard particularly the ownership test provided for by the suggested LOB Clause, paragraph 2(e)(i), as the benefits of a treaty would be denied to a company resident of a Contracting State (assumed in a EU Member State), if controlled by persons resident in another EU Member State, and the base erosion test in paragraph 2(e)(ii), as certain payments to persons resident in other EU Member States could prevent from the application of a treaty where the same payments to a person resident of the same EU Member State would not suffer the same prejudice. Such issues are not entirely overcome by the above commented paragraph 4 of the LOB Clause and by paragraph 3 which, by extending the applicability of the treaty to cases where, in the absence of the tests laid down by paragraph 2, still requires the active conduct of a trade of business (expressly excluding, for instance, passive holding companies) which is not a concept coincident with the notion of “artificial arrangements” developed by the ECJ, which would be the only ground able to justify a limitation to fundamental freedoms.

8. In consideration of the above, the proposed introduction of a “derivative benefits” provision (paragraph 13 et seq.) is highly welcome, inter alia, to accomplish the need for EU Member States to mitigate the risk of infringement of EU law. It is, however, important to notice that the conditions laid down in such clause (95% of the shares in the hands of a maximum of seven persons) are narrower than those contained in the general ownership test under the LOB Clause (50% of the shares in the hands of an unlimited number of persons) and therefore they could still create a potential discriminatory effect within a EU context. In this respect, it might be advisable to consider an alignment between the two mentioned conditions.

9. Furthermore, the proposed wording of “equivalent beneficiaries” within such provision limits the treaty benefits applicability to cases where the shareholders would be entitled to a tax rate with respect to particular class of income at least as low as the tax rate applicable under the Convention at stake; this only if such rate derives from the Convention in force between their equivalent beneficiary State of residence and the source State. There may be instances, however, where the application of a tax rate lower than the tax rate provided by the Convention at stake is provided by the source State domestic law or other international
arrangements (such as, within the EU, directives). In the light of the above it is appropriate to broaden the wording of the definition of “equivalent beneficiaries” to catch also such cases.

10. As regards the example depicted at paragraph 15 of the Draft and concerning the possible base erosion risk deriving from the application of a “derivative benefits” provision in relation to a company established in a low-tax jurisdiction, we notice that the concern expressed in the Draft seems to provide for a penalization of the base erosion in State T (where the IP was originally formed and then delocalized) through the denial of the treaty benefits in the relationships between State S and State R. This concern seems to entail that the LOB Clause and the other anti-abuse provisions contemplated in the Draft target any base erosion effect, even if the base erosion is realised in a State that is not the State which denies the treaty benefits. We would also like to underline that the Draft concerns should be adequately addressed by other treaty provisions or State T domestic rules, such as the arm’s length principle that should provide for an adequate remuneration for State T at the moment of the delocalization of the IP and CFC rules that should allow State T to retain its taxing powers also on (passive) income realised by Opco2 and subject to a low tax regime.

C. The GAAR

11. As anticipated above referring to the opportunity to introduce a GAAR along the lines of the “entitlement to benefits” clause proposed in the Draft, we would like to offer below some more detailed comments. On this regard, we suggest the following comments articulated as possible amendments to the clause and clarifications to the suggested Commentary.

12. With reference to the expression used in the clause, and namely “directly or indirectly”, our suggestion is to eliminate it and to add, next to the subsequent expression “any arrangement or transaction”, the expression “or series of arrangements or transactions”. Such amendments will clarify that the abuse of the treaty may also be the result of the combination of two or of even more transactions or arrangements none of which has the effect of directly gaining a treaty benefit but whose combination leads to such a result.

13. Another amendment to the clause at stake which we believe may increase its effectiveness and clarity is to replace the term “one or the main purposes” with either the term “sole purpose” or “essential purpose”. This will clarify that an arrangement is deemed to be treaty abusive only inasmuch it can only be reasonably explained by a benefit that arises as a result of the treaty application. In our view, this amendment is necessary in order to avoid that a transaction which is fully grounded on sound business reasons could trigger the application of the proposed rule solely because the transaction incidentally allows the achievement of tax advantages or benefits that are significant. In addition, this proposed amendment would align the proposed GAAR with the statement contained in the Draft at paragraph 29, last period, whereby it is affirmed the following “[w]here, however, an arrangement can only be reasonably explained by a benefit that arise under a treaty, it may be concluded that one of the main purposes of that arrangement was to obtain the benefit.”

14. Following to the amendments suggested above the “entitlement to benefits” clause would read as follows:
6. Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was the sole purpose of the arrangement or transaction or series of arrangements or transactions that resulted in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.

15. We believe as well that it should be further clarified that, even in case the tax benefits outweigh the benefits of other nature, a transaction should not trigger the application of the proposed “entitlement to benefits” clause (article X(6)) if it is not artificial and/or is grounded on sound business reasons. This line of interpretation (i) is consistent with the concept of “abuse” as clarified by the ECJ case law (see paragraph 3.2. above) and (ii) contributes to clarify the thin dividing line between abusive and non-abusive transactions.

16. In particular, by analysing paragraph 33 of the Draft, we believe that the difference between Examples A-B, on the one hand, and Examples C-D, on the other, lies on the fact that Examples A-B deal with purely artificial arrangements not grounded on any economic or commercial reasons, whereby Examples C-D deal with arrangements or transactions that, although imply the achievement of a tax benefit or advantages, are not artificial. As already anticipated at paragraphs 2 and 2.2. above, it would be helpful to clarify that some of the transactions which are deemed to be abusive under the proposed GAAR are already tackled under the beneficial ownership clause (this would be the case of the examples addressed in paragraphs 24 and 27 of the Draft).

17. Moreover, it would be helpful to clarify as well that the proposed GAAR does not preclude the transactions involved from being redefined or requalified under possible domestic anti-abuse rules; in particular, where a benefit under such GAAR is denied, nothing would prevent the above-mentioned domestic rules to redetermine the tax benefits as if the abusive transaction had never occurred.

D. Amendments to the tiebreaker rule on tax residence

18. The Draft, at paragraphs 50 to 53, underlines the need to adjust the current tiebreaker rule for determining the treaty residence of dual-resident persons other than individuals. In particular, the Draft recommends the introduction of the suggested clause already present and explained in the Commentary to Article 4, of the OECD Model Convention, paragraphs 24 and 24.1 (as updated in 2008), which would amend the present clause of the Model Convention.

19. We agree in principle to the adoption of such clause, but we believe that the Mutual Agreement Procedure referred to by the proposed amendment to Article 4(3) seems to address only cases when the tax authorities of a Contracting State have tackled the residence status of a person other than an individual under the application of the Convention. We believe that one should be left with the possibility of a preliminary ruling between the competent authorities aimed at avoiding situations of uncertainty and at defining the potential consequences of
dual-residence cases. Such provision would prevent disputes with the tax authorities and the granting of treaty benefits in inappropriate circumstances.

20. The suggested amendment to Article 4(3), by introducing the Mutual Agreement Procedure, does not alone entail the obligation of the competent authorities to find a remedy to resolve situations of double residence of a person other than an individual. To be effective it necessarily needs a Mutual Agreement Procedure clause drafted along the wording as amended in 2008; in particular, also in this case, reference should be made to Article 25(5) whereby a mandatory arbitration phase applies in case the mutual agreement between the competent authorities of the two Contracting States is not reached within two years; the unresolved issues will, at the request of the person who presented the case, be resolved through an arbitration process. This process should not be dependent on a prior authorization by the competent authorities: once the requisite procedural requirements have been met, the unresolved issues that prevent the conclusion of a mutual agreement must be submitted to arbitration. A Mutual Agreement Procedure as it has been designed in the past (and as it is implemented in the majority of the treaties in force at present), only based on a duty of diligence, which required the competent authorities concerned to “endeavour” to reach an agreement would not be a satisfactory solution.

21. The arbitration clause mentioned above should be applicable also in case of advance discussion of dual residence cases (i.e. before a case of double taxation has arisen). Such clause has hence to be regarded as an extension of the Mutual Agreement Procedure that serves to enhance the effectiveness of that procedure by ensuring that where the competent authorities cannot reach an agreement for the resolution of a dual-residence case, the issue will be submitted to arbitration. In conclusion, even if the suggestions of the Draft are most welcome we must consider that those amendments can be effective only on newly drafted and enforced treaties that will include not only the clause proposed at paragraph 53 of the Draft but also the above-mentioned arbitration clause in Article 25 of the Model Convention.

E. Anti-abuse issues for permanent establishments situated in third States

22. The Draft underlines the issues existing when income paid or derived in a Contracting State (hereinafter “State of Source”) by a resident of the other Contracting State (“State of Residence”) is (i) attributed to a permanent establishment of the recipient located in a third State (“Third State”) which provides for a low or nil taxation of the income concerned (being a low-tax jurisdiction) and (ii) the State of Residence exempts the income attributable to the permanent establishment located in the Third State. The Commentary already spotted those abusive cases clearly commenting on them through specific paragraphs inserted in the Commentary to Articles 10, 11 and 12 of the Model Convention. In addition thereto, the Draft, in order to avoid the granting of treaty benefits in the above mentioned cases, proposes to add in Article 1(4) of the Model Convention with the purpose of introducing a specific anti-abuse clause.

23. The clause at stake proposes a comparison between (i) the effective tax rate applicable on the income received and attributed to the permanent establishment in the Third State (calculated as the aggregate taxation of the State of Residence and Third State – using the expression “combined aggregate effective tax rate”) and (ii) the “general” tax rate applicable at the level of the head office (in the
State of Residence) should there be no attribution of the income to the permanent establishment in the Third State. We believe that the wording used in the clause is somehow misleading especially with reference to the second item of the comparison, namely the “general rate of company tax” applicable in the State of Residence. From the way the provision is worded we understand that this term of the comparison refers to the nominal tax rate applicable in the State of Residence, but in such event there would be an inconsistent analysis between the effective rate (on the one side) and the “general rate” (on the other side). Should the meaning be different, we strongly suggest then to clarify the intended meaning in the Commentary in order to reduce ambiguities in the interpretation of the provision.

24. In our view, the expression used in the clause, “of the general rate of company tax applicable in the first mentioned Contracting State”, should be replaced with the following wording: “[O]f the effective company tax rate applicable in the first mentioned Contracting State”, which would be more precise and technical than the one suggested in the Draft. We are of the opinion that the comparison should be made between two effective tax rates in order to preserve fairness and objectivity.

25. The proposed clause, at letter a) and b), correctly protects from the effects of the anti-abuse provision two specific situations that may not be deemed abusive: (i) the first refers to income received for the use of, or the right to use, intangible property “produced and developed” by the enterprise through the permanent establishment and (ii) the second refers to any other income deriving from the permanent establishment State in connection with, “or is incidental to”, the active conduct of a trade or business.

26. The exception under (i) above regarding the genuine allocation of intangibles in the permanent establishment State (which may apply, for example, a s.c. patent-box regime) with a fair requirement of active management and development is very welcome also in consideration of the current trend of introducing specific IP regimes by many countries. Nonetheless, one point of uncertainty is represented by the strict requirement of the intangibles being “produced and developed” through the permanent establishment. The expression seems easily applicable to those intangibles whose creation requires a specific and active R&D to be carried out through the permanent establishment, thus presuming an active investment in assets and other resources in order to create and possibly further develop the intangibles.

26.1. The “production and development” requirement, however, might not be applicable to other categories of intangibles like trademarks, domain names, trade secrets, and marketing intangibles more in general etc. for which the activity to maintain intact their values, could not take the strict form of “production or development” but more the form of ongoing maintenance and protection. A supplementary specification on those cases will be of utmost importance in order to understand the scope of application of the clause. Moreover, the provision seems to neglect pre-existing intangibles transferred from the head office (or other entities) to the permanent establishment or intangibles the permanent establishment economically owns in the sense developed in the Attribution of Profit to Permanent Establishments (2010) report, even if the activities may be performed elsewhere. On this particular point, a further explanation would also be welcome.
27. As per the exception (ii) indicated at paragraph 25 above, the main comment refers to the expression “or is incidental to”. We believe that if this particular expression is not given a wider or a different meaning (in which case a further and clear explanation would be strongly required) with respect to the other words “in connection with”, the clause should be read as follows: “the income derived in connection with, or is incidental to, the active conduct of a trade or business carried on in the third State through the permanent establishment […]” Finally, on exception (ii) we suggest to consider the insertion of a specific commentary on the meaning of “active conduct of a trade or business” also in connection with the definition of the word “business” under art. 3(1)(h) of the Model Convention.

28. With precise reference to the permanent establishment issues underlined in the Draft and here briefly commented, we would appreciate and consider useful, for the sake of clarity and coherence, whether it would be analysed and possibly clarified that the above-mentioned clause, and in particular paragraphs a) and b), should be interpreted on the basis of the principles laid down in the previous report titled *The Attribution of Profit to Permanent Establishments (2010)*, especially with reference to the sections regarding the intangibles (namely paragraphs 76-97).

**F. Double non-taxation**

29. In conclusion we would like to express our appreciation for the suggested amendments to the title and preamble of the Convention. We share the view that those changes will create a different interpretative context around the Convention by making crystal clear to the interpreter, at any time and in any situation, that the intentions of the Contracting States is not only to avoid double taxation but to prevent tax evasion and avoidance.

Yours sincerely,

Maisto e Associati
9 April 2014

Dear Sirs

Discussion draft on Action 6 (Prevent Treaty Abuse) of the BEPS Action Plan

We wish to make a submission with respect to the public discussion draft on BEPS Action Plan 6 (the “Discussion Draft”).

Matheson is an Irish law firm and our primary focus is on serving the Irish legal and tax needs of Irish and international companies and financial institutions doing business in Ireland. Our clients include over half of the Fortune 100 companies. We also advise 7 of the top 10 global technology companies and over half of the world’s 50 largest banks. We are headquartered in Dublin and also have offices in London, New York and Palo Alto. More than 600 people work across our four offices, including 75 partners and tax principals and over 350 legal and tax professionals.

1 Executive summary

The main points of our submission are as follows:

• In our view, the proposed limitation of benefits clause should not be adopted, as it creates bias in favour of larger jurisdictions. Jurisdictions with smaller economies which are reliant on a broad-based investor profile would be disadvantaged. The proposal would also create complexity and uncertainty and is in conflict with the fundamental freedoms of the European Union.

• If a limitation of benefits clause is retained, it must be refined fundamentally. Such a clause must contain a derivative benefits clause and the reference to ‘recognised stock exchanges’ must be expanded to include all recognised OECD stock exchanges.
The tax residency tie-breaker test for dual tax residency should retain an objective measure by which taxpayers can determine their tax residency position and which would underpin a mutual agreement procedure.

The proposed limitation of benefits provision should not apply to collective investment vehicles. Instead, the approach adopted by the OECD in its 2010 report on collective investment vehicles should be applied and retained.

The proposed limitation of benefits provision should not apply to securitisation companies. Cross-border securitisations are an important part of the financial system, which would be materially impeded by an application of the proposed limitations of benefits provision.

2 General comments on the limitation of benefits provision

We understand and agree with the intent of the OECD to target the abuse of double taxation agreements. Proposals to counter such abuse should be clear, consistently applied and should not inadvertently impede genuine substantive commercial arrangements. With this objective in mind, we would make the following points:

2.1 We agree with the proposal to introduce an anti-abuse provision into the Model Convention as this mechanism should provide the flexibility to counter treaty abuse in a targeted manner.

2.2 In our view, the proposed limitation of benefits provision should not be adopted. There are at least three reasons for this conclusion:

2.2.1 The limitation of benefits provision is a mechanism which is inherently biased in favour of larger jurisdictions and furthermore is biased against jurisdictions with smaller economies which are more reliant on a broad-based investor profile. This is because limitation of benefits clauses automatically grant treaty access where the majority of investors are same-country investors, but imposes much more restrictive conditions for smaller economies, which inevitably have a smaller domestic capital base with local businesses looking to raise capital from non-local investors.

2.2.2 The proposed limitations of benefits provision would also introduce significant complexity and uncertainty into cross-border dealings. This is because many of the concepts in the limitations of benefits provision are subjective in nature. For example, it will require a subjective determination to conclude whether a company has an ‘active trade or business’. It will also require a subjective determination to conclude where a company’s primary place of management and control resides, in cases where management functions are split between different jurisdictions, which is commonly the case. These uncertainties will likely lead to an increase in competent authority cases, tying up resources of both taxpayers and tax authorities.
2.2.3 Finally, in our opinion, the proposed limitation of benefits provision is in conflict with the principles on which the EU is founded. In particular, it cuts across the freedom of establishment, the freedom of capital, and the freedom of services.

Therefore, in our view, the limitations of benefits provision should not be adopted. Instead, the OECD should focus on the introduction of a general anti-avoidance rule, together with certain targeted anti-avoidance rules.

2.3 Should a decision be made to progress with the inclusion of a limitation on benefits provision in the Model Convention, we would have the following comments:

2.3.1 A derivative benefits provision must be included. The policy reasons in favour of introducing such a provision strongly outweigh any perceived potential for abuse. In particular, if all the investors in a company are entitled to the same degree of treaty benefits, the company itself should not be denied such access. Furthermore, there seems to be no policy or logical basis to restricting the derivative benefits provision to ‘seven or fewer’ persons. For example, if a company is owned by 20 investors, all of whom are entitled to the same degree of treaty benefits, why should the company itself be denied access? In our view, there should be no numerical limitation on such a derivatives benefit provision. It is important to note, in this regard, that a derivative benefits provision is particularly important to small open economies, to ensure that intermediate group companies should not be prevented from claiming treaty benefits, where the parent company is itself entitled to treaty benefits.

2.3.2 Active trading of shares on any recognised stock exchange in the OECD/G20 (and not just exchanges in the home country of the relevant company) should always satisfy paragraph 2(c)(A) of the limitations of benefits provision. Any restriction to stock exchanges located in the home jurisdiction will create a strong and unjustified bias in favour of larger jurisdictions with well-developed stock exchanges. There is no policy reason whatsoever to discriminate against companies resident in smaller economies who chose (for entirely reasonable commercial reasons) to raise capital by listing their shares on the larger and more liquid stock exchange of another jurisdiction. Any such listing (irrespective of which stock exchange is used) indicates clearly that treaty-shopping is not a concern for the relevant company.

2.3.3 The ‘active trade or business’ test at paragraph 3(b) of the limitation of benefits provision will be difficult, in most cases, to apply. In particular, it will prove challenging to determine whether the business conducted by one company is “substantial” in comparison to the business conducted by another company, where the functions and businesses of those companies are different, though complementary. Consequently, strong, clear and comprehensive commentary will be required in respect of this provision to ensure consistency in
interpretation. This commentary should provide detailed examples that deal with situations that are most likely to cause differences in interpretation between Contracting States.

2.3.4 Furthermore, the ‘active trade or business’ test should be amended to include that the active management of investments and subsidiaries would qualify as an active trade or business. Multinational groups frequently have intermediate companies in their corporate structure, for various commercial reasons including centralising risk management, granting security over certain assets, regulatory requirements, centralising regional operations, and as a result of the acquisition of new groups / companies. The management of such investments can be an ‘active business’ in itself in many cases. The proposed limitation of benefits clause should recognise this, and permit treaty access in such situations where sufficiently active business functions are being carried on with respect to such investment management operations.

2.3.5 Reference also needs to be made in the limitation of benefits provision to non-corporate entities which are ‘persons’ for treaty purposes. For example, unit trusts are generally treated as ‘persons’ for treaty purposes, and can have their units traded on stock exchanges, and have their units owned by multiple investors. Consequently, paragraphs 2(d), 2(e) and 5 need to make reference to such non-corporate entities, and their units.

2.3.6 The reference in paragraph 2(e)(i) to “persons who are residents of that Contracting State” should be expanded to refer to persons who are resident of either Contracting State. This appears to be a logical and fair amendment, and reflects the approach adopted in the subsequent sub-paragraph 2(e)(ii).

2.3.7 The limitation of benefits provision should be limited to arrangements between associated persons, which is the focus of the BEPS project, and should not apply to dealings between independent persons. A general anti-avoidance rule, together with certain targeted anti-avoidance rules, can deal with any perceived tax avoidance arising with respect to dealings between independent parties.

2.4 The proposal to have competent authorities agree on where a dual-resident taxpayer is resident for the purposes of the relevant double taxation agreement is positive. However, as the resources of competent authorities are increasingly being stretched, this may potentially result in lengthy periods during which taxpayers will not have certainty of tax residency pending completion of the mutual agreement procedure process. An objective tie-breaker test on a company’s residence should be retained (for example, the effective place of management test), together with detailed commentary on the factors and criteria that will be considered by the tax authorities in determining tax residence. Competent authorities should commit to agreeing on dual-residence requests within a specified short period of time, with appropriate arbitration provisions.
2.5 The proposed burden of proof for the general anti-avoidance rule, namely one of “reasonable to conclude”, is much too low. It would result in too much uncertainty in the application of this paragraph 6 and would leave taxpayers in an unfairly weak position. We would note, in this regard, that tax considerations will always feature in international dealings and investments. However, for this general anti-avoidance rule to apply, it should be clear that, on the balance of probabilities, one of the main purposes of a particular transaction was to achieve a treaty benefit. We would therefore submit that such term be removed from paragraph 6, so that it would be applicable where “having regard to all the relevant facts and circumstances, one of the main purposes of any arrangement or transaction was obtaining that benefit …”.

3 Collective investment vehicles and the limitations of benefits provision

The proposal to introduce a limitation of benefits provision into tax treaties, as currently drafted, would have a significant (and we believe unintended) detrimental effect on collective investment vehicles (“CIVs”). For these purposes, CIVs mean collective investment vehicles which are widely-held, hold a diversified portfolio of securities and are subject to investor-protection regulation in the country in which they are established.

In this regard, we would note the following points:

3.1 The question of how treaty benefits should apply to CIVs has recently been the subject of thorough OECD studies and in-depth reports, including reports of the Informal Consultative Group on the Taxation of Collective Investment Vehicles and Procedures for Tax Relief for Cross-Border Investors published in 2009, and the report adopted by the OECD Committee on Fiscal Affairs in 2010 entitled “The granting of treaty benefits with respect to the income of collective investment vehicles” (the “2010 Report”). This 2010 Report came to the general conclusion that CIVs should be entitled to the benefits of treaties, on their own behalf, and suggested specific provisions which member states may wish to include in their tax treaties to deal with any avoidance concerns.

3.2 We agree with the conclusions of the 2010 Report. It is entirely appropriate that CIVs should be granted treaty benefits. By their nature as regulated investment vehicles designed to promote collective investment, CIVs are not aimed at treaty shopping.

3.3 Consequently, the approach recommended by the OECD in the 2010 Report should continue to be the approach for CIVs, instead of the application of the proposed limitations of benefits provision.

3.4 Our concerns are focused, in particular, on the impact of the proposed limitation of benefits provision on cross-border CIVs, that is CIVs whose units interests, or shares are distributed on a cross-border basis. Unlike domestically-distributed CIVs, cross-border CIVs (by their nature) will not have a majority of investors resident in the jurisdiction of residence of the CIV itself. This was acknowledged in the 2010 Report which stated:

“The global CIV market is one in which the CIV and a significant portion of its investors are located in different countries. The global
CIV can be much more efficient – it can benefit from the economies of scale described above to a greater extent than smaller CIVs."

The 2010 Report highlighted the importance of cross-border CIVs, it explained:

"International diversification of investment portfolios is becoming more significant. For example, over 25% of all equity assets held by US CIVs are issued by non-US companies. About 30% of the assets of UK CIVs are invested outside the United Kingdom. More than one-third of the assets of Japanese CIVs are foreign securities. Assets of Luxembourg, Swiss and Irish funds are predominantly invested outside of their home market. As more investments are made cross-border, the issue of CIVs’ qualification for treaty benefits is becoming increasingly important."

As cross-border CIVs (by their nature) will generally not have a majority of investors resident in the jurisdiction of residence of the CIV itself, paragraph 2(e)(i) of the proposed limitation of benefits provision will almost never be capable of being satisfied by a CIV. Nor would the ‘derivatives benefits’ provision (as currently drafted) offer any benefit, as CIVs (by their nature) will generally have far more than seven investors.

3.5 Cross-border CIVs are good for the financial market and the stability and efficiency of the financial sector. Cross-border CIVs have been promoted both by regulators and law-makers over the past 30 years. As explained in the 2010 Report:

"regulators see the benefits of a smaller number of larger CIVs, and regulatory changes, such as the UCITS Directive within the European Union, are designed to encourage global business."

The EU has sought since 1985, through legislation on undertakings for collective investment in transferable securities ("UCITS"), to incentivise the establishment of cross-border funds. One of the key aims of the recent UCITS IV directive was to enable UCITS located in one EU member state to be managed, distributed and administered by a management company located in another EU member state. The UCITS IV directive contained various provisions to enhance efficiencies in cross-border investment, including the introduction of a management company passport, a master-feeder structure and cross-border merger provisions. Similarly, the Alternative Investment Fund Managers Directive ("AIFMD") promotes cross-border investments. Although AIFMD is focused on regulating alternative fund managers rather than the funds themselves, it encourages cross-border fund distribution by facilitating the marketing of alternative investment funds to professional advisors across the EU.

3.6 Cross-border CIVs, in general, and both the UCITS and AIFMD regimes, in particular, will be materially and unjustifiably undermined, should a limitations of benefits provision be applied to CIVs. As cross-border CIVs would generally be unable to satisfy a limitations of benefits provision and would thus suffer
additional costs (eg, withholding taxes) on their investments, investors will be incentivised to move their investments to CIVs which can (potentially) satisfy the limitation of benefits provision, namely domestically-distributed CIVs which are resident in their own jurisdiction. Consequently, there would be a real financial incentive tending towards the segmentation of the CIV market, with domestically-distributed CIVs having a real commercial advantage of cross-border CIVs. We presume that it cannot be the OECD’s intention to segment the CIV marketplace in this way.

3.7 In addition to these concerns in respect of cross-border CIVs, an additional general concern arises in respect of all CIVs. This relates to the intermediated-nature of the CIVs. The vast majority of investments in CIVs are made through intermediaries such as securities firms, banks, insurance companies and independent financial advisers. This system allows for greater efficiencies as intermediaries aggregate their customers’ daily transactions and effect a single net purchase or a net sale each day in a nominee account held by the intermediary on behalf of all of its customers. As a result, it is common for CIVs to have layers of intermediaries between itself and its customers. In many cases, these intermediaries are not located in the country in which the investor is located. The result is that many CIVs (both domestically-distributed and internationally-distributed) will not know who their investors are. Consequently, the CIVs will generally not (in practice) be in a position to confirm whether or not their investors satisfy the requirements of paragraph 2(e) of the limitation of benefits provision. It should be noted, in this regard, that CIVs are subject to the FATCA regime, and that the FATCA regime has accepted that it is entirely appropriate for CIVs to rely on the intermediated distribution process (so that the CIVs are not obliged to identify their ultimate investors for FATCA purposes).

We would therefore submit that CIVs should not be required to satisfy a limitation of benefit provision in order to obtain treaty access. Instead, the approach described in the 2010 Report should be applied with respect to CIVs.

4 Securitisation companies and the limitations of benefits provision

The proposal to introduce a limitations of benefits clause into tax treaties, as currently drafted, would also have a significant (and we believe unintended) detrimental effect on securitisation companies involved in cross-border securitisation transactions.

In this regard, we would note the following points:

4.1 Securitisation is a key element of the international financial markets, and offers a channel for borrowers to directly access capital markets. Residential and commercial mortgages, auto loans, trade receivables and bank lending are all funded, to a material degree, by securitisation.

4.2 The importance of securitisation has been recognised by global regulators:

“[the International Organisation for Securities Commissions] believes that securitisation markets can play a role in supporting economic growth ... Securitisation markets potentially [make] bank lending less...”
sensitive to abrupt changes to the cost of funds, ultimately affecting the availability of finance to economic growth. For that reason, access to these funding sources may be important to those economies experiencing slow growth.”

“The ECB welcomes the [PCS] initiative, which aims at increasing the attractiveness of asset-backed securities among investors and originating banks. A well-functioning ABS market in the EU would allow investors to diversify their investments and ... thereby contribute to a smooth financing of the real economy”

“I would like to reaffirm that for the [EU] Commission securitisation is considered as an efficient mechanism to increase the credit availability and lower the cost of credit in line with the G20's November 2010 report that noted that “re-establishing securitisation on a sound basis remains a priority in order to support provision of credit to the real economy and improve banks’ access to funding in many jurisdictions.” Furthermore, there is no question that it is in the private and public sector interest to reactivate securitisation markets”

4.3 In the European market, it is frequently necessary to carry out securitisations on a cross-border basis. For example, a bank may wish to securitise loans which it has made in a number of jurisdictions or a multi-national company may wish to raise finance by securitising its trade receivables owing from customers in a number of jurisdictions. In these instances, a single securitisation company is established in one (typically EU) jurisdiction, to acquire the relevant financial assets (eg, the loans or receivables) owing from obligors resident in a number of different jurisdictions.

4.4 In such securitisations, the securitisation company will typically look to make sure that it has access to double tax treaties. This is to ensure that no withholding taxes will apply to income streams earned by the securitisation company.

4.5 Cross-border securitisation companies share two similarities to CIVs. First, investors in cross-border securitisation companies are international in nature; they are not normally limited to investors resident in the jurisdiction of the securitisation company. Second, the securitisation company will not, in most cases, know the identity of its investors; in the main, this is due to the fact that investors hold their investments in securitisation companies through clearing systems such as Euroclear, Clearstream and the Depository Trust Company of New York. For example, the investors in a securitisation of trade receivables originated by a European multinational company may invest by way of commercial paper or medium term notes, issued by the securitisation company, which are held in Euroclear.

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1 IOSCO, Final Report on “Global Developments in Securitisation Regulation”, November 2012
2 Mario Draghi, President of the European Central Bank in a letter to the European Financial Services Round Table supporting the PCS Initiative, June 2012
3 Emil Paulis, European Commission, speaking at AFME’s Funding Conference in Madrid, November 2011
4.6 As a result, cross-border securitisation companies will not be in a position to satisfy the proposed limitation of benefits provision. They will generally not know who their investors are, and (even if they do) those investors will in the main not be resident in the jurisdiction of residence of the securitisation company.

4.7 Like CIVs, cross-border securitisation companies are good for the financial market and the stability and efficiency of the financial sector. Cross-border securitisation companies are being promoted by both regulators and central banks, especially within the European Union. Mario Dragi recently said “We think that a revitalisation of a certain type of [asset-backed security], a so-called plain vanilla [asset-backed security], capable of packaging together loans, bank loans, capable of being rated, priced and traded, would be a very important instrument for revitalising credit flows and for our own monetary policy” (our emphasis). This revitalisation can only happen on a cross-border basis.

4.8 It is therefore critical that securitisation companies are not prevented from accessing the benefits of tax treaties by reason of the imposition of a limitation of benefits provision. Securitisation companies should, instead, be subject to the general requirements of being a ‘resident’ of a contracting state, being ‘liable (or subject) to tax’ in that contracting state, and of being the ‘beneficial owner’ of the income or gains earned. If a securitisation company satisfies these requirements, then it should generally be entitled to treaty benefits. It should not also be required to apply a limitations of benefits provision, which it would inevitably fail to satisfy. If a particular state has a concern about potential avoidance situations, the solutions outlined in the 2010 Report for CIVs could equally be applied to securitisation companies. Therefore, we would therefore submit that securitisation companies should not be required to satisfy a limitation of benefit provision in order to obtain treaty access. Instead, an approach similar to that described in the 2010 Report for CIVs should be applied with respect to securitisation companies.

5 European Union law and the limitations of benefits provision

We understand that the rationale for introducing a limitation of benefits clause is to provide objective rules to identify clear situations that should not qualify for treaty benefits. We have concerns that a limitation of benefits provision goes beyond what is required to tackle treaty abuse and can capture genuine commercial structures. In particular, the limitation of benefits provision potentially impacts on certain of the EU fundamental freedoms, including a company’s freedom of establishment, the freedom of stock exchanges to provide services to companies located in other EU Member States and the free movement of capital. For example:

(a) a company resident in one member state of the European Union could be denied access to tax treaties (even assuming the ‘derivative benefits’ provision is included) if that company was owned by ten investors resident in other EU member states; and
(b) a listed company resident in one member state of the European Union could be denied access to tax treaties if that company’s places of management and control were divided between a number of different EU member states.

Whilst it might be said that the provision for an ‘active conduct of a trade or business’ in paragraph 3(a) of the limitation of benefits provision would sometimes permit treaty access in such situations, in our experience this can be a very subjective and uncertain test. Treaty access can vary from year to year depending on the level of commercial activity being carried out in the relevant company. Furthermore, different tax authorities will take different views as to what constitutes an ‘active’ trade or business, and different requirements of substance will likely be required by different tax authorities.

The EU fundamental freedoms can be limited in certain circumstances, however, the ECJ in the Cadbury Schweppes decision of 2004 made it clear that anti-abuse provisions could only target the creation of “wholly artificial arrangements” by incorporating a company in another EU Member State “only for tax reasons, without any business purpose or substance over form, thus lacking of an economic reality”.

Given the complex nature of the limitation of benefits provision and the potential for conflict with EU laws, we believe that the limitation of benefits clause should not be included and the focus in targeting double tax treaty abuse should be on developing the general and targeted anti-abuse provisions, and related commentary.

Yours faithfully

Sent by email, bears no signature

MATHESON
MEDEF’s comments on the OECD discussion draft on BEPS action 6: Preventing the granting of treaty benefits in inappropriate circumstances

Dear Pascal,

MEDEF is pleased to respond to the OECD request to send comments on the Discussion Draft on preventing the granting of treaty benefits in inappropriate circumstances issued on the 14th of March (hereafter “the draft”).

We welcome the work that has been undertaken by the OECD and the opportunity given to the business community to comment although the tight timeframe makes it challenging.

As mentioned in the draft, the objective is to rewrite both the OECD model tax convention and the commentary to tackle treaty abuse which is considered to be “one of the most important sources of BEPS concerns”.

1. We understand the necessity to deny the granting of treaty benefits for artificial schemes or offending transactions. However, as business representatives, we pay particular attention to the maintaining of the removal of double taxation and the promotion of cross-border flows and
exchanges through tax treaties. Tax treaties are concluded with the principal purpose of promoting exchange of goods and services, and the movement of resources (capital resources as well as persons) by eliminating international double taxation.

MEDEF is concerned that the draft might lose sight of this overarching goal.

2. Indeed, given the multiplicity of the anti-abuse rules proposed in the draft we fear that the OECD model appears more as a convention creating a new tax base, either by depriving a contracting State of its possibility to voluntarily exempt an income or by preventing bona fide commercial transactions to benefit from double tax relief. We wish to emphasise that the basis of levy of tax remains the domestic law, which is merely limited by tax treaties to the extent of scope of taxation. The right to levy taxes shall not be transferred to bilateral agreements.

MEDEF would therefore recommend the draft to focus on real abuses in order to maintain the interest for taxpayers and international trade to use tax treaties.

3. Besides, we do not support the three pronged approach (LOB, GAAR and SAARs) which compiles existing regulations and does not seem efficient to target real abuses. If it was to be maintained, it would significantly reduce the applicability of tax treaties.

MEDEF urges the OECD to choose only one appropriate mechanism to target artificial situations.

4. Moreover, the notion of abuse as described in the draft is unclear to us, especially when mentioning the obtaining of a more favourable tax treatment as one of the main purposes. It is a generally accepted principle that taxable persons are free to choose the organisational structures and the form of transactions which they consider to be most appropriate for their economic activities and for the purposes of limiting their tax burdens (RBS Deutschland C-277/09 § 53).

When different alternatives are offered to a taxpayer, it may choose to structure its business so as to limit its tax liability (Halifax C-255/02 § n°73) and it falls under sound financial management and cost-efficiency strategy to take the least costly legal option. States, even within the context of bilateral negotiation, retain the power to design their tax system according to their priorities, economic needs and competitiveness. Taking advantage of tax benefits explicitly and legally provided by a State other than its state of residence cannot be condemned and considered per se as an abuse (Barbier C-364/01 § 71) except in case of wholly artificial arrangements which do not reflect economic reality and are set up with the sole aim of obtaining a tax advantage (Tanoarch C-504/10 §51). Any other option would affect the freedom of entrepreneurs and expose them to an unacceptable risk of arbitrary.

It should be made clear that tax avoidance refers specifically to wholly artificial arrangements which do not reflect economic reality and are set up with the sole aim of obtaining a tax advantage contrary to the aim of the double tax treaties.

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1 Except otherwise mentioned, the cases laws refer to ECI rulings
MEDEF advocates a clearer and more specific definition of abuse (i.e. “wholly artificial arrangement” with lack of substance as described in Cadbury Schweppes case law).

5. MEDEF finally would like to insist on the necessity to promote BEPS Action 14 “make dispute resolution more effective” to ensure dispute resolution is always available and provides for a mandatory remedy to double taxation issues within acceptable timeframe.

We hope our contribution will give you a clearer insight into our expectations. We remain at your disposal to interact on any of the above issues and will also be pleased to answer any questions you may have regarding these comments.

Yours sincerely,

Vanessa de Saint-Blanquat
General comments

The draft provides for three different layers of anti-avoidance rules, in addition to the already existing “beneficial owner” clause, to be included in the tax treaties: Limitation of benefit (“LOB”), General Anti-Avoidance Rule (“GAAR”) and Specific Anti-Avoidance Rules (“SAARs”). This contradicts the result business legitimately expected from BEPS Action 6 to provide a clearer, simpler and more secure environment for bilateral trade.

According to the Action Plan on Base Erosion and Profit Shifting, the purpose of Action 6 is to “develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances”. During the meeting held on 1st October 2013 between the OECD and the BIAC, businesses stressed that the OECD works should target arrangements or operations with no substance and propose specific anti-abuse rules. In this respect, one can only note that there is no attempt in the draft to identify the “inappropriate circumstances”.

The three-pronged approach illustrates this initial flaw since, instead of designing anti-abuse rules that would address “inappropriate circumstances”, the draft suggests to insert in tax treaties (1) a provision which aims at allowing a country to apply its domestic anti-abuse rules, (2) a new article “Entitlement to Benefits” which would contain both a LOB provision and a GAAR and (3) SAARs.

Multiplying anti-abuse rules raises several questions, neither answered nor addressed in the draft even if a possible conflict between these rules is implicitly acknowledged in paragraph 6: “Although a domestic general anti-abuse rule could prevent the granting of treaty benefits in these cases [case where a person tries to circumvent limitations provided by the treaty itself, a more direct approach involves the drafting of anti-abuse rules to be included in treaties”.

Those questions are:

- How are these conventional anti-avoidance rules supposed to coordinate with the variety of domestic anti-abuse rules? Which one should prevail? Will not they be redundant? Some countries, for instance, France, Australia, New Zealand, and US already have general anti-avoidance rules in their domestic legislations which, based on the proposed modification of Article 1, paragraph 3, of the Model Tax Convention, should not, be affected by treaty provisions and might thus be used to prevent treaty abuse.

- How are the tax treaty anti-avoidance rules supposed to coordinate between them? Are they supposed to be applied cumulatively or alternatively? In the latter situation, which one should prevail?

- In case of divergence between contracting States (e.g. on the notion of the “one of the main purposes” to justify the application of the GAAR, or on the notion of “one of the principal purposes” to apply the safeguard clause for LOB) which one should prevail? A tax treaty is a contract between two States having a common purpose and it should be applied in this respect. The denial of the benefit of the treaty for a taxpayer should result from a common decision of both the States, either with a specific procedure to be described in the anti-abuse
In order to avoid these difficulties, Action 6 should first focus on ensuring that tax treaty provisions do not prevent countries to apply existing domestic anti-abuse rules and on recommending domestic rules preventing the granting of treaty benefits in inappropriate circumstances. Only in situations where recommended domestic rules would not be sufficient or appropriate to prevent the treaty abuse, should the draft propose anti-abuse rules to be inserted in tax treaties.

With regard to tax treaty anti-abuse rules, the LOB clause or the GAAR should be proposed as separate options, allowing the contracting States to choose what suits best for them considering their existing domestic anti-abuse rules. Furthermore, as far as treaty abuse is concerned, after having identified the “inappropriate circumstances” mentioned in the plan for Action 6, several alternate international approaches should be considered, such as the concept of “beneficial ownership”, the “subject to tax” clause or “substance test” provisions.

The OECD should choose the most appropriate mechanism to avoid treaty abuse and ensure that taxpayers are not submitted to a multiplicity of conventional clauses, not to mention the domestic ones.

**LOB (Limitation Of Benefit) clause**

1. LOB clause was originally created by the US and has been often modified over the years in order to avoid denying treaty benefits to non-abusive situations (e.g., the insertion in 1982 of the “Competent Authority Test” – article 22-4 of the 2006 US Model Income Tax Convention; the insertion of the “Derivative Benefit Test” in some of the tax treaties signed by the US). However, it should be noted that the LOB clause has not been adopted widely by other countries. Indeed, it is a very detailed regulation which refers to common law concepts and notions: it might then be misinterpreted by civil law countries and give rise to conflicting interpretations.

2. As mentioned in the Technical Explanation to the 2006 US Model Income Tax Convention, the purpose to the LOB clause is “to prevent residents of third countries from benefiting from what is intended to be a reciprocal agreement between two countries” and is thus not primarily designed to prevent abusive situations. For doing so, the Technical Explanation states that “the provision does not rely on a determination of purpose or intention but instead sets forth a series of objective tests. A resident of a Contracting State that satisfies one of the tests will receive benefits regardless of its motivations in choosing its particular business structure”.

LOB clause mainly deals with companies’ interposition and the exclusion of taxpayers to benefit from the convention. It does not in itself targets situations of treaty abuse.

3. This purpose explains why the application of the objective tests set forth in the LOB clause (a public company test, an ownership and base erosion test, an active trade or business test)
may lead to denying treaty benefits to resident companies which are not part of a treaty-shopping arrangement. For instance, the objective tests may deny the possibility to use the treaty for situations resulting from previous, external or historical group structure: in case of acquisition of foreign groups, it is quite common to acquire holding structures for which it is difficult for the buyer to keep local management. LOB clause will deny the benefit of the treaty although the new place of management of the holding is located in a State which treaty provides for the same treatment as the source State.

4. Concerning the drafting of the LOB clause:
   a. §2 c ii): “at least 50 percent of the aggregate voting power and value of the shares (and at least 50 percent of any disproportionate class of shares) in the company is owned directly or indirectly by five or fewer companies entitled to benefits under subdivision i) of this subparagraph, provided that, in the case of indirect ownership, each intermediate owner is a resident of either Contracting State”. We do not understand the necessity for each intermediate owner to be resident of either contracting State. This sentence should be replaced by a sentence stating that “each intermediate owner is a resident of a State with which the source State has a tax treaty providing for a similar treatment” or something similar.
   b. §3 a): “if the resident is engaged in the active conduct of a trade or business”. This sentence needs to be further explained through guidelines since the notion of “active conduct” depends on the nature of the activity. It is particularly not adapted for holding companies.
   c. §3 b): “only if the trade or business activity carried on by the resident in the first-mentioned Contracting State is substantial”. The notion of “substantial” is very subjective and introduces uncertainty especially as it is determined “on facts and circumstances”.

5. The safe harbour clause mentioned at §4 (“Competent Authority Test”) may not provide sufficient protection against the strict application of the objective tests since it requires a decision of the contracting State. Besides, the requirement that “the establishment, acquisition or maintenance of such person and the conduct of its operations did not have as one of its principal purposes the obtaining of benefits under this Convention” leaves too much room for the tax authorities and notion of “one of its principal purposes” should be replaced by “its main purpose” or “its principal purpose” if not “exclusive”. Moreover, guidance should be provided on who should bear the burden of proof, when should the test be fulfilled for being eligible to the treaty benefit (i.e., at the time of the investment in the resident entity or the structuring of the group of entities, at the time of the cross-border flow for which the tax treaty benefits are claimed, year by year?). In this respect, in its current drafting, this clause does not seem to take into account the fact that business structures and activities are evolving all the time, step by step: it might be difficult to answer clearly the question in a moving world with many various constraints and parameters.
6. As it is designed, the LOB clause is too complex and rigid, thus not adapted to the multiple situations which can be encountered on a day to day basis. It might deny the treaty benefits although the objective tests are fulfilled at the level of the direct or indirect shareholders of the resident entity and no treaty shopping exists. In order to soften such consequences and to the extent a LOB clause is adopted, the “derivative benefits” provision should be included to ensure a non-qualifying treaty resident to be eligible to the benefits of the treaty as the parties owning him would themselves be. Furthermore, LOB clause inserted in tax treaties signed by countries members of the European Union may prove contrary to the freedom of establishment and free movement of capital (e.g., the US has inserted the “derivative benefit” provision in its tax treaties signed with EU member States in order to mitigate this risk).

Regarding the “derivative benefits” clause, the OECD should take this opportunity to amend its provisions in order to take into account the difficulties which have already been identified (see, for instance, the recommendations of the NYC Bar Committee on Taxation of Business Entities: NYC Bar Report on Derivative Benefits Provisions in Tax Treaties, Tax Notes International, vol. 51, July 7, 2008, p. 43).

7. To the extent a LOB clause is nevertheless adopted, it should include a most favoured nation clause in order to avoid discrimination for taxpayers. Such most favoured nation clause would create a level playing field between countries since a Contracting State would not be allowed to agree provisions with a tax treaty partner more favourable than with another one.

**GAAR (General Anti-Avoidance Rule)**

1. To address treaty abuse, including treaty shopping situations that would not be covered by the LOB provision - which proves the objective of Action 6 is not covered by such a LOB-, the draft recommends adding a GAAR to tax treaties. The intention is clearly to supplement the LOB provision. This means that passing the LOB test would not, in itself, exclude the application of a general anti-abuse rule. In this respect, we question once again the utility of such an addition in terms of clarity, simplicity and certainty.

2. A conventional GAAR clause will lead to the compilation of GAARs and to prevalence issues between conventional and domestic rules. Moreover, there is a significant risk that diverging interpretations of the GAAR will lead to double taxation. Besides GAAR are very much linked to the tax audit procedure which is a domestic issue. Contrary to the EU, there is no Supreme Court at the international level which could harmonise the interpretation: as we can see for the “beneficial owner” notion, it is quite sure that the States will not have the same reading of the GAAR. Finally, if the GAAR applied is the domestic one, it will ensure better understanding and easier analysis for taxpayers on how the Courts may apply it according to the facts.

3. We then advocate a conventional clause providing for the application of the domestic GAAR. We think it should be of the responsibility of States to create such a rule, if not existing, according to their own taxation framework and principles. This would allow for more
flexibility and could be adapted to the evolution of both domestic legislation and jurisprudence. It is reasonable to consider that treaties will not prevent their application (as it is already the case) if they target artificial or mainly tax driven structures/arrangements.

4. Concerning the drafting of the GAAR. We are concerned by the vague, arbitrary and unclear definition that is provided in the draft:

   a. “It is reasonable to conclude”: this is very general and there is no burden of proof on the tax authorities. Besides which contracting State shall prevail?

   b. “one of the main purposes” should be replaced by the “main/principal/dominant purpose”. It is framed too widely and does not provide sufficient clarity, as illustrated by the examples set out in §33 (what are the tests used in order to determine whether or not the GAAR would apply?). It requires probing into taxpayers’ intentions underlying the transaction, which may be difficult to ascertain objectively. Moreover, it seems to contradict §9.5 of the commentary on Article 1 (OECD Model Convention 2010 update) referring to “the main purpose”. Apart from the fact that merely obtaining a favourable tax treatment on application of the tax treaty, by itself, cannot be sufficient to allege “treaty abuse”, it seems clear that there has been a strengthening.

   In the same way, §31 should be deleted as structuring its business with a view to optimise taxes should remain a right for businesses/individuals as long as it is not artificial or mainly tax driven.

   We would like to draw to your attention the recent decision (29.12.2013) of the French Constitutional Court rejecting the French general anti-abuse rule contained in the 2014 draft budget as being not compliant with the French Constitution. It intended to extend the scope of the French GAAR to transactions that are “principally” tax driven, whereas the current wording of the law refers to “exclusively” tax driven transactions.

   The unconstitutionality of this proposal was raised on different grounds:

   ▪ excessive lack of legal certainty for taxpayers and especially risk of arbitrary application of the law by tax administration
   ▪ lack of accessibility and comprehensibility of the law: the project was considered to be unclear and ambiguous
   ▪ too broad definition compared to the corresponding 80% penalty

   c. “Indirectly” should be cancelled: indirect benefits could be numerous; besides, if the benefit is only indirect it cannot be the main objective.

   d. “unless it is established”: the burden of proof, an actual and formal proof, is there required from the taxpayer, contrary to the above wording “reasonable to conclude” which benefit to the tax authorities; that comes from the wording of the present §9.5 of the comment on article 1, but a comment is not the same as hard law. Moreover, taxpayers should not be requested to provide a negative proof i.e. prove that tax is not one of the objectives of a transaction. Taxpayers should only be requested to prove that there were genuine business reasons to organise a
transaction in a certain way and that the reality was in line with the legal form (i.e. form consistent with substance).
There should be a conscious and deliberate attempt to structure a transaction to obtain such advantage which otherwise is not in line with the intent of the relevant provisions, and is not merely an incidental result of the transaction.

e. “object and purpose of the relevant provision”: this will be difficult to define as frequently each signing State has a different view on the meaning of the treaty provisions; in treaties there is hardly something like the intention of the legislator. Therefore, where is the taxpayer supposed to find such information?

SAARs (Specific Anti-Avoidance Rules)
SAARs already exist in treaties for example under the name of “beneficial owner concept”. To avoid complexity, we advocate for conventional SAARs to be applied in the first place as they focus on specific revenues. Only in the situation where an artificial situation is not targeted through these SAARs would the GAAR be applicable (subsidiarity principle).

§ 43 (dividends - holding period): The proposed provision should be amended in order to include the possibility to benefit from the tax treaty benefits even if the holding period requirement is not met at the time of distribution in case the shares are held for a sufficient period of time after the distribution so that the holding period requirement will be met. In this respect, the taxpayer may commit to hold the shares for the holding period, failure to do so triggering the retrospective denying of the treaty benefits. Such retrospective denying would be simpler than asking for a refund which is often long and burdensome for both the taxpayers and tax authorities.

§ 52 (residence - tie-breaker rule): In most cases, the “effective management” criterion is sufficient to determine the residence state of a taxpayer. As a consequence, the “effective management” test should not be replaced by another tie-breaker rule. Instead, the “effective management” test should remain the principal test, to be completed with other tie-breaker rule. In this respect, the proposed rule raises several concerns since a mutual agreement procedure is unlikely in practice to be an improvement, as prior experience of such a rule in some treaties has shown. Furthermore, double residence situations do not necessarily derive from abusive arrangement but, in most cases, derive from the authorities of the Contracting States having a different interpretation of the tax treaty. As a consequence, in our view, in case the “effective management” test does not eliminate the double residence, the double residence should prevail until the Contracting States agree and determine which the residence State is. The Contracting States would then be motivated to reach an agreement.

§ 56 (PE triangular situations): In the case of PEs and triangulation, the proposal to require a minimum effective tax rate before a PE in a third country can be afforded treaty benefits would represent a major departure from the existing operation of most tax treaties and
would seem to require justification in any particular case on the grounds of treaty abuse rather than simply by reference to an effective tax rate measure.

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Finally, it should be noted that some States introduce new taxation rules that do not fall into the scope of tax treaties. Although it is not the aim of Action 6, we would like to emphasise on the risk of double taxation and the competitiveness issues.

Examples:

- Withholding taxes which are not covered by treaties on the grounds they are not WHT because they are paid by the issuer and not taxpayers;
- Capital gain taxes due in case of indirect transfer (multiplication of the States who introduce domestic legislation in this respect to avoid the transfer of SPV to avoid local tax but the new rules are so broad that they involves non-abusive cases);
- CFC rules considered as deemed dividend to avoid the PE exemption.
April 9, 2014

By email

Ms. Marlies de Ruiter
Head of the Tax Treaty, Transfer Pricing and Financial Transactions Division
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Dear Ms. de Ruiter:

The National Foreign Trade Council (NFTC), organized in 1914, is an association of some 250 U.S. business enterprises engaged in all aspects of international trade and investment. Our membership covers the full spectrum of industrial, commercial, financial and service activities, and our members have for many years been significant investors in many countries, including all of the OECD member countries and the G20 countries.

NFTC seeks to foster an environment in which companies can be dynamic and effective competitors in the international business arena. To achieve this goal, businesses must be able to participate fully in business activities throughout the world, through the export of goods, services, technology, and entertainment, and through direct investment in facilities abroad. As global trade grows, it is vital that companies be free from double taxation that can serve as a barrier to full participation in the international marketplace. Tax treaties provide the certainty and stability in the investment environment that is necessary to allow business to participate in the global marketplace. That is why NFTC has long supported the expansion and strengthening of the U.S. tax treaty network.

I am writing in response to the Public Discussion Draft released March 14, 2014, in connection with the BEPS Action Plan, entitled “BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances” (the “Discussion Draft”). While NFTC is supportive of several of the proposed changes to the OECD Model Tax Convention (the “OECD Model”), NFTC believes that the OECD should reconsider its proposals to adopt the “main purpose test” articulated in Section A.1.a) ii) of the Discussion Draft and the title and preamble language
articulated in Section B of the Discussion Draft. If the proposals were adopted, NFTC respectfully suggests revisions to take into account the concerns below. In addition, while NFTC believes a balanced limitation on benefits article could be a valuable tool in combatting treaty shopping, an overly restrictive one, like that proposed in the Discussion Draft, will exclude many legitimate business enterprises not engaged in treaty shopping from the benefits of treaty protection and, accordingly, will do more harm than good. NFTC also recommends the adoption of a derivative benefits provision.

A. NFTC generally supports anti-treaty shopping provisions in treaties

NFTC generally supports the adoption of anti-treaty shopping provisions in treaties. In treaties, governments often reduce source country taxation on nonresidents. In order to be willing to do so, governments negotiate for reductions in foreign taxation on their own residents. As double and excessive taxation are reduced between the two states, trade between them is enhanced. If the residents of a non-treaty state are able to access an income tax treaty between two other states, the residents of that third country will have no reason to urge their government to make the concessions required to enter into an income tax treaty with either of the two aforementioned states; and that third country’s government would gain nothing, and only lose revenue, by entering into such treaties. Thus, well-crafted anti-treaty shopping measures further the development of tax treaty networks.

However, if these measures are overly restrictive they can undermine the tax treaty network by shutting off legitimate businesses from access to treaties. Consequently, NFTC generally supports the adoption of anti-treaty shopping measures, but it also strongly believes that efforts in this regard must not distract from the primary purpose of income tax treaties, which is to prevent double taxation and provide taxpayers with a stable cross-border investment environment which one government alone cannot provide. As discussed more fully below, NFTC believes that the treaty shopping proposals in the Discussion Draft have not struck the right balance and are in need of revision.

B. Summary of the Discussion Draft’s treaty shopping proposals

Section A.1.a) (“Treaty shopping”) of the Discussion Draft recommends three changes to the OECD Model:

1) changing the title and preamble to express a wish to prevent tax avoidance and an intent to avoid creating opportunities for treaty shopping;

2) adding a “specific anti-abuse rule” (hereinafter, an “LOB provision”); and

3) adding a “more general anti-abuse rule” (hereinafter, a “Treaty GAAR”).

C. The Treaty GAAR

(1) The Treaty GAAR undercuts the value of the LOB provision
Beginning with paragraph 7 of the current Commentary on Article 1 of the OECD Model (the “Commentary”), under the heading “Improper use of the Convention,” the Commentary generally describes the principle contained in the Discussion Draft’s Treaty GAAR, and provisions like the Discussion Draft’s LOB provision. See, e.g., Commentary ¶¶ 9.5 and 20. Turning the Commentary discussion into OECD Model provisions with both the Treaty GAAR and the LOB provision, however, would have the perverse effect of rendering the benefit of the anti-abuse package in the OECD Model far less than the sum of its parts.

Without an LOB provision, a Treaty GAAR serves an anti-abuse purpose, although it requires more subjectivity than would an LOB provision. With an LOB provision, a treaty provides a series of bright-line tests for entitlement to treaty protection in order to serve the same purpose. The virtue of the LOB tests (as opposed to the Treaty GAAR) is that they foster the ultimate goals of income tax treaties in an administrable way that provides certainty in application. The Treaty GAAR as an add-on would provide little additional support for treaty policy, while undoing the administrability and certainty achieved by the LOB provision on its own.

Because of the objective nature of the LOB provision, it is well established that the provision can preclude treaty benefits in cases where there is no treaty shopping concern. If the objective tests are overly restrictive, as in the case of the model proposed in the Discussion Draft, legitimate business enterprises with no treaty shopping motivation will be deprived of the benefits of the treaty, undermining the fundamental goal of promoting bilateral trade and investment between residents of the treaty partners. A balanced LOB provision avoids this pitfall and achieves the certainty and administrability that an objective test provides. Including a subjective test like the Treaty GAAR in addition to an LOB provision does nothing to alleviate the limitations of the latter and sacrifices its administrability.

(2) The Treaty GAAR undercutsthe value of the treaty network

Because of the subjective nature of the Treaty GAAR, it is virtually guaranteed that Contracting States will interpret and apply the Treaty GAAR differently. To the extent this occurs, benefits under any given treaty will not be bilateral in practice. Two Contracting States agree to make concessions in an income tax treaty because they are bilateral. When the architecture of the treaty guarantees that they will not be bilateral, it undermines the purpose of the treaty and understandably reduces each country’s incentive to enter into one. Moreover, a Treaty GAAR will open the door to the effective renegotiation of a treaty’s terms by one Contracting State, without that Contracting State having to either make concessions to the other Contracting State or terminate the treaty.

(3) Difficulties interpreting the Treaty GAAR

The Treaty GAAR conveys an inherently contradictory message: governments intend to confer treaty benefits, unless taxpayers intend to avail themselves of them—unless, perhaps, the tax-motivated behavior is consistent with the “object and purpose” of the relevant treaty provisions. We question whether any amount of guidance will ever cure this infirmity.
This contradictory message will make the Treaty GAAR difficult to interpret and apply in practice. The Discussion Draft shows that the drafters also wrestled with these contradictions. After stating in paragraph 31 that a treaty benefit need not be “the sole or dominant purpose” and may be just “one of the main purposes” of a transaction to constitute a “main purpose” of the arrangement or transaction, the Discussion Draft provides an example that appears to contradict these statements. Example C in paragraph 33 involves a company (“RCo”) planning to establish a manufacturing plant in one of three countries. The example states that “[a]fter considering the fact that State S is the only one of these countries with which [RCo’s state of residence] has a tax convention, the decision is made to build the plant in that State”; yet the example goes on to conclude that “it cannot reasonably be considered that one of the main purposes for building the plant is to obtain treaty benefits.” If both of these assertions are true, then there is a subtlety here that can easily be missed by tax administrators and practitioners. The plant in question clearly was built where it was built because State S’s treaty provided benefits. Thus, it also cannot reasonably be considered that one of the main purposes for building the plant in State S is not to obtain treaty benefits. While the NFTC agrees that treaty benefits should be granted under the facts of the example, the example clearly demonstrates that even in a common and straightforward business transaction such as the one in Example C, it will be difficult to judge whether or not treaty considerations are a “main” consideration. The examples in the Discussion Draft confirm that there is an exceptionally fine line between transactions that might invoke the Treaty GAAR and those that do not, which will cause taxpayers great angst in assessing the consequences of their everyday business transactions and will be unduly challenging for tax administrators to interpret.

We do not believe that paragraphs 19 through 33 of the Discussion Draft remedy the lack of clarity regarding when the Treaty GAAR will or will not deny treaty benefits. They do describe a number of situations in which the Treaty GAAR might preclude treaty protection, but they stop short of mandating such preclusion. Even in the seemingly abusive cases, the abuses meant to be prevented are highly contingent on peculiarities of the internal law of the country from whose tax treaty protection was sought. If a country’s internal tax law is particularly vulnerable to abuse, treaty negotiators have historically tailored the treaty with that country accordingly, possibly even going so far as to adopt a Treaty GAAR if necessary. As a general OECD Model, however, adding the Treaty GAAR to the LOB provision would be counterproductive.

If the Treaty GAAR were to be incorporated into the OECD Model, there would need to be an express provision enabling any taxpayer to receive an advance ruling that the Treaty GAAR does not apply to a proposed transaction. Given the uncertainty that taxpayers would face in interpreting a Treaty GAAR, tax administrators would be swamped with such requests. Expeditious handling would be burdensome to governments, yet necessary, which may call at the very least for measures to ensure such handling. In addition, if a general anti-abuse rule were to be added to the OECD Model, it should apply only in a case where obtaining a treaty benefit was “the main purpose” of the arrangement or transaction, rather than merely “one of the main purposes” of the arrangement or transaction.

(4) **Experience supports our view**
The United States went through an instructive process in connection with the treaty and protocol it signed in 1999 with Italy. The negotiators included an LOB provision, but in addition, they included a general anti-abuse rule similar to the Discussion Draft’s Treaty GAAR in the dividends, interest, royalties and other income articles. The Treasury Department indicated that it intended to include such provisions in the U.S. Model Income Tax Convention.

Ultimately, the U.S.-Italy treaty was ratified only after being stripped of its Treaty GAAR provisions at the behest of the U.S. Senate, and the U.S. Model did not adopt such provisions. The problem was lack of clarity, which was demonstrated by the U.S. Treasury Department’s inability to provide it to the Senate.

(5) Recommendation

Based on the concerns highlighted above, NFTC believes that the Treaty GAAR should not be incorporated into the OECD Model.

D. LOB provision

As we indicated above, the LOB provision proposed in the Discussion Draft is overly restrictive in several respects. It is extreme in its near conformity to the 2006 U.S. Model. Of the U.S. treaties now in force, a small minority include all the provisions of this model. For this reason there is relatively little experience from which to judge their workability as a whole.\(^1\) Furthermore, these provisions are miscast as a template for universal use in all bilateral negotiations, especially those between countries with robust tax systems. NFTC recommends that the Discussion Draft’s version of the LOB provision be modified, and that the OECD devote additional study to the differences between the Commentary and Discussion Draft versions of LOB before any decision is made to adopt the Discussion Draft’s version in its model. Below we set forth a series of concerns with the LOB provision as proposed in the Discussion Draft, along with a few examples illustrating just some of the difficulties we foresee.

(1) Same-country owner requirements

Of particular concern are the same-country requirements on both ultimate owners (persons who own a company’s stock “directly or indirectly”) and intermediate owners embedded in the ownership prong of the “ownership/base erosion test” (subparagraph 2 e) i) of the LOB provision). The corresponding provision in paragraph 20 of the current Commentary on Article 1, has no residence test for intermediate owners, and no same-country residence test for ultimate owners. Moreover, while there is a residence test for intermediate owners in the provisions of paragraph 20 of the Commentary on Article 1 and the Discussion Draft that entitle subsidiaries of publicly traded companies to treaty benefits, neither of those tests limit “good” ultimate or intermediate owners to residents of the same country as the company seeking treaty

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\(^1\)Moreover, only one U.S. treaty in force, with New Zealand, contains all of these provisions and does not include a derivative benefits provision. As discussed below in Part E, the derivative benefits provision serves as a necessary backstop where the objective tests of other provisions prove to be overly restrictive.
benefits. It is not clear what treaty abuse the same-country owner requirements in the ownership/base erosion provision is intended to address, especially when applied to treaties between countries where companies do substantial business, yet the requirement would have the unintended result of denying treaty benefits in many common business structures. For example, if a U.S. company and a non-U.S. company wanted to form a joint venture company in the non-U.S. company’s residence country, the joint venture company would fail the ownership/base erosion test if the U.S. company held a majority interest.

As an example that arises from the residence requirements imposed on intermediate owners (a requirement not present in paragraph 20 of the Commentary on Article 1), a multinational group will often have regional holding companies for non-tax reasons. Assume a publicly traded company in Country A (“ACo”) forms a regional holding company in Country B which has a subsidiary in Country C (“CSub”) (among other subsidiaries). If the treaty between Country A and Country C were to include the Discussion Draft’s version of the subsidiary of a publicly traded company test and ownership/base erosion test, CSub would fail to satisfy both tests. In such case, ACo’s provision of services to CSub, for example, could raise questions whether CSub’s profits are taxable in Country A notwithstanding that it has no “PE” in Country A within the meaning of Article 5.

The intermediate owner requirement in the derivative benefits provision included in paragraph 13 of the Discussion Draft could give rise to similar problems. We would strongly urge the OECD to conduct further study of the consequences of such provisions before including them in its Model.

(2) **Base erosion**

The “base erosion” prong of the ownership/base erosion test and derivative benefits test is also overly restrictive in that payments to certain qualified persons (within the meaning of paragraph 2 of the LOB provision) can still be considered base eroding payments, thereby disqualifying a company from claiming treaty benefits. For a multinational group with a publicly traded parent, a payment to any group member other than the ultimate parent company would constitute a base eroding payment unless it satisfies the “ordinary course” exception (which applies only to payments for services or tangible property). The proposal could cause ordinary business transactions with third parties to be problematic and also restrict the group’s ability to make intergroup payments necessary to carry on its business operations (e.g., its ability to move cash to where it is needed in the group). Assume a publicly traded company in Country D (“DParent”) wholly owns Country D subsidiary (“DSub”) and DSub licenses intangible property to an unrelated country D corporation (“Customer”) which is wholly owned by country D residents. If any treaty between Country D and another country were to include the

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2 We are not aware of a U.S. treaty currently in force that contains such a restriction. The proposed protocol (signed in January 2013) to the U.S.-Spain treaty is apparently the first to include an intermediate owner requirement in a derivative benefits test, and would require intermediate owners to be residents of either a member state of the European Union or a party to the North American Free Trade Agreement (but would not require them to be equivalent beneficiaries).

3 Both tests consider “arm’s length payments in the ordinary course of business for services or tangible property” to be non-base eroding payments (the “ordinary course exception”).
Discussion Draft’s version of the ownership/base erosion test, Customer might fail to satisfy such test because its third party royalty payments to DSub would constitute base eroding payments (even though DSub is considered a qualified person under the subsidiary of publicly traded company test). Similarly, assume DParent also owns a Country E subsidiary (“ESub”) and DSub makes a loan to ESub. If the treaty between Country D and Country E were to include the Discussion Draft’s version of the derivative benefits test, ESub might fail to satisfy such test because its interest payments to DSub would constitute base eroding payments. It is unclear what treaty abuse is being targeted by these rules, and their restrictive nature presents unwarranted complexities.

(3) Publicly traded test

Finally, the “publicly traded test” (subparagraph 2 c) i) of the LOB provision) is problematic. In addition to the requirement that the tested company’s principal class of shares be regularly traded on one or more recognized stock exchanges, the test also requires that either (i) the principal class of shares be primarily traded on one or more recognized stock exchanges “located in” the company’s state of residence (the “primarily traded requirement”), or (ii) the company’s “primary place of management and control” be in the company’s state of residence (the “managed and controlled requirement”).

The primarily traded test fails to take two factors into account. First, in today’s global business environment, it is not uncommon for a company’s shares to be traded largely on exchanges outside its state of residence. To access the global capital markets, it is often necessary for a company to list and trade on a foreign exchange, and it may be that such foreign exchange is substantially larger than any exchange located in the company’s home country. Of the U.S. treaties that have a primarily traded requirement, the majority allow a company’s stock to be primarily traded on some recognized stock exchanges outside the country of residence, unlike the Discussion Draft provision. Second, stock exchanges with a physical “location” in the traditional sense are fast becoming a relic, as trading comes closer and closer to becoming an entirely digital enterprise.

If a company fails to satisfy the primarily traded requirement, its only route for claiming treaty benefits under the publicly traded test—which for several reasons is the test that NFTC members largely need to rely upon—would be to rely on the managed and controlled test. This result puts companies and tax administrators in a difficult position given the test’s subjective nature. How practical is it to expect tax executives and administrators to determine, with the necessary degree of certainty on a year-to-year basis, whether executive officers and senior management employees of a multinational enterprise exercise day-to-day responsibility for more of the strategic, financial and operational policy decision making for the enterprise in one treaty country than in any other country, and whether their staff conduct more of the day-to-day activities necessary for preparing and making those decisions in that country than in any other country?

Some organizational structures, in particular those with multiple business segments and dispersed management, will undoubtedly lead to some arbitrary and capricious results, in addition to uncertainty regarding how the test is to be applied. These interpretive questions
have yet to be addressed under the few U.S. treaties that use this version of the publicly traded test. Moreover, adopting an unclear and subjective test in the publicly traded test defeats the fundamental purpose of the LOB provision, especially as applied to companies like NFTC’s members, which is to provide an objective and administrable measure that sufficiently prevents treaty shopping.

NFTC believes that the LOB provision adopted in the OECD model should use the language of the publicly traded test included in paragraph 20 of the current Commentary on Article 1.4

E. Derivative benefits

The provision set forth in paragraph 13 of the Discussion Draft (the “derivative benefits” test) would be a crucial addition to the LOB provision.5 Derivative benefits provisions serve as a needed backstop to the other LOB provisions, making treaty benefits available in situations that involve no treaty shopping, but that nevertheless do not satisfy the objective tests in those other provisions. It would obviate the need to resort to paragraph 4 of the LOB provision (hereinafter, the “discretionary benefits” provision) in many cases where treaty abuse is very unlikely to be present. Making such resort unnecessary is critical to making the anti-abuse rules practicable.

However, the suggestion in paragraphs 14-16 of the Discussion Draft, namely to distinguish between “base eroding payments” and other payments for derivative benefits purposes, would drain much of the value of a derivative benefits test. The example in paragraph 15 assumes that State S gives the same treaty protection to royalties beneficially owned and derived by State T residents and State R residents. “Parent” satisfies the narrow requirements of the proposed definition of an “equivalent beneficiary,” which implies that Parent is either publicly traded, a governmental entity, a charity, or a pension fund. State S has bargained for the benefit of the same low royalty rates with both State T and State R. Under these circumstances, there simply is no tax policy to be protected by discriminating between an OPCO 2 that is itself publicly traded or locally owned, and one that is owned by Parent. Granting OPCO 2 benefits in the first case, but not the second, would require recourse to discretionary benefits to achieve what seems to have been intended in both cases. This type of non-policy-based, accidental interference with treaty benefits defeats the purpose of an LOB provision.

F. Title and preamble

The Discussion Draft proposes the following new title: “Convention . . . for the elimination of double taxation with respect to taxes on income and on capital and the prevention of tax evasion and avoidance” (emphasis added). The proposed preamble provides a declaration that the parties intend that the Convention eliminate double taxation “without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance.”

4 That test provides that a qualified person includes a company if “the principal class of its shares is listed on a recognised stock exchange . . . and is regularly traded on one or more recognised stock exchanges.”

5 See, however, the comment in Part D(1) above regarding the intermediate owner requirement in the Discussion Draft’s example of a derivative benefits test, which we believe is unnecessary.
The title should be conformed to the preamble in this respect. Absent clarification, this title could be interpreted to suggest that treaties can increase taxation that would not otherwise be imposed under domestic law. To the contrary, it is a well-established principle that treaties should only relieve taxation imposed under domestic law.

In addition, the authors of the Discussion Draft appear to expect that a treaty’s incorporation of such a title and preamble language will be relevant to the interpretation and application of the treaty. This would seem to be true either in cases where treaty interpretation is governed by the Vienna Convention on the Law of Treaties (cited in the Discussion Draft), or by U.S. law. The proposed preamble language should only be relevant when interpreting terms of a treaty that are ambiguous. This is generally consistent with the method of interpretation generally used by U.S. courts. Alternatively, the title and preamble language might broadly turn treaty interpretation into a subjective exercise, requiring a consideration of the context, object and purpose of treaty provisions to determine whether reduction of internal law tax is warranted, even when interpreting unambiguous treaty provisions. We urge that this latter approach be ruled out by the Commentary on any title and preamble provisions incorporated into the OECD Model.

* * *

NFTC appreciates the opportunity to comment on the Discussion Draft, and urges the OECD to consider these comments in its work on the OECD Model Tax Convention.

Sincerely,

Catherine Schultz
Vice President for Tax Policy
cschultz@nftc.org
202-887-0278 ext. 2023

Re: Comments on Public Discussion Draft
BEPS ACTION 6: PREVENTING THE GRANTING OF TREATY BENEFITS IN INAPPROPRIATE CIRCUMSTANCES

1) Change adoption approach: amending each bilateral tax treaty or signing a multinational convention?

Assuming that plenty of countries would agree with this action and decide to include the suggested provisions into their tax treaties, a practical question will come out: how the provision changes should be proceeded?

It seems unpractical also inefficient to negotiating protocols for amending the over 3000 bilateral tax treaties one by one across the world. Thus, my suggestion is to go for a multinational convention, like the mutual assistance convention OECD initiated. The countries signing this multinational convention will automatically change their tax treaties, which they concluded with the other countries who also signed this multinational convention. It could be efficient from treaty negotiation perspective, and also all (or most of the countries) eventually will be able to have same provision in their treaties with respect to this issue and then countries could deal with treaty abuse based on the same context.

2) Relationship between domestic rules and tax provisions

(i) Whether the treaty benefits could be overruled by a new domestic anti-treaty abuse rule? This question must be resolved on each country basis before any „recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances“ can actually take
effect in any country, especially for the “Cases where a person tries to circumvent limitations provided by the treaty itself”.

Not every country taking an “earlier treaty, latter statute” approach like the U.S.. For the countries where tax treaty are superior to the domestic law, relevant treaty provisions must be added to introducing the implementation of the new domestic anti-treaty abuse rules during treaty application.

(ii) What is the scope of the domestic anti-treaty abuse rules applicable in the treaty application? Is it only to be the domestic rules existing when the anti-abuse treaty provision is introduced into the treaty? Or any updated or new rules after the treaty signing shall be applicable as well?

This issue is important, as it matters on how much certainty the treaty/domestic law can provide to the taxpayers. Also it matters on how the contracting states will interpret the treaty provision and perform its “power” (counterfeiting treaty abuse herein) in good faith through legislating new anti-abuse rules after the treaty signing.

3) OECD Convention and Commentaries’ influence in non-OECD countries

The number of OECD member states is limited, while the influence of the OECD Convention and commentaries also various in different countries. Although many countries give high weight to the OECD convention and commentaries, it still has not be aligned through the worldwide scope that OECD convention and commentaries are the uninformed “international forms” accepted by every state.

Thus, changing the convention and the commentaries are good starting point, but the real work might need to landing at how to change the treaties provisions signed/to be signed by each individual countries.

Thus, my suggestion is to preparing a separate acknowledgement note, in addition to a multinational convention suggested before, to include all the explanatory notes similar to the relevant provisions to be put into the commentaries. Then, the states signing the multinational convention will also sign this acknowledgement note. The acknowledgement note might not be necessary to be binding on the contracting states, but it would provide an aligned platform all the future interpretation and performing the multinational convention.

4) Comments on the specific sessions

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<th>Section</th>
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<td>A</td>
<td><strong>Is treaty abuse a form of tax avoidance?</strong></td>
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<td>Seems that OECD differentiated the concepts of treaty abuse from tax avoidance, at least through reading the proposed paragraph 12.5 of the Commentary on Article 10. (the 4th paragraph of the page 4 in this discussion draft). If it is the case, it will not reflect some countries’ domestic laws approach.</td>
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<td>For example, China clearly stipulates treaty abuse is one form of tax avoidance arrangement in its domestic law. The elements for identifying treaty abuse and tax adjustment methods are no difference with the other tax avoidance forms.</td>
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<th>A</th>
<th><strong>What’s the relationship between the specific anti-abuse provision (suggested in the 1st paragraph of the page 5 in this discussion draft) and the treaty provision referring the domestic anti-abuse rules will apply?</strong></th>
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<td>Will the specific anti-abuse treaty provision or the domestic anti-abuse rule will be applied on one treaty shopping case, if the application results of these two rules are inconsistent?</td>
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<th>A</th>
<th><strong>What is the policy consideration for extending the benefits to the „derivative benefits“? For taxpayer’s interest or the contracting state’s tax administration interest?</strong></th>
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<td>Is it really necessary to have a separate „derivative benefit“ provision (Paragraph 18 on page 8) in the tax treaty, if such a benefit is also be subject to the „limitation of benefits“ provision?</td>
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<td>Wouldn’t it be much simpler if releasing the criteria for „tax resident“ under Article 4 or releasing the criteria for the proposed „entitlement to benefits“ provision to include all these „derivate benefits“?</td>
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<th>A</th>
<th><strong>Who undertakes the burden of proof for the main purpose of the transaction is „accordance with the object and purpose of the relevant provisions of this Convention“? (Paragraph 18 on page 10)</strong></th>
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<td>If leaving such burden of proof to the taxpayers, taxpayers will have to firstly identify the object and purpose of the convention before they can prove its transaction to both of the source and the resident countries. The object and purpose of the convention is a controversial and subjective issue. How can taxpayers, in particular those small-scale or even individual taxpayers may have the capacity to investigate and provide proof?</td>
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| | If leaving the burden of proof to the tax authorities, there could be a conflict of the contracting states domestic laws which might leave the...
burden of proof to the taxpayers. It is difficult to draft a provision, and it could be more difficult to implement the provision.

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<th>A</th>
<th>With respect to the “one of the main purposes” (Paragraph 31 on page 12), it would grant too much power to the states. The negative results could be (i) a danger that the contracting states may abuse this power; and (ii) too much uncertainty on the taxpayers. Suggest to limit it to the “sole” purpose, at least will be landing at “the main purpose”.</th>
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<td>B</td>
<td>Will including „double non-taxation“ into the treaty be in consist with tax treaty’s function? A commonly accepted principle about the function of tax treaty is that tax treaty is to allocate taxing rights between the contracting states, rather than imposing/or creating taxing obligation to the contracting states. If including „avoidance of double non-taxation“ in the purpose of the treaty, either the source state or the residence state will be imposed with an obligation to tax, otherwise it will breaching its commitment on the treaty. Thus, I cannot be line to include this double-non-taxation concept into the context of the treaty.</td>
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April 9, 2014

VIA EMAIL

Organization for Economic Cooperation and Development
Tax Treaties, Transfer Pricing and Financial Transaction Division
taxtreaties@oecd.org

Mr. Pascal Saint-Amans
Director, Center for Tax Policy and Administration (CTPA)
OECD, 2, rue Andre Pascal
75775 Oarucus /Cedex 16
France
Pascal.SAINT-AMANS@oecd.org

Re: Organization for International Investment (OFII) Comment Letter on the OECD Discussion Draft on BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

Dear Mr. Saint-Amans:

The Organization for International Investment (OFII) is a not-for-profit U.S. business association that represents the U.S. subsidiaries of global companies headquartered outside the United States. On behalf of its member companies, OFII promotes policies that enable global companies to establish U.S. business operations. As such, we advocate for fair, non-discriminatory treatment of businesses engaged in inbound U.S. investment. In particular, OFII’s members support economic and tax policies that facilitate cross-border trade and investment.

Based on our more than two decades long history of promoting U.S. inbound investment from global companies, we are keenly aware of the complex issues raised by the OECD’s Discussion Draft on BEPS Action 6 (Discussion Draft). OFII strongly believes that bilateral tax treaties serve an integral role in facilitating trade and investment by providing a reliable tax environment for companies doing business in multiple jurisdictions and preventing double taxation. We support carefully crafted rules that prevent abuse of treaties while ensuring legitimate business activities are not penalized. Thus, OFII and its member companies support and commend the OECD’s endeavor to combat treaty abuse. Importantly, however, we believe that certain proposals recommended in the Discussion Draft would penalize enterprises engaging in legitimate business transactions and would inhibit cross-border investment.

In the introduction to the Action Plan on Base Erosion and Profit Shifting, the OECD clearly recognized the key role of tax treaties in eliminating double taxation and the need to achieve this goal on the basis of agreed international rules that are clear and predictable, thereby giving certainty to both businesses engaged in global commerce and governments. To achieve this overarching goal, OFII urges the adoption of certain changes to the Discussion Draft. Specifically, we recommend the inclusion of a derivatives benefits test, as well as modifications
to certain Entitlement to Benefits (ETB) provisions to ensure they are narrowly focused on treaty abuses. We also urge the exclusion of a “main purpose test,” which conflicts with an administrable and predictable limitation on benefits (LOB) article.

The following discussion provides detailed comments expanding on OFII’s concerns with the Discussion Draft.

*The limitation on benefits provision of any bilateral treaty must be focused to prevent specific treaty abuses. As currently drafted, the proposed Entitlement to Benefits article would deny benefits to legitimate business structures and transactions.*

In general, we believe that a comprehensive LOB article that sets forth clear, objective requirements for qualifying for benefits under a bilateral tax treaty is beneficial to both taxpayers and tax administrators. For taxpayers, a carefully drafted LOB article provides a level of certainty that enables them to effectively conduct cross-border business operations, while, for tax administrators, the LOB article sets limits that prevent “treaty shoppers” from inappropriately accessing benefits under the treaty.

**Omission of a Derivative Benefits Test**

OFII strongly supports the inclusion of a derivative benefits test in the ETB article. This test is a critical component of any comprehensive LOB article and is required to prevent the inappropriate limitation of benefits in legitimate commercial business transactions and structures. The purpose of the derivative benefits test is to entitle a resident of a contracting state to treaty benefits if the owner of the resident company would have been entitled to the same benefit had the item of income been earned directly by that owner. Thus, under a derivative benefits test, the beneficial owner of an item of income receives no greater treaty benefit than would otherwise be afforded to its parent company had the item of income been earned by the parent company directly from the state of source.

We believe the example the OECD provided to highlight concerns with a derivative benefits provision does not justify its exclusion from the proposed ETB article. The ability of a company to make a deductible payment of an item that qualifies for preferential treatment in the recipient’s country is unrelated to any treaty provision. It should not preclude the inclusion of a derivative benefits test in the ETB. We recommend the inclusion of a derivative benefits test as it would provide a basis for treaty entitlement for customary multi-tiered business structures where no treaty shopping concerns exist.

**Specific Clauses of the ETB Require Modification**

The proposed ETB article set forth in the Discussion Draft does not represent the clear, objective requirements that are necessary in order for an LOB article to work effectively. We believe the proposed ETB article is overly restrictive and would limit access to the treaty by legitimate business enterprises undertaking customary cross-border business operations.

For example, the publicly traded test, which is the ETB provision that enables access to a treaty by many of the world’s largest public enterprises, includes two unnecessarily restrictive
requirements, one of which must be met in order for a publicly traded company to qualify for treaty benefits. First, the requirement that the company’s shares be traded on a stock exchange located in its country of residence is impractical. Many multinational companies’ shares are traded on regional exchanges that facilitate access to the broadest investor base and cross-border capital flows, which are legitimate commercial reasons. Second, the alternative requirement that the company’s primary place of management and control be located in its country of residence similarly does not reflect current global business models many multinational companies use to organize their management structure in a decentralized manner. These additional requirements to the proposed publicly traded test in the ETB provision should be removed.

In addition, the proposed ETB article includes a restriction on meeting several of the objective ETB tests when there is an intermediate entity in an ownership structure that is located in a third jurisdiction, i.e., it is not a resident of either contracting state. The restriction, included in the language of ETB provisions for a subsidiary of a public company test, the ownership/base erosion test, and the potential derivative benefits test, would adversely impact many global enterprises that structure their global operations along regional business lines. The inclusion of this restriction would result in many multinational companies not satisfying the objective ETB criteria notwithstanding that each entity in a particular structure carries out a specific business purpose in its country of residence. An intermediary rule is overly broad and is not targeted to treaty shopping concerns. We recommend that such intermediary rules be excluded from the ETB article.

The ETB’s ownership/base erosion test would also unnecessarily deny treaty benefits for joint venture business arrangements, a common investment vehicle used by many multinational enterprises to conduct business operations. The ownership prong of the test requires at least 50 percent of the beneficial interests in the joint venture be owned by residents located in the same country as the joint venture. This requirement could potentially result in a situation where a joint venture company exclusively owned by residents of the two contracting states does not satisfy the ownership prong of the test because the majority of the beneficial interests in the joint venture are owned by residents of the state of source. This limitation unduly restricts access to a treaty by an entity when there is clearly no “treaty shopping” or other inappropriate use of the treaty by a third country resident. OFII recommends that the ownership prong of this test take into account residents of either contract state.

In addition, the base erosion prong of the proposed ETB article includes a restriction that treats ordinary course of business payments, such as royalties or interest, as base eroding payments when made to any recipient other than a locally traded company. This limitation unnecessarily restricts the types of non-base eroding payments that may be made even when the enterprise making the payment operates exclusively on a local basis. OFII recommends that the definition of non-base eroding payments include any arm’s length payment made in the ordinary course of business and not just those payments made for services or tangible property. In addition, payments made to residents of the same country as the country of residence of the tested company should not be treated as base-eroding payments unless the recipient company is predominately owned by nonresidents.

1 Under the proposed derivative benefits test, each intermediate entity would need to be an "equivalent beneficiary," rather than a resident of one of the Contracting States.
The inclusion of the proposed subjective main purpose test, in addition to the other requirements in the ETB article, is unnecessary to address treaty concerns, and it undermines the clarity and predictability principles that are intended by a limitation on benefits article to facilitate cross-border trade and investment.

OFII member companies work on a regular basis within a U.S. LOB article, and we endorse the inclusion of a comprehensive LOB article in bilateral tax treaties. However, we are concerned that adding a subjective main purpose test to the ETB article 1) eliminates the clarity and predictability that is a cornerstone of an anti-treaty shopping article and a stated key principle of the BEPS Action Plan; 2) fails to achieve any balance between policing the inappropriate use of tax treaties by a minority of those seeking to qualify for benefits with the goal of providing responsible businesses with clear and workable rules; and 3) erodes the role of tax treaties in promoting cross-border trade and investment.

The United States considered and rejected the inclusion of a main purpose test in its bilateral tax treaties. The United States determined the inclusion of a subjective provision would add unnecessary uncertainty and undermine a taxpayer’s ability to objectively rely on a treaty. Instead, the United States has consistently included a LOB article that sets forth clear, objective tests that both facilitates reliance by taxpayers and avoids interpretive issues that make administering the treaty difficult for tax administrators.

The Discussion Draft indicates that detailed commentary would accompany a main purpose test; however, even with the inclusion of detailed instructions many questions would still exist in the application of the main purpose test. For example, a multinational company may be considering where to locate a group treasury center, narrowing the choice to a handful of countries that have a robust financial services sector, solid infrastructure, and suitable corporate and creditors’ rights laws. When deciding which country to choose, the company selects one jurisdiction because of its extensive treaty network. This example raises the question of whether that decision would be considered a violation of the main purpose test since obtaining access to the selected country’s treaty network was “one of the main purposes” of choosing that jurisdiction. A similar issue is raised by a multinational company seeking to form a regional holding company.

Significantly, choosing an appropriate location for a group treasury center or regional holding company are common decisions for many multinational companies. These decisions are commonly based on where trade and capital flows can occur most efficiently, which often takes into account a jurisdiction’s tax treaty network. We do not believe that basing such a common business decision on a particular jurisdiction’s treaty network should be a violation of a main purpose test.

Overall, OFII is concerned that the uncertain treatment fundamental business decisions would receive under the application of a main purpose test would undermine the function and purpose of tax treaties. We urge the OECD to implement clear, objective rules to prevent treaty abuse and remove the main purpose test from the ETB article.
OFII supports domestic anti-abuse rules that set forth objective criteria; otherwise, the ability to claim treaty relief from excessive taxation will become uncertain and unpredictable.

As noted above, in the introduction to the BEPS Action Plan, the OECD clearly recognized the key role of tax treaties in eliminating double taxation and the need to achieve this goal on the basis of agreed international rules that are clear and predictable, thereby giving certainty to both businesses and governments engaged in global commerce. This overarching goal must also be taken into account in the Discussion Draft’s proposals related to domestic anti-abuse rules. Domestic anti-abuse rules must be based on objective criteria that facilitate clear application of the rules by taxpayers and tax administrators and encourage global economic growth through cross-border trade and investment.

*********

OFII appreciates the opportunity to provide comments on the OECD BEPS Action 6 Discussion Draft and we hope that the above comments will be taken into account in further refining the Discussion Draft. We look forward to the prospect of commenting on further developments under the OECD BEPS Action Plan.

Sincerely,

[Signature]

Nancy McLernon
President & CEO
Organization for International Investment
Petrofac Group Representations

Discussion Draft on Preventing The Granting of Treaty Benefits in Inappropriate Circumstances

In response to the paper issued on 14th March 2014 requesting comments from Business and Industry to the proposals in respect of prevention of double taxation treaty abuse, Petrofac Group has the following comments.

Petrofac

Petrofac Limited is a FTSE 100 company listed on the London Stock Exchange and is the holding company for the international group of Petrofac companies (Petrofac). Petrofac is an oilfield services group and operates in 29 countries across the globe, with its primary operational offices in the UAE, UK, India and Malaysia.

Project sites are located in a number of countries where we:

- design and build new oil and gas facilities,
- manage and maintain existing facilities,
- enhance the performance of more mature or marginal facilities, and
- develop and train our customers’ staff to work more effectively and safely.

We operate onshore and offshore, and any of our service lines can be delivered on a standalone basis or they can be integrated together, under a range of commercial models. We have over 18,000 employees around the world.

Corporate History

Petrofac was founded in 1981 in Tyler, Texas, USA.

In 1991 Petrofac established a significant operational centre in Sharjah (UAE) in order to access a low cost skill base which was geographically located in or close to our target markets. The first projects won by Petrofac in the Middle East were in Oman and Algeria.

A small engineering presence was established in the UK in 2001, which primarily carried out Front End Engineering Design work. The UK presence was further expanded with the acquisition of a Scottish facilities management business in 2002 and a Scottish training group in 2004.

In 2005 the parent company Petrofac Limited was admitted to the Official List of the London Stock Exchange. Malaysia and Mexico have subsequently become important and growing markets for Petrofac.

In the meantime there has been massive growth in the UAE, with approximately 6,500 employees now based in the Sharjah offices. The growth of Petrofac has been driven by the commercial imperative to have a low cost base in a highly competitive market.

Action 6

Petrofac agrees with the objective of Action 6, but has serious concerns that the measures drafted will not achieve the matching of economic activity and taxing rights which is what we believe to be the underlying principle the OECD is striving to achieve.

Anti-abuse measures

Our concern around the matching of economic activity and taxing rights can be demonstrated with a simple example where an Engineering, Procurement and Construction (EPC) project is undertaken by our UAE
incorporated and tax resident engineering company (which employs over a third of the Group’s global workforce) in another Contracting State. The measures in the draft proposals suggest that if double non taxation arises this is almost automatically abusive, and that treaty benefits should not be granted. In this case the attribution provisions in the relevant UAE treaty would ensure that the activity carried out in the UAE was not treated as local source income in the country where construction activity took place, and would not be taxed there. This is entirely appropriate given the scale of activity undertaken in the UAE, but because the offshore contractual payments are not then subject to tax on receipt, it is implied that the benefit of the business profits article should not be available.

If this measure were taken to its logical conclusion Petrofac could be commercially disadvantaged if bidding against an entity that was tax resident in a jurisdiction with a relevant treaty and a tax rate lower than that of the Contracting State.

The discrimination becomes even more extreme where withholding tax is applied to offshore payments (which would be relieved under a treaty), and this becomes a final cost to Petrofac, but is either reduced under treaty and/or credited against home state tax by a competitor.

**Limitation of Benefits (LOB)**

Petrofac acknowledges that action needs to be taken to prevent treaty shopping and that this can best be achieved through specific provisions in double tax treaties. However we do not believe that the current LOB clause achieves these objectives but rather it imposes a series of wholly artificial constraints on how multinational organizations would have to structure their businesses in order to qualify for treaty benefits.

For example:

**Paragraph 2**

1. Petrofac has its key business operations and markets outside of the UK but in 2005 Petrofac Limited chose to list on the UK stock exchange, a decision driven by the liquidity and depth of the UK market. As such it is not and never has been resident in the Contracting State where its principal class of shares are traded

2. Petrofac Limited is resident in its country of incorporation under domestic legislation and central strategic management and control is exercised there. However following the establishment of a number of group service centers in other locations which were set up for commercial and cost reasons, some non-strategic operational and financial decisions may be delegated by the Board to those service companies. In addition the service companies would in the normal course of their business, conduct many of the day to day activities necessary for preparing information to enable executive officers to make strategic decisions. Under domestic legislation and that of the countries where the service centers are located, Petrofac Limited remains resident in its country of incorporation, but may not under the LOB definition have its primary place of management and control in the Contracting State of which it is resident.

3. Petrofac will often look to align its legal entity structure with its business unit structure. This is particularly true where there are operational, legal, financing or segregation of risk issues. As a result the holding company structure may include legal entities that are not resident in either Contracting State such that even if Petrofac Limited was a ‘qualified person’ the requirements of Paragraph 2 c) ii) could not be met.

Therefore for purely historic reasons connected with the way the business has developed over the last 30 years, Petrofac Limited and a number of its subsidiaries may not be qualified persons under the LOB definitions.

**Paragraph 3**

Petrofac recognizes that Paragraph 3 provides some relief for company’s where the resident entity is not a qualified
person. However it is concerned that because of the highly integrated nature of its business where a number of group entities work together to deliver major contracts the substantial trade or business activity test found in Paragraph 3 b) could lead to perverse outcomes particularly in the context of large EPC contracts where activity in one of the Contracting States can initially be relatively small, ramp up significantly and then reduce again over a three to five year period.

Paragraph 4

Paragraph 4 of the draft LOB clause provides for a competent authority to grant treaty benefits where the criteria in paragraphs 2 and 3 are not met, if they determine that treaty shopping was not a main driver for the existence of the company. However, we do not think that given the time critical nature of bidding for and implementing significant contracts in the oil industry it is appropriate to leave competent authorities to decide, at some point of their own choosing that treaty benefits would or would not be available. This would not be commercially or practically acceptable.

For all the reasons stated above Petrofac believes that a generic LOB article would impose wholly artificial constraints on the way multinationals structure themselves and force many groups to have to undertake wholesale reorganisations simply to meet the arbitrary requirements of the article. As such we do not believe it would be appropriate to have a LOB clause included in the OECD model treaty.

Conclusion

More generally Petrofac would like to emphasise the concern that it is the nature of Petrofac’s core business to enter into long term contracts, typically 2-5 years, but in some cases 15 or more years. It is difficult to negotiate change of law clauses which would deal with the changes contemplated under BEPS, which are far reaching and to an extent unpredictable. Pricing in our commercial model is based on the facts known at the time of negotiation, including the tax position, and it is imperative to both Petrofac and its clients that there is fiscal stability in all of the relevant jurisdictions.

It is Petrofac’s view that there will be sufficient alternative measures under the BEPS initiatives to address any mismatch between economic activity, beneficial ownership and taxing rights, without the far reaching and generalised measures under the anti-abuse section of Action 6. Petrofac has genuine and significant substance in a low tax jurisdiction, and we do not believe that this should mean that we are competitively disadvantaged, or forced to consider relocation, (which could in itself be determined as a tax avoidance measure in accordance with the discussion draft).
Dear Sir / Ms

DISCUSSION DRAFT ON BEPS ACTION 6: PREVENTING THE GRANTING OF TREATY BENEFITS IN INAPPROPRIATE CIRCUMSTANCES

We welcome the opportunity to make a submission on the Discussion Draft on Preventing The Granting of Treaty Benefits In Inappropriate Circumstances ['the Discussion Draft'] issued by the OECD on 14 March 2014.

Pitcher Partners is one of the largest accounting associations in Australia outside the Big Four. Our specialisation is advising smaller public companies, large family businesses and small to medium enterprises - which we refer to as “SMEs” in this submission.

General comments on SME taxpayers

Tax treaties play a critical role in removing barriers to cross-border trade and investment by SMEs. Any rules that create uncertainty and unpredictability for SME taxpayers about whether they are eligible for the benefits of a treaty will undermine this role.

SME taxpayers already face problems dealing with the compliance issues that are presented by:

- the domestic tax law of their country of residence;
- the tax laws of the countries that they have expanded into;
- the interaction of the domestic tax law of their country of residence with the tax laws of the countries that they have expanded into; and
- the application of any applicable tax treaties.
The Discussion Draft, by making it more difficult for any taxpayer to access the benefits of a tax treaty, will exacerbate these existing compliance issues for SMEs.

We believe that the Discussion Draft will not provide the correct balance between compliance costs and revenue risks for SME taxpayers. In particular, forcing SMEs to have to work through a detailed limitation of benefits rule that larger taxpayers [such as publicly traded companies] will generally be able to easily satisfy without too much analysis, makes little sense in our view and should not be adopted as a policy by the OECD.

**Process to develop any limitation of benefits rule**

The process to decide upon and develop any limitation of benefits rule needs to consider that what might be suitable to require from a large business taxpayer could be totally unsuitable for a SME taxpayer - i.e. when the balance between revenue integrity and compliance costs is properly taken into account.

It is crucial in our view that the process to decide upon and develop any limitation of benefits rule should not be done at a high level - it needs to be practically focused, based on ‘real life’ case studies and it must specifically consider the compliance costs for SME taxpayers.

In particular, the compliance costs for SME taxpayers in working through the proposed limitation of benefits rule set out in the Discussion Draft would seem to far outweigh any potential revenue gains. If SME taxpayers are to be required to work through a limitation of benefits rule (which we do not support) then something far simpler is required.

**Additional comments**

Additional details regarding our general comments on SMEs can be found in the attached Appendix.

**Further information**

Please contact the writer on 03 8610 5401 if you would like more information on, or clarification of, any of the issues raised in this submission or to organise a meeting to discuss this further.

Yours faithfully

PITCHER PARTNERS ADVISORS PROPRIETARY LIMITED

D J HONEY
Executive Director

Encl: Appendix
Appendix - Additional details regarding our general comments on SMEs

Introduction

Our specialisation is advising smaller public companies, large family businesses and small to medium enterprises - which we refer to as “SMEs” in this submission.

In terms of defining SMEs in $A terms, we agree with the classification adopted by the Australian Taxation Office (“ATO”) in its 2013/14 Compliance Program - which regards entities with an annual turnover of up to $250 million as SMEs.

Tax treaties play a critical role in removing barriers to cross-border trade and investment by SMEs. Any rules that create uncertainty and unpredictability for SME taxpayers about whether they are eligible for the benefits of a treaty will undermine this role.

Based on our experiences with SME taxpayers, the major problems they face with tax treaties are:

1. not actually having the resources to analyse and correctly apply the tax treaties in the first place; and
2. the fact that on a cost / benefit analysis it is usually extremely hard to justify spending a large amount of money on complying with the precise terms of a tax treaty.

For example, an Australian private company making its first small expansion outside Australia is unlikely to be able to justify spending thousands of dollars on professional fees to determine if it is disqualified from enjoying the benefits of a tax treaty.

We also highlight that:

(a) there is currently little evidence of widespread erosion of the Australian corporate tax base from tax minimisation activity by multinational enterprises;¹ and

(b) Australia already has a detailed domestic general anti-abuse rule [in Part IVA of the 1936 Tax Act] that deals with tax avoidance generally and which can be used to prevent treaty abuse.

The Use of Trusts by SMEs in Australia

Trusts (and, in particular, Discretionary trusts) are used by thousands of SMEs in Australia as a vehicle for not only holding investments but also for conducting active business operations. For example, it is not uncommon to find that a SME taxpayer will have all of the shares in an operating company held by one family discretionary trust and another discretionary trust holding the assets used by that company - with the beneficiaries of both trusts including a wide range of members of the same family.

As the members of a family may [at any given time] be tax residents of not only Australia but a number of other countries, distributions from these discretionary trusts

¹ See paragraph 83 of the Scoping paper issued by the Australian Federal Treasury in July 2013 entitled ‘Risks to the Sustainability of Australia’s Corporate Tax Base’
can be made totally to Australian tax residents in one year and to a mix of Australian and foreign tax residents in another year.

It is also commonly the case that the trustee of a discretionary trust will, for asset protection purposes, be a private company - whose directors and shareholders may, once again for asset protection purposes, sometimes include non-family members (such as a professional adviser).

Against this background, our experience with Australian SMEs expanding into the US has been that the strict technical application of the limitation of benefits rule in the tax treaty between Australia and the US has not only been problematic but can in some cases make Australian SMEs ineligible.

As the limitation of benefits rule in the Discussion Draft is based on the limitation of benefits rule that is used in US treaties, we are concerned that it will inappropriately restrict SMEs from accessing the benefits of tax treaties.

**Limitation of Benefits Rule**

For example, if the limitation of benefits rule in the Discussion Draft is implemented then a large number of SMEs will be forced to rely on paragraphs 3 and 4 of the proposed article. In this regard, we note that:

(a) the 'substantial test' in paragraph 3 will be problematic unless it is made clear that it is merely included to prohibit an enterprise from creating a nominal presence in the resident country in order to access the benefits of the treaty; and

(b) if US experience is any guide, the discretionary grant of treaty benefits under paragraph 4 could be a lengthy and costly process under which a taxpayer will not know whether it is eligible for treaty benefits until the end of the process.

The great majority of SMEs taxpayers simply do not have the resources available to them to work through a detailed limitation of benefits rule. We submit therefore, that the process for developing any general limitation of benefits rule for accessing tax treaties:

- must take into account the compliance costs that will be imposed on SME taxpayers;

- needs to consider that what might be suitable to require from a large business taxpayer could be totally unsuitable for a SME taxpayer - i.e. when the balance between revenue integrity and compliance costs is properly taken into account; and

- should not be done at a high level - it needs to be practically focused and based on 'real life' case studies.

Forcing SMEs to have to work through a detailed limitation of benefits rule that larger taxpayers [such as publicly traded companies] will generally be able to satisfy without too much analysis, makes little sense in our view. If SME taxpayers are to be required to work through a limitation of benefits rule (which we do not support) then something far simpler and based on easily understood objective tests is required.
Response to OECD Draft on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances
Organisation for Economic Co-Operation and Development
Centre for Tax Policy and Administration
2 Rue Andre Pascal
750016 Paris
FRANCE

Attn: Tax Treaties, Transfer Pricing and Financial Transactions Division OECD/CTPA

April 9, 2014

To Whom It May Concern:

OECD Discussion Draft on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

Thank you for providing Praxity, AISBL¹ with the opportunity to comment on the Discussion Draft on Preventing of Treaty Benefits in Inappropriate Circumstances. In an effort to reduce review efforts for OECD, we have compiled responses from several Praxity member firms; information about the contributors and cooperating firms is included in this letter.

It is important to note that we generally approve of OECD’s efforts to create a set of measures to prevent treaty abuse situations and update limitation of benefits clause as well as other tax abuse prevention mechanisms, discussed in the Draft. What follows are our thoughts on specific elements of the discussion draft that highlight areas of concern for businesses and tax professionals and aim at creating a balance between prevention of tax avoidance and the effect of anti-abuse measures on bona fide taxpayers.

Yours faithfully,

On Behalf of Praxity

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¹ Praxity IVZW, also known as Praxity AISBL ("Praxity"), is a global alliance of independent firms. Praxity is organised as an international not-for-profit entity under Belgium law, with its registered office in Belgium. Praxity has its administrative office in London which is operated under Praxity - Global Alliance Limited, a not-for-profit company registered in England and Wales, limited by guarantee, with its registered office in England. Praxity does not practice the profession of public accountancy or provide audit, tax, consulting or other professional services of any type to third parties. The alliance does not constitute a joint venture, partnership or network between participating firms. The firms that participate in the alliance are independent separate legal entities, and Praxity does not guarantee the services or the quality of services provided by participating firms.
BKD, LLP; Dixon Hughes Goodman, LLP; Plante & Moran PLLC; and WeiserMazars LLP are participant firms of Praxity - the world’s largest alliance of independent accountancy firms which has a presence in more than 80 countries. The authors have made every effort to ensure commentary and factual information contained within this publication are accurate and current. The information/views expressed are not official statements of position, and should not be considered as commercial or technical client advice without seeking professional guidance. This publication has been prepared only as a guide. No responsibility can be accepted by Praxity for loss occasioned to any person acting or refraining from acting as a result of any material in this publication. Any views expressed or advice given are those of the author/authors only and Praxity cannot be held responsible for them.
RESPONSE TO OECD DISCUSSION DRAFT ON PREVENTING THE GRANTING OF TREATY BENEFITS IN INAPPROPRIATE CIRCUMSTANCES

Praxity Response Prepared by:
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OECD DISCUSSION DRAFT ON PREVENTING THE GRANTING OF TREATY BENEFITS IN INAPPROPRIATE CIRCUMSTANCES

The Public Discussion Draft on Tax Treaty Abuse (the Draft) is a practical document that suggests several concrete mechanisms for avoidance of treaty abuse situations. At the same time, certain suggestions of the Draft raise concerns among tax practitioners and businesses. More specifically, the biggest concerns are the complexity of the suggested changes and their possible overreaching effect on taxpayers. Our comments below highlight the areas of such concern.

Multiple Overlapping Mechanisms To Deny Treaty Benefits

The Draft discusses two types of avoidance: where taxpayers try to circumvent limitations of a treaty itself, and where taxpayers attempt to circumvent provisions of domestic rules by applying treaty provisions. The Draft suggests that existing mechanisms of tax treaties are not up to speed with current tax avoidance practices and thus are not sufficient to address both types of avoidance by themselves. In response to that challenge, the Draft proposes concurrent application of three anti-abuse mechanisms, each of which used individually can trigger denial of treaty benefits. They are: (1) limitation of benefits (LoB) clause test, which is to be updated to modern standards; (2) specific provisions aimed at arrangements one of the main purposes of which is to obtain treaty benefits, i.e. “main purpose” test; and (3) application of domestic general anti-avoidance regimes (local GAARs). Concurrent application of three separate tests, however, creates uncertainty for multinationals and individuals with international exposure.

It appears that the aim of the Draft is to use all their mechanisms to prevent any and even remote tax abuse situations, to the point that it is almost forgetting bona fide resident interests. The more so that the nature of anti-abuse tests is quite different: the LoB clause is an objective test that allows taxpayers to rely on mechanical determination of treaty benefits availability, while the “main purpose test” is subjective and is based on facts and circumstances of each particular case. It seems that the latter test is more appropriate for domestic case law, which typically develops general anti-avoidance doctrines anyway, for instance “substance over form” or “step transaction” doctrine in the U.S. It is our opinion that the use of a more general subjective “main purpose” test concurrently with the LoB clause could undermine one of the main purposes of tax treaties – to create a reliable framework for avoidance of double taxation for law-abiding taxpayers. As such, we believe the LoB clause by itself would be
sufficient to reduce the avoidance measures described in the Draft and the main purpose test could be removed.

If the main purpose test is retained (in the form that it was used, for instance in recent Germany-China tax treaty), its scope could be nonetheless limited to that of dominant purpose of tax avoidance, rather than “one of the main purposes”, as it is currently phrased. At the very least the taxpayers should benefit from a *bona fide* presumption for the purposes of the main purpose test. LoB clause is a more proper instrument which allows taxpayers to rely on the treaty and obtain a certain degree of confidence in their chosen tax positions. The analysis of factual patterns should be left with the authority of domestic legal system and domestic GAARs. The competent authorities should only step in where there is evidence through exchange of information or other treaty mechanisms of a potential avoidance situation.

**Limitation of Benefits Clause: Complex And Restrictive**

While the LoB clause can be an effective instrument of combatting tax avoidance, it should not be overly complex in its language and application. Existing U.S. LoB clauses can serve a good example of over-complexity: the only clear-cut test applies to public companies (aside from individuals), but medium-sized business entities are subject to additional tests on qualified ownership and base erosion/base reduction. The latter test mostly affects medium-sized business and LoB over-complexity may discourage such taxpayers from resorting to treaties at all, thus leaving them at a disadvantage as opposed to bigger public company businesses.

More straight-forward LoB clauses used by certain other jurisdictions could serve a more appropriate general standard. For instance, newer tax treaties of Japan (e.g. with New Zealand, the Netherlands, Australia) contain a much simpler test for business entities to qualify under. The LoB tests provide relief for business entities of either contracting states that are owned directly or indirectly by qualified persons (such as individual residents, governmental organizations, public companies, charities, etc.), by at least 50 percent of the voting power or other beneficial interests of the entity. It is thus possible and reasonable to start with a clear general standard, which the contracting states may further develop, if they chose to do so.

At the same time, certain provisions of “complex” LoB clauses may be useful, such as the derivative benefits clause, and certain safe harbor exceptions. The “derivative benefit” clause is typically found in U.S.-EU-country treaties. It allows an entity to benefit from a treaty when it has so-called equivalent beneficiaries, i.e. beneficiaries that are residents in a treaty country allowing the same or more favorable treatment that the treaty under which the residents are attempting to qualify. Derivative benefits clause can remedy quite typical structuring situations where a joint venture is created by three different residents: they would still be able to enjoy the benefits of the treaty which will allow to look through the structure to determine equivalent beneficiaries, even if the entity failed to satisfy the general 50% control test of the LoB clause otherwise.

It is important to preserve a safe harbor test in case of active conduct of trade or business in the country of incorporation. Another safe harbor that is worth incorporating into the LoB clause is the headquarters exception. This exception appears in several treaties and provides that regional headquarters are allowed to benefit from treaties when the entity functions as a “qualifying headquarter of a
multinational group”, typically this occurs when a substantial portion of the overall supervision and administration of the group is conducted by such entity. This exception is quite important, since many multinationals currently organize their regional centers in that way.

Further, certain terms used by the Draft for the purposes of LoB eligibility test should be clarified: such as the definition of gross income, which can be interpreted as either revenue or gross profits, or the definition of deductible payments – to distinguish them from certain exempt items.

**Poor Mechanism For Dual Residency Conflicts Resolution**

The Draft suggests an amendment to paragraph 3 of Article 4 of the OECD Model Tax Convention. The amendment requires that the competent authorities of the contacting states resolve conflicts in case of dual residence of business entities. Further, this provision completely denies treaty benefits to a business entity in the absence of such agreement. Thus, there is no reliable mechanism for business to resolve dual residency situation, but rather an administrative procedure. It is doubtful whether the competent authorities of various jurisdictions would be prepared to deal with a large inflow of requests, which is surely to follow considering the number of multinationals and conflicting domestic residency rules. Reaching an agreement between competent authorities might turn out to be not only an administrative burden but also and most certainly a time-consuming exercise. Thus, effective management test could be useful to retain and complemented by a criteria of an independent entity (separate to the criteria of substance). Perhaps, the focus should be on the development of an extra “intermediate” test, somewhat similar to tie-breaker rules that are used for determination of individual residency. The test could be based on such criteria as, for instance, effective management and control, place of business operations, location of assets, key personnel and resources, etc.
On behalf of the Public Affairs Executive (PAE) of the EUROPEAN PRIVATE EQUITY AND VENTURE CAPITAL INDUSTRY

9 April 2014

To     Organisation for Economic Co-operation and Development (OECD)

Re     Consultation on Public Discussion Draft BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances.

Introduction:

The Public Affairs Executive (PAE) of the European Private Equity and Venture Capital industry is pleased to provide its comments on the public discussion draft released by the OECD on Action 6 (“the Consultation Document”).  

We write on behalf of the representative national and supranational European private equity (including venture capital)1 bodies. Our members cover the whole industry, from the institutional investors who provide the capital for investment to the private equity firms who invest the capital in European companies at all stages of their development.

Importance of Private Equity in Financing the Real Economy:

Private equity provides patient and engaged investment for the long-term, providing finance to businesses across OECD countries, and particularly to SMEs.

The private equity industry participated in the process that led to G20/OECD High-Level Principles of Long-term Investment Financing by Institutional Investors in 2013.2 As set out in Principle 1.4, a pre-condition for long-term investment is “tax neutrality towards different forms and structures of financing”. This Principle also adds that “investment frameworks should as far as possible be made consistent across countries to facilitate the cross-border flow of long-term financing.” Any standards for addressing the issue of Treaty Abuse under the BEPS Action Plan must also be examined against this backdrop therefore.

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1 The term “private equity” is used in this paper to refer to all segments of the industry, including venture capital. The term “venture capital” is used in specific contexts where there are issues that relate particularly to this segment.

As confirmed in the recent European Parliament Report on Long-term Financing of the European Economy\(^3\), “private equity firms can provide valuable non-financial support, including consultancy services, financial advice, advice on marketing strategy, and training” to investee companies. This sentiment has been echoed in the recent European Commission Communication on Long-term Financing\(^4\), which acknowledges the private equity industry as an important source of financing to pension funds and SMEs. Private equity represents all these qualities on a global, not just European basis.

We would also like to highlight Principle 6.2 which states that “governments should avoid introducing or maintaining unnecessarily barriers to international investment – inward and outward – by institutional investors, especially when targeted to long-term investment. They should cooperate to remove, whenever possible, any related international impediments.”

**How Private Equity Operates:**

Private equity funds raise capital from institutional investors such as pension funds, insurance companies, or family offices. These private equity funds are managed by specialist investment managers who invest the capital in companies across a wide variety of sectors, including consumer, industrial, engineering, life sciences, bio-technology, computer software, infrastructure, etc, at various stages of the life of the company.

Most private equity funds have an international investor base. The investors are either subject to corporate income tax in their country of residence (insurance companies, family offices), or are exempt from such tax by their nature (pension funds, charities).

The choice for the private equity fund’s location is normally made on the basis of various factors (residence of the management team, investment objective, regional focus). From a tax perspective, it is key that the location and structure of the fund is tax neutral for the investors. In other words, the pooling of the investments via the fund entity should not trigger additional tax for investors when compared with a situation in which the investors invest directly in those companies.


\(^4\) European Commission Communication on Long-term Financing of the European Economy, 27 March 2014, pp 6 & 13
Context of the Consultation:

The private equity industry fully appreciates the concerns of the OECD that action is needed to effectively prevent double non-taxation, as well as cases of no or low taxation associated with practices that artificially segregate taxable income from the activities that generate it. We also support a coordinated and comprehensive international approach to tackle these important issues.

We note that the Consultation Document refers to the 2010 OECD Report\(^5\) on the treatment of Collective Investment Vehicles (hereinafter: the “CIV Report”) and the Commentary to article 1 of the OECD Model Convention regarding the “Application of the Convention to CIVs”. The policy objective in this provision is to achieve tax neutrality between direct investment versus investment via funds, also referred to as “collective investment vehicles” or “CIVs”. The OECD made several proposals to grant treaty benefits to CIVs in their own right. This is because it is recognised that it is not obvious to expect that treaty benefits are being granted to the investors in a CIV on a transparent or “look through” basis in practice.

The private equity industry is concerned that the BEPS Action 6 Draft Plan (the “Treaty Abuse Draft”), if implemented, will disallow treaty access to many CIVs (and their holding entities) used in the private equity industry. The Abuse Draft is likely to affect many funds that invest cross border because most CIVs will simply not pass the proposed Limitations on Benefits (LOB) test.

As a result, the tax burden of investing via funds is likely to substantially increase. This would clearly bring the investment environment further away from the policy objective - adopted by the OECD Council - of tax neutrality between direct investments and investments via a CIV.

Disallowing funds from treaty access may easily result in double (or even triple) taxation. As a result, institutional investors may stop investing in private equity if the tax burden associated with cross-border investing becomes too high. The application of the Treaty Abuse Draft would be a major setback for the aim of creating a “level playing field”.

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\(^5\) The Granting of Treaty Benefits with respect to the income of Collective Investment Vehicles, public discussion draft 9 December 2009 to 31 January 2010, released by the CFA-OECD (2010) and the Commentary to the OECD Model Convention regarding CIVs.
Proportionality & Impact on Collective Investment Vehicles:

Many of the challenges presented to the private equity industry by the Consultation Document are borne of the fact that the document does not consider the position of CIVs to any extent (private equity being one of many classes of CIV). This is perhaps to be expected, given that CIVs are not a particular focus of BEPS, but it remains the case that the failure to consider the position of CIVs has directly led to many of the issues noted in this response.

It is clear from previous OECD publications such as the 2010 OECD Report on the treatment of collective investment vehicles, and the January 2013 TRACE implementation package, that the OECD is aware of the particular challenges faced by CIVs in relation to treaties. This recognition is to be welcomed, but we strongly urge the OECD to turn this recognition into a workable plan for the treatment of CIVs. We see two alternatives in this regard:

Firstly, CIVs of all descriptions can be explicitly excluded from the current Treaty Abuse Draft, and provision made in the proposed amendments to the model treaty to make clear that the LOB provision and/or purpose test will not act to restrict the ability of a CIV (or associated investment structure) from accessing treaty benefits. A new work stream could be created to address the particular circumstances of CIVs, building on the past OECD CIV initiatives. This is our preferred approach. Alternatively, the position of CIVs of all descriptions could be taken into account as part of the Action 6 work, and actions to address the particular circumstances of CIVs should be adopted at the same time as and as part of the output of the Treaty Abuse Draft work.

Limitation on Benefits (LOB) Test:

The private equity industry does not consider that the LOB provision is proportionate or necessary to meet the policy objective of preventing treaty shopping. As such, we are of the view that the LOB provision should be abandoned. Not least, this is in recognition of the significant cost and complexity which will arise if new arrangements have to take into account both an LOB provision and a main purpose provision (in addition to existing concepts such as beneficial ownership). Taken together, these provisions would represent a considerable burden and will ultimately act as a disincentive to international investment.

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7 Treaty Relief and Compliance Enhancement (TRACE), January 2013
As currently drafted, many private equity funds and holding companies owned by such funds would not meet the LOB test for several reasons:

(i) the fund and the holding companies will not be listed;

(ii) neither the fund nor the holding companies will be treated as carrying on an active trade or business for the purposes of the proposed LOB test. Under the formulation of the LOB test currently proposed, the making or managing of investments will be deemed not to satisfy this test unless carried on by a bank, insurance company or securities dealer.

(iii) the “derivative benefits” provision as currently proposed is very narrow. The proposed LOB test, as drafted, would disqualify a fund entity (including holding companies of a fund entity) as a “qualified person”, and would therefore deny tax treaty protection to the fund. This is because at least 50% of the beneficial interests in a fund are often not owned by persons that are resident in the country where the investment vehicle is resident. This is inherent to the nature of many private equity funds that raise capital from investors in many different jurisdictions.

Holding companies in certain jurisdictions can ensure that CIV investors are afforded greater certainty regarding insulation from legal liabilities that might flow out of a domestic structure to non-domestic parents. This matter is particularly relevant where shareholder consent outside of the investee jurisdiction is given, or entities are deemed to be subject to a controlling parent which can give rise to liabilities arising in the controllers hands. An intermediate holding jurisdiction can often provide the only meaningful shield to these risks.

Investors in private equity funds are often entitled to treaty benefits in their home jurisdiction. We believe that an expanded derivative benefit provision could afford some relief from the double taxation which certain investors in private equity are likely to suffer should the proposals proceed as drafted. However, there will be significant challenges to applying a derivative benefits provision in certain circumstances, for example, in the case of investment into private equity funds by other fiscally transparent funds such that the treaty status of ultimate beneficiaries is not apparent to the private equity fund. It is important to note that the implementation of FATCA will not result in fund managers having access to information about the treaty status of each ultimate beneficiary of investment returns from the fund.
Even if it were decided to include a so-called “derivative benefits test”, there would still be uncertainty in many cases whether the LOB clause would allow treaty access. We provide some examples below to illustrate these problems.

**Example 1:**

A venture capital fund (“VC fund”) is organized as a limited partnership in country X. Among its investors are pension funds, endowments, family offices and insurance companies from 10 different countries, all of which are OECD member countries. The VC Fund invests in expansion capital of a start-up company in the life sciences business (“Target”) established in country Y. The VC fund owns all its investments, including the equity interest in Target, through a wholly-owned holding company (“Holding”) in country Z.

After 6 years of growth and development, the VC fund’s investment in Target is sold successfully. Under its domestic tax law, country Y imposes a capital gains tax on the disposal of shares by foreign shareholders. Generally, this capital gains tax cannot be imposed on foreign shareholders under article 13 OECD Model Treaty if the foreign shareholder of Target is a tax resident of a country with which country Y concluded a tax treaty based on the OECD Model Treaty. Country Z and Country Y concluded such a tax treaty which is in effect.

Under the proposed LOB test however, the VC fund and Holding would be disqualified from obtaining treaty benefits. If the investors in the VC fund would have invested directly in Target however, it is likely that all investors would have qualified for treaty benefits under the proposed LOB test. This demonstrates that the proposed LOB affects many CIVs and the wholly-owned holding companies through which the CIVs make their investments.

In addition, the proposed LOB test works out even worse as it may create triple taxation because the investee companies in which the VC fund makes investments may be denied treaty benefits as well as a result of the proposed LOB.

**Example 2:**

In the same scenario as Example 1 above, let us consider what happens when the VC fund invests together with another (similar) VC fund established in country A in the life sciences business of Target, established in country Y. The two VC funds jointly acquire 60% of the shares in Target. The business of Target is developing very successfully and it is going to license patents to unrelated parties worldwide, receiving royalties in return. Target wants to claim tax treaty relief for withholding tax on the royalty payments. If Target were domestically owned by
investors established in country Y, it would qualify for treaty benefits under Article X(2)(e) of the proposed LOB.

Target, however, needed funding from the VC funds for the development of its business to the next stage, including further development of the patents. As a result of the funding by the VC funds, Target cannot rely on article X(2)(e) anymore, and can claim treaty benefits only if it passes the “substantial business test” of Article X(3) of the proposed LOB. There are however too many uncertainties to rely on the substantial business test.

We foresee a lot of discussion and debate as to the question of what exactly qualifies as “substantial in relation to the trade or business activity carried on by the resident or associated enterprise in the other Contracting State”? If a multinational pharmaceutical in country B pays royalties to Target, the business activity of Target must be substantial in relation to the trade or business of the multinational in order to pass the test. This will mean that Target will often be disqualified and face full withholding tax liabilities.

Given the above, while we do not support the concept of an LOB provision, if this aspect of the proposals does proceed then we would urge the OECD to include specific provision for CIVs (including the holding entities through which CIVs invests if such holding entities are controlled by the CIV) in the derivative benefit concept, recognising that this would have to work as part of a wider framework for treaty access for CIVs.

In particular, consideration should be given to including a CIV (and the aforementioned holding companies) in the definition of a “qualifying person”, provided that certain conditions are met (for example, that the CIV is not controlled by one or a small number of investors, and/or that the CIV is registered or is managed by a registered fund manager

**Main Purpose Test:**

Even if the LOB test is satisfied, the “Main Purpose Test” will be another major obstacle for claiming tax treaty protection by CIVs. The examples given at paragraph 33 of the Consultation Document make clear that it is acceptable to take treaty access into account when making investment decisions. On the face of it this would seem at odds with the paragraph 6 test.

We agree with the text of paragraph 30 of the Consultation Document, which broadly explains that in order for the test to not apply, it is not sufficient to merely assert that access to treaty benefits was not a main purpose of an
arrangement; it must be so that all available evidence is taken into account in determining the purpose of an arrangement. However, we do not consider that the objective approach described under Paragraph 29 is appropriate.

In answering the question of the main purpose of an arrangement, it is the facts and circumstances which the parties actually took into account in arriving at that arrangement - not what an independent third party believes that they should have taken into account - which should be relevant. To do otherwise would be disproportionate and likely to affect normal commercial arrangements as parties will have no appetite for engaging in protracted discussions over what facts and circumstances are relevant to establishing purpose. As such, the test should be subjective, not objective.

Finally, it is unclear how the “Main Purpose test”, if applied objectively, would work out in practice for a typical European private equity fund. The Treaty Abuse Draft states that “[t]o determine whether or not one of the main purposes of any person concerned with an arrangement or transaction is to obtain benefits under the Convention [a tax treaty], it is important to undertake an objective analysis of the aims and objects of all persons involved in putting that arrangement or transaction in place or being a party to it”.

In combination with the recommendation to confirm that a tax treaty will not prevent a state from applying its domestic anti-abuse rules, we fear that many countries may take the position that a typical investment vehicle of a fund is not entitled to treaty benefits, as not all of the investors in a given fund would be entitled to exactly the same treaty benefits, had they invested directly.

Conclusion:

Private equity funds are not in the business of treaty shopping. The primary purpose of private equity, just like other CIVs, is a business purpose, i.e. pooling of capital to make investments. As long as different countries’ interpretations of what constitutes a permanent establishment are not harmonised across the globe, tax treaty access will remain crucial in order to achieve tax neutrality for funds, and to avoid double or even triple taxation in otherwise genuine bona fide investment structures.

The position of CIVs in relation to treaty access must be considered and addressed before the Treaty Abuse Draft work stream continues.

We do not consider that the proposed LOB test is proportionate or necessary in order to meet the policy objective.
Contact

Thank you in advance for taking our comments into account as part of the consultation process. We would be more than happy to further discuss any of the comments made in this paper.

For further information, please contact Danny O’ Connell at the European Private Equity & Venture Capital Association (EVCA).

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The Public Affairs Executive (PAE) consists of representatives from the venture capital, mid-market and large buyout parts of the private equity industry, as well as institutional investors and representatives of national private equity associations (NVCAs). The PAE represents the views of this industry in EU-level public affairs and aims to improve the understanding of its activities and its importance for the European economy.

About EVCA

The EVCA is the voice of European private equity.

Our membership covers the full range of private equity activity, from early-stage capital to the largest private equity firms, investors such as pension funds, insurance companies, fund-of-funds and family offices and associate members from related professions. We represent 650 member firms and 500 affiliate members.

The EVCA shapes the future direction of the industry, while promoting it to stakeholders such as entrepreneurs, business owners and employee representatives.

We explain private equity to the public and help shape public policy, so that our members can conduct their business effectively.

The EVCA is responsible for the industry’s professional standards, demanding accountability, good governance and transparency from our members and spreading best practice through our training courses.

We have the facts when it comes to European private equity, thanks to our trusted and authoritative research and analysis.

The EVCA has 25 dedicated staff working in Brussels to make sure that our industry is heard.
To OECD/CTPA
Tax Treaties, Transfer Pricing and Financial Transactions Division
Sent per email to: taxtreaties@oecd.org

Cc:
Ministry of Finance, Norway
Sent per email to: postmottak@fin.dep.no

OECD, Centre for Tax Policy and Administration on Base Erosion and Profit Shifting (BEPS)
Sent per email to: CTP.BEPS@oecd.org


COMMENTS ON ACTION 6 PREVENT TREATY ABUSE

The OECD has invited interested parties to send comments by 9th April 2014 on a discussion draft, which includes the preliminary results of the work carried out in the three different areas identified in Action 6:

A. Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances.

B. Clarify that tax treaties are not intended to be used to generate double non-taxation.

C. Identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country.

PWYP Norway is a national chapter in the worldwide network Publish What You Pay, which work for transparency and accountability in the extractive industries. While the Norwegian chapter is backed by 19 Norwegian civil society organizations, the full international network is backed by more than 800 organizations worldwide, most of them working in resource rich countries in the South.

PWYP Norway has recently sent its comments to the consultation on economic “spillovers” to the IMF, which we copied to OECD/BEPS. However, we would like to introduce this cover letter in order to link the paper to IMF closer to the work OECD is doing on treaty abuse. Attached is the full document sent to IMF.
We will particularly address “the design of domestic rules” under A, “double non-taxation” under B and “the tax policy considerations that ... countries should consider” under C above.

In the document to IMF we outline 4 areas that need to be addressed in order to avoid capital flight and treaty abuse:

- **Unilaterally:** A country needs to have a good system of withholding taxes in order to avoid amongst other treaty abuse. It is fully possible to significantly hinder capital flight if a few general principles are followed with respect to how withholding taxes are built up. First, multinational companies need at least one road to freely receive money back on an investment. This should be through dividends, which is always based on after-tax cash flows. Withholding taxes on dividends should therefore preferably be set to zero. Second, other cash flows which are not based on individual transactions, and which are always based on pre-tax cash flows, should preferably have withholding taxes built up using a system which takes into account the tax level in the country that receives the dividends. Such a system is fully described in chapter 4B in the document to IMF attached to this letter, and PWYP Norway regards it as a prerequisite in order to enter into a tax treaty.

- **Unilaterally:** Despite the ability of withholding taxes to stop a lot of capital flight, they are quite inadequate to deal with the problem of abuse of the financial instrument derivatives. PWYP Norway has produced a report, “Protection against derivative abuse”\(^1\), where we describe the main mechanisms of how derivatives can shift potentially enormous amounts of pre-tax money across borders. In chapter 4C in the document to IMF attached to this letter, we describe how a simple, unilateral mechanism can stop derivatives abuse while at the same time protect the proper use of derivatives for hedging etc. PWYP Norway regards it as fundamental to have mechanisms in a tax system that effectively stops derivatives abuse. The protection will work also against new derivatives that are developed and the suggested mechanism is thus a general protection mechanism in a tax system.

- **Unilaterally:** Despite the ability of withholding taxes to stop a lot of capital flight, they are quite inadequate to deal with capital gains issues in a country’s tax system. In chapter 4C in the document to IMF attached to this letter, we describe several approaches to capital gains taxation that a country needs to take into consideration before entering into a tax treaty. PWYP Norway regards it as highly necessary for a country to have a symmetrical approach to capital gains taxation in order to avoid capital flight through capital gains.

- **Multilaterally:** PWYP internationally has for years promoted introduction of rules for publishing tax payments on a country-by-country and a project-by-project basis. This has resulted in country-by-country regulation in the US for extractive industries and in the EU for extractive industries, forestry and also in France for the banking sector. PWYP Norway has produced a report, “An extended country-by-country reporting standard”\(^2\), that addresses the need for putting such tax payments into their natural context on a country-by-country basis, as no figure in isolation is very meaningful. PWYP Norway has demonstrated how this can very simply be done by publishing, in notes to the financial accounts, 8 key financial figures, that creates the link between the tax payments published country-by-country and the basis for these tax payments. This is fully described in chapter 4D in the document to IMF attached to this letter. PWYP Norway regards it as fundamental in order for country-by-country reporting to

\(^1\) [http://www.publishwhatyoupay.no/en/protection-derivative-abuse](http://www.publishwhatyoupay.no/en/protection-derivative-abuse)

\(^2\) [http://www.publishwhatyoupay.no/en/node/16403](http://www.publishwhatyoupay.no/en/node/16403)
work properly and be a cost effective and effective instrument, that this context is published together with or in conjunction with the tax payments. PWYP Norway believe that extended country-by-country reporting is fundamental

- for investors to follow their money and be better able to prioritize which companies to invest their money in
- for regulators to create the appropriate regulation for multinational companies and national companies alike
- for civil society to ensure that companies are playing by the same rules.

PWYP Norway would recommend that OECD puts country-by-country reporting of tax payments *in context* as a main instrument to secure insight into multinational companies in order to support investor control, better regulation by governments and better guidelines from multinational institutions like the OECD and improved democratic control by civil society, media and others. PWYP Norway believes extended country-by-country reporting is the best instrument to counter principal-agent problems in today’s world related to multinational companies and issues related to base erosion and profit shifting out of developing countries. It is thus highly beneficial that OECD supports and promotes extended country-by-country reporting.

We refer to the attached document for a full description of the problems highlighted and solutions promoted by PWYP Norway.

PWYP Norway sees that OECD intend to publish all comments received, and we appreciate this transparency.

Yours sincerely,
On behalf of Publish What You Pay Norway,

Mona Thowsen,
Secretary General
PwC’s comments on Action 6

PwC welcomes the opportunity to comment on the OECD Public Discussion Draft regarding BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances. As a global professional services business with a network of firms throughout the world, we work with a full variety of business enterprises both as advisers and auditors and are continuously involved in dialogues with tax administrators throughout the world. This experience makes us keenly aware of the challenges faced by both taxpayers and tax administrators in the interpretation and application of income tax treaties.

We welcome the Discussion Draft as a starting point in the OECD’s development of Action 6 for preventing the granting of treaty benefits in inappropriate circumstances. The OECD has played a leading role in setting the standards that have led to a robust network of income tax treaties that are vital in the promotion of international trade and investment by removing tax barriers to cross-border transactions. We submit, however, that many of the proposals in the Discussion Draft have the potential to erode this accomplishment by creating uncertainty for both taxpayers and governments and by narrowing which business enterprises would have access to income tax treaties to mitigate excessive taxation and double taxation.

Below, we offer our specific comments and suggestions in the context of the proposals set out in the Discussion Draft. To put our comments in perspective, they are guided by the following fundamental principles:

- Bilateral income tax treaties exist, first and foremost, because they promote cross-border trade and investment between residents of the treaty partners by eliminating tax barriers.
- The intended beneficiaries of tax treaties are the individuals, organisations, and enterprises that are subject to residency-based taxation in their home country and have sufficient nexus in that country.
- If a tax treaty lends itself to inappropriate use by residents of third countries or facilitates double non-taxation, the above vital roles are compromised.
- In order to not undermine the fundamental role of tax treaties, rules developed to combat their inappropriate use should:
  - Be designed to ensure that they do not impede access to treaty benefits for bona fide residents that are not motivated by treaty shopping or abusing the rules to achieve unintended benefits;
  - Adhere to the standards set out in the OECD’s Action Plan to establish “agreed international rules that are clear and predictable, giving certainty to both governments and businesses”; and
  - Be administrable so that they do not strain the resources of tax administrators.

We submit that the current draft falls short of meeting these basic goals and we offer our suggestions as to how to bring the proposals into conformity with these goals.
1. Comments on Part A

Executive Summary

In summary we:

1. Recommend specific modifications to the proposed Entitlement to Benefits article to eliminate overly restrictive standards and to add clarity and predictability;

2. Recommend that the final paper clarify that the Working Party has not addressed the application of income tax treaties to collective investment vehicles and pooled funds, which is being addressed independently of the BEPS project;

3. Urge that the main purpose test be eliminated from the article as it would undermine a basic benefit of the article of providing objectivity and predictability and the concerns it is aimed at addressing should be dealt with in other ways as we explain below; and

4. Offer comments on the dual residency test and additional anti-abuse rules considered in the Discussion Draft.

1.1. Entitlement to Benefits article: eliminate overly restrictive standards to add clarity and predictability

We welcome the inclusion of an article providing objective criteria for establishing a person’s entitlement to treaty benefits. Such provisions, if appropriately drafted, will serve to provide a yardstick for situations where granting treating benefits is justified and where it is not. This increases the investment certainty for business. This would also reduce tax controversy by providing tax authorities and courts objective criteria to assess whether entitlement to treaty benefits is appropriate. However, the Entitlement to Benefits article as proposed in the Discussion Draft seems unduly and unnecessarily complex, adding new areas of uncertainty and controversy and has the potential to deprive bona fide business enterprises of access to treaty benefits.

In the next section, we identify and explain specific changes we would recommend to achieve an acceptable model that addresses treaty shopping without impeding access to the treaty for those not engaged in treaty shopping. This reduces new and unnecessary areas of controversy. In doing so, we draw on the experience in the US, where a limitation on benefits (LOB) article has been included in income tax treaties since the 1980s. We note that, in recent years, the US has added further restrictions, many of which are repeated in the Discussion Draft’s model, that we believe are inappropriate (as detailed below). Only a handful of US tax treaties have these additional restrictions.

1.2. Suggested revisions to the Entitlement to Benefits article

In the following comments, we suggest modifications to specific sections of the article.

1.2.1. Publicly traded company test

c) a company if:

i) A) the principal class of shares (and any disproportionate class of shares) is regularly traded on one or more recognised stock exchanges
This modification eliminates the additional criteria in the current draft that would require a publicly traded company to also establish that it has a substantial presence in its residence country based on where its shares are primarily traded or where its primary place of management control takes place. This is based on the position in recent US tax treaties, added at a time when US policy makers were focused on formerly US parented groups that had “inverted” so that the parent was no longer a US corporation. It was added to limit the ability of inverted companies to access US tax treaty benefits. This is an addition that was made to address a domestic tax policy concern. The more appropriate place to address that concern is in domestic law (and, in fact, it is addressed in US domestic law by the addition of a provision that treats a former US company meeting the provision’s criteria as continuing to be treated as a domestic corporation for tax purposes).

However, since the substantial presence test has nothing to do with residents of third countries accessing the benefits of the treaty, it has no place in an LOB article. Most importantly, it would deprive many publicly traded companies of access to the treaty because: (1) they choose to list their shares on an exchange outside their country of residence to access an exchange with broader access to investors and (2) the corporation is a multinational enterprise that has decentralised management. In summary, the publicly traded test we have proposed is a test that has been accepted as the appropriate standard for decades and was altered in the US, not because of any perceived shortcomings to the test but rather to further a domestic policy objective. It would add a significant layer of complexity, particularly in the context of the imprecise principal place of management and control test, which would harm both taxpayers and tax administrators.

Likewise, the proposed paragraph 2c)i)A) requirement for shares to be traded on a local stock exchange would in our view breach EU/EEA law for treaties between EU or EEA countries and should, to be EU/EEA law compliant, be expanded to shares traded on a stock exchange anywhere in the EU/EEA (see in particular the ECJ RBS case C-311/97).

1.2.2. Subsidiary of a publicly traded company

le at least 50 percent of the aggregate voting power and value of the shares (and at least 50 percent of any disproportionate class of shares) in the company is owned directly or indirectly by five or fewer companies entitled to benefits under subdivision i) of this subparagraph

This is the same language as in the Discussion Draft except that it eliminates the restriction that, in the case of indirect ownership, each intermediate owner is a resident of either Contracting State. The Discussion Draft offers no explanation of why this restriction is needed and we question the foundation for such a restriction (which is repeated in the ownership/base erosion test and in the derivative benefits test, as discussed below).

Such a restriction on intermediate companies would in our view again be contrary to EU/EEA law (see in particular the Papillon case re tracing French tax grouping via an intermediate Dutch company C-418/07).

In most countries, a dividend from a subsidiary to its parent company is exempt from taxation in the hands of the parent company. So, income earned in the subsidiary could readily be distributed to the parent and then reinvested by the parent in an affiliate in a third country.

We do not see why there should be any policy reason justifying why having the income pass through a third country intermediate holding company is unacceptable whereas having the income move horizontally is perfectly acceptable. Most multinational enterprises (MNEs) involve hundreds, if not thousands, of affiliates each based in a specific country for business reasons dictated by the function the company performs. It is very common for an MNE to have regional holding companies established in jurisdictions whose laws and infrastructure are most compatible with a holding company function. We submit that, before a restriction that would constrain a typical MNE by precluding an efficient regional holding company structure is adopted, the reason why this is considered necessary should be aired to give stakeholders an opportunity to provide input.
1.2.3. Ownership/base erosion

e) A person other than an individual, if:

i) on at least half the days of the taxable year, persons who are residents of a Contracting State and who are entitled to the benefits of this Convention under subparagraph a), subparagraph b), subdivision i) of subparagraph c), or subparagraph d) of this paragraph own, directly or indirectly, shares or other beneficial interests representing at least 50 percent of the aggregate voting power and value (and at least 50 percent of any disproportionate class of shares) of the person, and

ii) less than 50 percent of the person’s gross income for the taxable year is paid or accrued, directly or indirectly, to persons who are not residents of either Contracting State entitled to the benefits of this Convention in the form of payments that are deductible for purposes of the taxes covered by this Convention in the person’s Contracting State of residence (but not including arm’s length payments in the ordinary course of business for services or tangible property).

This proposed language departs from the Discussion Draft in three important respects.

First, for the same reasons as discussed immediately above, it eliminates the requirement that any intermediate owner be a resident of the same country as the tested company, a requirement even more questionable in a test that also includes a base erosion criterion.

Secondly, it treats residents of either country as acceptable owners of at least fifty percent of the shares. This is the test that has historically applied under US tax treaties and was changed to the more restrictive version treating only residents of the same country as the residency of the tested company as “good” owners around the same time the substantial presence test was added to the publicly traded test, presumably for the same domestic policy considerations aimed at inverted companies. Again, the Discussion Draft has no direct discussion of why a joint venture company owned or controlled by residents of the two Contracting States should be denied access to the benefits of the treaty. However, footnote 3 in the Discussion Draft suggests that where a resident of a Contracting State seeks treaty benefits through use of an entity resident in the other Contracting State, this could be considered a form of treaty shopping. This would be a novel departure from the traditional view of treaty shopping – that is, a resident of a third jurisdiction attempting to achieve the benefits of the treaty. Most countries have anti-deferral rules, such as CFC legislation and, in the case of the US, its passive foreign investment company (PFIC) rules, that would currently tax its residents on income earned by a CFC or a PFIC if the income were passive in nature. In other words, the policy issue perceived in footnote 3 is best addressed by domestic legislation and, in fact, already is in the domestic law of many countries, rather than artificially disrupting the formation of a business joint venture.

Thirdly, we have revised the base erosion test to provide that deductible payments made to residents of either of the Contracting States will not be considered base eroding payments. Under the Discussion Draft, payments that are not for services or tangible property, such as interest or royalties, made to corporate recipients can only escape base eroding categorisation if the recipient is a publicly traded company. Hence, a totally local enterprise that, in the ordinary course of business, makes payments on a loan from a bank that is a subsidiary of a publicly traded bank holding company, or makes payments to a local business for a license of software may find itself disqualified from the ownership/base erosion test.

1 If the OECD adopts something along the lines suggested in the recently issued Discussion Draft on Tax Challenges in the Digital Economy which would limit interest expense to interest paid on external debt, then interest should not be considered a base eroding payment for purposes of the LoB because the ability to erode a particular jurisdiction’s tax base would be eliminated.
1.2.4. Active trade or business test

The resident is engaged in the active conduct of a trade or business in the Contracting State of which it is resident (other than the business of making or managing investments for the resident’s own account, unless these activities are banking, insurance or securities activities carried on by a bank, insurance company or registered securities dealer respectively), substantially all of its income is derived in connection with, or is incidental to, that trade or business, and if a resident of a Contracting State derives an item of income from a trade or business activity conducted by that resident in the other Contracting State, or derives an item of income arising in the other Contracting State from an associated enterprise, the trade or business activity carried on by the resident in the first-mentioned Contracting State is substantial in relation to the trade or business activity carried on by the resident or associated enterprise in the other Contracting State. Whether a trade or business activity is substantial for the purposes of this paragraph will be determined based on all the facts and circumstances.

For the purposes of applying the above paragraphs, activities conducted by persons connected to a person shall be deemed to be conducted by such person. A person shall be connected to another if one possesses at least 50 percent of the beneficial interest in the other (or, in the case of a company, at least 50 percent of the aggregate vote and value of the company’s shares or of the beneficial equity interest in the company) or another person possesses at least 50 percent of the beneficial interest (or, in the case of a company, at least 50 percent of the aggregate voting power and value of the company’s shares or of the beneficial equity interest in the company) in each person. In any case, a person shall be considered to be connected to another if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same person or persons.

We have altered this test to provide that the test is met if substantially all of the resident's income is derived from the active conduct of its trade or business (rather than limiting its application to income that is connected to the trade or business) to simplify the test, with the added requirement that business connected income must be substantially all of the income of the tested entity and, for that reason, have added this to the category of qualified persons. To provide greater certainty in applying this, we recommend that substantially all the income of the tested entity be defined as at least 75% of the entity’s gross income. Guidance on this provision should make clear that a look-through approach would apply for dividends and interest received from connected persons.

It may be difficult for source states within the EU/EEA to agree on the proposed clause as it currently stands in their treaties with other EU/EEA states. Under the proposed wording, the relevant business needs to be conducted in the residence state only, but business conducted in other EU/EEA states is disregarded. The freedom of establishment in the EC Treaty (Article 49 TFEU) requires all EU (and similarly EEA) member states to refrain from imposing restrictions or obstacles on the right to establish in other member states. If the contracting state (source state) is an EU/EEA state it is bound thereby (similarly to the situation in the “Open Skies” cases (see EC IP/02/1609 5 November 2002) with regard to the requirements imposed on shareholders). This suggests that it will be necessary to make it sufficient that the taxpayer be engaged in suitable business in any EU/EEA member state outside the other contracting state (source state) to qualify for treaty benefits.
1.2.5. Derivative benefits

The Discussion Draft leaves open whether the model Entitlement to Benefits article will include a derivative benefits test, providing an example of the concern that has been raised and then continuing with what the model derivative benefits test would provide if included. The reason for inclusion of a derivative benefits test is clear: if the owner of a tested company could have obtained the same or better benefits had it received the benefitted income directly, the use of the subsidiary/tested company cannot have had a motive of shopping for a treaty benefit. Since it is common for MNEs to have one or more holding companies within the group, qualification for treaty benefits under a derivative benefits test accommodates common corporate structures and does not accommodate treaty shopping.

In addition to this, we note in this regard the ECJ "Open Skies" cases in which the ECJ held that the "nationality clauses" in 8 EU countries’ bilateral international air transport agreements with the US were held to breach EU law, namely, the EC treaty (now TFEU) fundamental freedoms. In particular, the requirement in most of those bilateral agreements for more than 50% of the shares in their national airline to be held by nationals of that airline’s home country breached the freedom of establishment of the EC treaty. Similarly, in our view, EU/EEA law (in particular, the ECJ Papillon case: C-418/07) requires EU/EEA countries to be able to trace bilateral treaty entitlement via any EU/EEA country entity, and not just via the relevant EU/EEA country and its treaty partner entities. Accordingly, we urge the OECD to take this into account, as otherwise, in our view, the OECD will be proposing a limitation on benefits article which 23 of the 42 BEPS countries will be unable to adopt, as it would be in breach of EU/EEA law.

Based on our view that a derivative benefits test should be an integral part of the article, we suggest the following formulation:

3. A company that is a resident of a Contracting State shall also be entitled to the benefits of this Convention if:

a) at least 95 percent of the aggregate voting power and value of its shares (and at least 50 percent of any disproportionate class of shares) is owned, directly or indirectly, by seven or fewer persons that are equivalent beneficiaries, and

b) less than 50 percent of the company’s gross income for the taxable year is paid or accrued, directly or indirectly, to persons who are not equivalent beneficiaries, in the form of payments (but not including arm’s length payments in the ordinary course of business for services or tangible property) that are deductible for the purposes of the taxes covered by this Convention in the company’s State of residence.

5 e) the term “equivalent beneficiary” means a resident of any other State, but only if that resident

i)A) would be entitled to the benefits of a comprehensive convention for the avoidance of double taxation between that other State and the State from which the benefits of this Convention are claimed, provided that if such convention does not contain a comprehensive limitation on benefits article, the person would be entitled to the benefits of this Convention if such person were a resident of one of the States under Article 4 of this Convention; and

B) with respect to income referred to in Articles 10, 11 and 12 of this Convention, the rate of tax that would be available under such convention to a company resident in such other State and eligible for benefits under such convention (and otherwise comparable to the company claiming benefits under this Convention) with respect to the particular class of income for which benefits are being claimed under this Convention is at least as low as the rate being claimed under this Convention; or
ii) is a resident of a Contracting State that is entitled to the benefits of this Convention by reason of paragraph 2 of this Article.

The above formulation departs from the version in the Discussion Draft as follows:

First, as in the case of the subsidiary of a publicly traded company and the ownership/base erosion tests, and for the same reasons, we have eliminated the restrictions on intermediate owners.

Secondly, we have included as an equivalent beneficiary any company that qualifies for treaty benefits under the income tax treaty between that company’s country of residence and the source country, in contrast to the Discussion Draft that would limit the corporate category to publicly traded companies. We believe our formulation is more in keeping with the spirit of the test and also addresses the criticism of the base erosion test that we noted in our discussion of the ownership/base erosion test; without this change, that test would not treat certain ordinary course of business payments to a non-public company as acceptable for the test.

Thirdly, we have clarified the rate comparison test to make clear it is comparing the rates generally available under the two treaties.

1.2.6. Discretionary grant of treaty benefits

Paragraph 4 of the proposed article would provide an important safety net for companies that do not qualify under any of the objective tests and we endorse its inclusion. However, we would note from the US experience that the discretionary grant of treaty benefits based on this standard is a lengthy and cumbersome process in which a company will not know whether it is eligible for treaty benefits until the end of the process. It also requires tax administrators to devote additional resources to the process. In other words, it would not be a realistic response to the restrictive nature of the article proposed in the Discussion Draft. In fact, if the restrictions we have identified as troublesome are not eliminated, tax administrators are likely to be overwhelmed with requests for the discretionary grant of benefits.

To make Paragraph 4 more practical, we suggest (i) that the relevant Competent Authority be compelled to complete the process within a reasonable time frame, say six months, with the automatic grant of the requested benefits if the time requirements are not met and (ii) the OECD provide guidelines for the factors to be considered by the Competent Authority, including examples. The examples could include: (i) a company that is acquired by private equity interests that met the EBT criteria prior to the acquisition, (ii) the privatisation of a former governmental entity, (iii) a family owned company that met the 7 or fewer requirement of the derivative benefits standard but now has more than 7 owners due to the expansion of the family ownership, and (iv) a company that is created by the legislative body of its country of residence.

1.2.7. Example in paragraph 15

The Discussion Draft considers the possible inclusion of a derivative benefits standard for eligibility for treaty benefits but raises concerns about “base eroding” payments that give rise to BEPS concerns. It illustrates this by an example in which a State S company (the tested company) is wholly owned by a parent company in State T that meets the equivalent beneficiary standard and the State S company makes a royalty payment to a sister company in State R and the State R company also qualifies as an equivalent beneficiary. The BEPS concern identified in the example is that State R provides a preferential rate of tax on royalties. We question whether this is a concern that should preclude the inclusion of the test for treaty eligibility frequently relied on in US tax treaties.

The OECD has repeatedly stated in the context of the BEPS project that BEPS is not about tax rate competition, yet the Discussion Draft cites a preferential tax rate as the reason for omitting a derivative benefits test. We note that all three companies in the example would be entitled to the same source country tax reduction under the relevant treaties, so the establishment of the tested company in State S does not provide any treaty benefit
that would not otherwise be available. We further note that the Parent in State T could also pay a royalty to the affiliate in State R and that apparently does not raise BEPS concerns. Similarly, any resident of State S qualifying under any of the tests in the article could pay a royalty to an affiliate in State R without raising BEPS concerns. If the preferential tax regime for royalties in State R is considered a BEPS concern, then the proper avenue for addressing it is in the Harmful Tax Practices Action item. If the preferential rate is considered to constitute a harmful tax practice, then the appropriate response is for State S to take this into account in its treaty with State R. If the preferential regime is not harmful and State S has considered it in the context of the treaty with State R, then there is no reason to consider that preferential regime in determining whether derivative benefits are appropriate.

**1.3. Main purpose rule**

**1.3.1. General comment**

The inclusion of a main purpose rule in the treaty in addition to and as a part of the Entitlement to Benefits article would eliminate the principal benefit of the Entitlement to Benefits article of providing certainty and predictability and would seriously erode the role of tax treaties in promoting bilateral trade and investment. The uncertainty and subjectivity of the main purpose test is underscored by the Discussion Draft’s explanation of the test in paragraphs 24 through 31 which makes clear its broad and uncertain scope. A large part of the concern about treaty shopping can be mitigated in the standards a country applies in deciding to enter into a treaty relationship. Decisions on which countries are appropriate treaty partners and restraints built into individual treaties to address areas of concern based on the domestic laws of the potential treaty partner can go a long way towards alleviating concern about treaty shopping. This is a far better way to address the concern than adopting a broad, subjective test of taxpayer intent.

A main purpose rule relies largely on subjective criteria – as opposed to measurable and, thus, objective criteria. This poses a significant risk as in many countries general anti-abuse rules were introduced just recently or have not yet been introduced – and, hence, the domestic tax authorities or courts have no or limited experience in applying such a rule. In countries that have had a similar rule, the results in the courts have been mixed, adding to the uncertainty. The potential is clear for growing controversy taking up valuable time of tax administrators and taxpayers.

**1.3.2. The US experience with a main purpose test**

The main purpose test has been proposed in US tax treaties and soundly rejected by the US Senate, the legislative body whose approval is required for US ratification of a tax treaty. The Senate’s 1998 rejection was explained, in part, as follows:

“The new main purpose tests in the proposed treaty are subjective, vague and add uncertainty to the treaty. It is unclear how the provisions are to be applied. In addition, the provisions lack conformity with other U.S. tax treaties. This uncertainty could create difficulties for legitimate business transactions, and can hinder a taxpayer’s ability to rely on the treaty.”

**1.3.3. The role of examples and Commentary**

The Discussion Draft states that the main purpose test is to be supplemented by detailed Commentary that would explain its main features and provide examples. Perhaps this is to suggest that the subjectivity of the test could be mitigated by the detailed Commentary. If it is really possible to provide greater objectivity and certainty of results by standards expressed in the Commentary, we suggest those standards, after public consultation, should be the rule, rather than an explanation of an otherwise vague rule.
The examples set out in the Discussion Draft are examples at either end of the spectrum and, as a result, do not add clarity but rather raise more questions regarding its scope. The examples illustrating where the main purpose would apply involve facts that could be addressed by more targeted anti-abuse rules which we believe is the right avenue for addressing treaty abuse. The examples illustrating where it does not apply may imply its application in similar circumstances that are not within the scope of the example. For example, Example C involves a decision by a company regarding where to locate manufacturing facilities to take advantage of lower labour costs and concludes that including in its considerations the availability of treaty benefits does not violate the main purpose test. This example raises the question of whether the same result should apply if the activity, rather than manufacturing, is the common practice of MNEs to concentrate holding company and financing centre operations in separate companies for reasons unrelated to taxation. If an MNE chooses to locate its treasury centre in a jurisdiction that has a favourable network of tax treaties, is that a violation of the main purpose test?

We submit it should not be, but absent an example confirming this analysis, an MNE would, in effect, be penalised for placing its holding company or treasury centre in a jurisdiction with a broad network of tax treaties. Countries could adopt appropriate rules dealing with the assignment of income, which would deal with many of the abusive cases identified in the Discussion Draft.

1.3.4. Impact on mergers and acquisitions

The main purpose test could have a chilling effect on cross-border mergers and acquisitions and would appear particularly relevant for private equity which will normally fail the publicly traded LOB test and may have to rely on the competent authority route. When one MNE group purchases another, the group structures may not be compatible. Structures that might have incurred little or no withholding tax prior to the acquisition may become subject to substantial withholding tax. Will it be possible to reorganise following such an acquisition or will such a reorganisation be considered to fail the main purpose test?

1.3.5. Impact on the investment community

The Discussion Draft’s discussion of the main purpose test fails to take into account that treaties are not used solely by multinationals. Treaties are equally important in allocating taxing jurisdiction with respect to investment income. The best known example involves a resident of Country X investing in an investment fund organised under the laws of Country Y which may earn dividends or other income from an investment in a company resident in Country Z. For any number of reasons, a main purpose test does not work well in this fact pattern. All countries agree that the goal in such cases should be to tax the ultimate investors/beneficial owners only once. The unfortunate reality is that sometimes treaties have to be used to attain that goal. In such cases, the fund might literally be said to have as its main purpose claiming treaty benefits, but nothing about that is abusive.

1.3.6. The importance of procedural safeguards

If it is ultimately concluded to recommend a main purpose test, the OECD needs to recommend effective procedures so that the uncertainty of such a test is not magnified by a lengthy period of uncertainty regarding the propriety of its application. A taxpayer should have the right to know what its tax responsibilities are without having a lengthy process for resolving whether the application of the main purpose test is appropriate. If this uncertainty cannot be resolved by an effective advance ruling process or an expedited process for dispute resolution after a government claim that it applies, the cost to the business and investment community will be excessive.

We further recommend that if an enterprise meets any of the other criteria in an LOB article for eligibility for treaty benefits, the burden be placed on the tax authority challenging the access to treaty benefits to clearly demonstrate that the main purpose test applies. In addition, to ensure that a single Competent Authority does not violate the spirit of the main purpose test by aggressive interpretation of the standards, a decision by a
Competent Authority to apply the main purpose test should require acceptance of that decision by the Competent Authority of the treaty partner with mandatory binding arbitration to resolve disputes. Finally, to mitigate the unpredictability of reliance on the judgment of each tax authority as to taxpayer intent, changing a main purpose to the main purpose would provide taxpayers a measure of protection against over-zealous use of this tool by tax authorities.

1.4. **Collective Investment Vehicles**

Significant work has been done by the OECD to date, notably in publishing the April 2010 Report *The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles* (the 2010 CIV Report). The report seeks to address the specific issues of collective investment vehicles (CIVs) within the overall framework of tax treaties. A key principle is that “the goal is to achieve neutrality between a direct investment and an investment through a CIV in the international context” (see inter alia paragraph 6.18 of the draft paragraphs proposed as additions to the Commentary on Article 1, set out at paragraph 62 of the 2010 CIV Report).

The 2010 CIV Report recognises the wide variety of legal characteristics and tax attributes that it is possible for the CIV type of entity to possess. However, it proposes two main alternative avenues for integrating CIVs into the treaty framework.

- CIVs are to be treated as *individuals* who are “residents of the Contracting State” in which they are established and as the beneficial owner of the income they receive; or
- CIVs are not treated as “residents of the Contracting State” in which they are established, but they may make claims to treaty benefits on behalf of their investors.

As a general matter, we strongly urge that further and prompt action by the OECD, to bring CIVs into the Model Treaty framework in the ways proposed in the 2010 CIV Report, is now essential. As CIVs clearly are not within the scope of Action 6 and could inadvertently be deprived of treaty benefits due to the lack of focus on CIV and other pooled funds in the proposed Entitlement to Benefits article, we urge that the final version of Action 6 make clear that further work needs to progress on the application of treaties to CIVs and similar pooled investments at an accelerated pace to assure they are appropriately addressed in any final version of an LOB article.

1.4.1. **Private equity and hedge funds**

In addition, to date the term “CIV” has been applied to funds that are widely held, hold a diversified portfolio of securities and are subject to investor protection regulation in the country in which they are established. This definition excludes an extremely important group of collective investment arrangements that may be categorised as pooled private capital investment funds. It has been acknowledged previously that the issues and principles faced by CIVs could also be applied to them.

We strongly urge that such arrangements are also included in the Model Treaty framework in ways that follow the recommendations noted above, for the same rationale. Systems and solutions may need to be developed to ensure tax administrations are able to ensure proper compliance with tax obligations, from the perspective of both source and residence countries. However, this practical challenge should not deprive appropriate investors from the benefit of tax treaties to avoid effective double or greater levels of taxation.

1.5. **Tie-breaker rule**

We do not consider that the long-standing effective management tie-breaker for dual residence should be replaced by a competent authority process because of the uncertainty both regarding outcome and timing this involves. Although competent authority is used by one BEPS country in particular, the vast majority of tax
treaties still use place of effective management for which there is experience and some case law. The competent authority process by comparison is not transparent and can take considerable time. Two years or more is not unusual.

Hence, an amendment of the tie-breaker rule would add considerable uncertainty to multinational companies. This is increased by the fact that – as mentioned – today’s reality is marked by diaspora ie a scattering of management across a number of countries and very often criteria for unlimited taxation are given to two or even more countries without the companies recognising this. If the tie-breaker rule were to move away from the criterion of place of effective management which has worked for years as a fair principle for allocating residency for treaty purposes, numerous companies would be affected without any treaty abuse whatsoever as trigger.

If a change were nevertheless made to adopt the competent authority process, there should be a mandate for expeditious resolution of the status of the taxpayer, say within 3 to 6 months. If no mutual agreement can be achieved within a reasonable period of time, mandatory binding arbitration should be required.

1.6. PEs in third country states (triangular branch situations)

Under paragraph 56 of the Discussion Draft, it is proposed to adopt an approach under which treaty benefits are to be denied where income is attributable to a permanent establishment (PE), and the result is that the aggregate tax burden on that income represents an effective rate less than 60% of the general rate of company tax in the State where the enterprise is resident. This “triangular branch provision” would constitute a major change from existing practice.

We submit that treaties are the wrong vehicle for addressing this concern. The concern is founded on the fact that the residency jurisdiction has agreed to deduct or substantially lower its taxation of profits attributable to a PE and the PE jurisdiction taxes lightly or not at all. If that is truly a concern, it should be addressed in the context of Harmful Tax Practices. It has always been a basic principle of treaty policy that when treaty benefits are tied to taxability in the residence jurisdiction, the standard is whether the item of income is subject to tax in that jurisdiction, not on whether a tax is actually paid. It is also commonly accepted that rate competition is not considered harmful competition. Hence, whether a rate reduction in the residence jurisdiction combined with low or no tax in a PE jurisdiction justifies denying or limiting source country tax relief is not at all clear and is a matter that should be addressed outside the abuse of treaties work.

1.7. Domestic law anti-abuse provisions

In endorsing the use of domestic anti-abuse rules, the OECD should make clear that it is not acceptable for a State to override its treaty obligations in the guise of an anti-abuse rule. A clear distinction should be drawn between domestic laws that address treaty abuse and domestic laws that reflect a change in policy that is in conflict with its treaty obligations.

2. Comments on Part B

We note that, on the 4 April 2014, the United States Council for International Business (USCIB) submitted comments on Action 6. One of those comments addressed the proposed changes to the Preamble to treaties to stress that one of the goals of tax treaties is to avoid creating opportunities for inappropriate use of tax treaties. The Discussion Draft explained that the motivation for the proposed change to the Preamble was that Article 31(1) of the Vienna Convention on the Law of Treaties includes the principle that treaties should be interpreted “in their context and in light of its object and purpose.”
The USCIB suggested additional clarifying language which we agree would be in order to present a balanced presentation of the object and purpose of the treaty and avoid having courts give undue weight to the clarification that treaties are not to be interpreted to create opportunities for inappropriate use. Accordingly, we endorse the USCIB proposed language which we repeat here (with the USCIB additions underscored);

*Desiring to further develop their economic relationship and the promotion of bilateral trade and investment by removing artificial barriers and promoting greater certainty and predictability of tax results to residents and to enhance their cooperation in tax matters,*

*Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty shopping arrangements aimed at obtaining reliefs provided in this Convention principally for the indirect benefit of residents of third States)…*

### 3. Concluding remarks

For the goals of Action 6 to be effectively achieved, the appropriate tools for combatting inappropriate use of tax treaties must be developed with sensitivity so as not to undermine the basic purpose of tax treaties – that is, to remove tax barriers to cross-border trade and investment. If the final formulation of the rules disrupts the normal course of international business or establishes barriers to access to tax treaties for the majority of residents of treaty countries that are not making inappropriate use of the treaty, the solution will be far worse than the problem. We hope you will find our comments helpful in reaching that balance between effectively policing abuse and furthering the cross-border trade and investment that is so vital to maintaining a vibrant global economy.
COMMENTS ON MARCH 14 2014 DISCUSSION DRAFT BEPS ACTION 6

Steve Suarez
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1. This document responds to the OECD’s request for comments on the Public Discussion Draft dated March 14 2014 on BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances (the “Discussion Draft”). The comments that follow deal with selected aspects of the Discussion Draft rather than being a comprehensive analysis. Paragraph references are to the relevant paragraph of the Discussion Draft except where otherwise noted. The comments that follow represent the views of the author, and should not be attributed to Borden Ladner Gervais LLP.

2. Three over-riding principles should be established at the outset. First, taxpayers considering investment of any kind (and in particular cross-border investment with all of the incremental risk that this entails) require a high level of certainty as to the tax consequences. On a global scale, the amounts of money involved in cross-border commerce and investment are enormous, and the duration usually very significant. Potential investors and businesses need to plan many years out and have a meaningful degree of confidence that the legal underpinnings of their decisions are stable, predictable and understandable. Tax treaties represent a core element of these legal underpinnings, and if taxpayers and their advisors cannot achieve a reasonable level of certainty in advance as to the tax consequences of a particular activity, in most cases that activity simply will not be undertaken, either because the outcome is outside the risk tolerance for most taxpayers or because the uncertainty makes it prohibitive to finance. The need for certainty is particularly acute in a withholding tax context, where payers of amounts face potential liability for withholding at treaty-reduced rates, and lack of certainty as to the applicable rate creates a commercial impediment to the transaction.\footnote{It should by no means be blithely assumed that the risks involved can be solved by a simple indemnity that requires time and expense to enforce collection on, particularly in situations where the identity of direct or indirect investors may change from time to time.}

3. Moreover, a related issue is the need for tax administrators to appreciate the cost of over-breadth. It is not essential or optimal that tax rules be drafted so broadly as to encompass every conceivable form of tax avoidance where the result of doing so is also to catch legitimate commercial activity that is not abusive. There will always be those seeking to push the envelope of acceptable tax planning, and while dealing appropriately with tax schemes that frustrate or abuse the rules is certainly important.
and a worthy objective, over-zealous pursuit of these few does not justify the imposition of anti-abuse rules that also potentially encompass the vast majority of taxpayers who conduct their affairs within the object and spirit of tax treaties. Tax administrators have many tools at their disposal, and are able to take action at any time (including drafting new rules) where necessary to respond to activity perceived to be objectionable. The important point to appreciate is that just as there is a cost to not stopping actions that result in the granting of treaty benefits in inappropriate circumstances, there is an even greater cost to drafting rules that can reasonably be interpreted as denying treaty benefits to the majority of taxpayers who are quite prepared to conduct themselves within the bounds of acceptable tax planning.

4. In this regard it is important to understand that the timeframe in which commercial decisions are made in a competitive business environment is such that it is rarely feasible to rely on some form of pre-approval from tax administrators in order to achieve a sufficient level of certainty. Transactions generally occur relatively quickly, and quite often the commercial elements evolve or change considerably from start to finish. As such, over-broad and/or unclear tax rules that depend on an advance ruling from tax administrators to provide relief for “good” transactions are simply not an acceptable or practical substitute for readily-understandable rules whose scope is properly limited to what they should encompass and no more.

5. Finally, the importance of fair transitional relief should be acknowledged. While no taxpayer has an inherent right to a perpetual state of affairs, tax administrators must acknowledge that taxpayers legitimately make commercial decisions based on the rules as established by governments from time to time. To the extent that commercial decisions have been made on the basis of long-established treaty principles (e.g., fiscal residence and/or beneficial ownership as the basis for granting treaty benefits), a change in those principles should warrant careful consideration as to equitable transitional relief to allow for restructuring to reflect a change in these core principles.

**Treaty-Based Approach**

6. The treaty-based approach adopted in the Discussion Draft for dealing with the inappropriate use of treaties is very much to be commended. Tax treaties constitute bilateral agreements between countries. To the extent that one signatory to a tax treaty decides that it is unhappy with the treaty’s provisions (for example, that fiscal residence is an insufficient standard for the granting of treaty benefits generally, or that the “beneficial owner” threshold for reduced withholding tax rates on interest, dividends and royalties is inadequate), the appropriate course of conduct is to enter into discussions with the other signatory in order to change the terms of the treaty (which
terms taxpayers have relied on in good faith in structuring their affairs) or otherwise reach a bilateral agreement as to a course of action. Unilateral action should be a last resort.

7. As the Discussion Draft points out, a country’s domestic law rules that are inconsistent with existing provisions of a tax treaty freely entered into by that country contravene the *Vienna Convention on the Law of Treaties*, and in such circumstances the treaty provisions should prevail.² The Discussion Draft’s acknowledgement of the primacy of a treaty-based approach to the inappropriate use of treaties (rather than domestic-law initiatives that effectively repudiate existing treaty obligations) is both timely and opportune, particularly given the radical and unfortunate domestic law treaty override proposed in Canada’s 2014 federal budget.³ The spectacle of different countries each pursuing a “go-it-alone” strategy of dealing with perceived deficiencies in their tax treaties will inevitably result in uncertainty, confusion and expense for both taxpayers and tax administrators, and impede the international commercial activity that tax treaties are meant to encourage. We are all in this together.

**The Proposed LOB Article**

8. The proposed adoption of a U.S.-style limitation on benefits (LOB) provision within tax treaties to elevate the threshold required for the granting of treaty benefits is an appropriate policy change. While by no means a panacea, in concept the LOB format is one that in most cases should offer an acceptable level of objectivity and certainty as to when treaty benefits should be available, and the fact that the U.S. has included such a provision in its treaties for many years means that taxpayers and their advisors have considerable experience in interpreting and applying the concepts. As noted in the Discussion Draft (para. 9), this approach will address a large number of potentially problematic situations, and indeed if anything the U.S. LOB-style approach could be characterized as relatively restrictive, as experience shows that treaty benefits can be denied in various circumstances in which no treaty abuse is present.

9. It is unclear why the Discussion Draft views the inclusion of a derivative benefits section within an LOB rule as potentially contentious or undesirable. In particular, the example provided in para. 15 seems to involve a situation in which the problem is not the inappropriate grant of treaty benefits, but rather a preferential domestic law regime. It is very surprising that tax administrators would consider the grant of treaty benefits in these circumstances to be either inappropriate or indicative of a deficiency in a

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² Discussion Draft, footnote 12.
derivative benefits clause. If State S has chosen to forego its right to tax royalties earned by residents of both States R and T, then it would not appear that the level of resident-country tax imposed is relevant to State S’s treaty policy on taxing royalties earned by non-residents. It would be helpful to understand why any perceived tax avoidance (if indeed such exists) is considered to be a matter not better dealt with through another means (for example such as the harmful tax practices work stream).

**Paragraph 6 of Proposed LOB Article**

10. By far the most alarming element of the Discussion Draft is the proposed inclusion in the LOB article of the general anti-avoidance rule (“Paragraph 6”) described in paras. 18-33. If adopted, Paragraph 6 would essentially claw back the benefits of objectivity, certainty and practicality that would otherwise be achieved through the use of an LOB provision. It represents a very blunt instrument whose costs far exceed its benefits.

11. As discussed above, a truly meaningful degree of certainty for taxpayers is essential in order to encourage cross-border investment, and in the vast majority of cases the objective tests provided for under a typical U.S.-style LOB article give taxpayers the requisite knowledge to understand when the treaty signatories intend treaty benefits to be granted. Taxpayers can agree or disagree with the relevant standard for granting treaty benefits (indeed, many would say that they are denied in various circumstances when they ought not to be in a standard U.S.-style LOB article), but they are reasonably well understood and taxpayers can plan their affairs accordingly. Conversely, under Paragraph 6, taxpayers who squarely meet the tests of the other elements of the LOB article still find themselves liable to be denied treaty benefits under a residual, vaguely-worded general anti-avoidance provision that is very subjective and open to interpretation.

12. To begin with, the use of a “purpose” test as a suitable basis for determining eligibility for treaty benefits generally is very much open to question, and the Discussion Draft offers little to support the case in its favour. It is by no means self-evident that treaty benefits should be denied (or even *prima facie* denied) solely by reason of the fact that a taxpayer has actively sought to obtain them. Tax treaties exist to encourage cross-border commercial activity, and the benefits they offer are in fact intended to influence taxpayer behaviour. This being the case, why then should the structuring of transactions to come within the terms of a tax treaty be considered evidence of tax avoidance or improper tax planning? If the reasons why actively seeking the benefits of a tax treaty constitute strong evidence of improper planning are indeed so obvious, it should be simple for tax administrators to articulate them. While it can reasonably be argued that a taxpayer’s motivation may be relevant in at least some circumstances, the
reasons in support of using the proposed purpose test in the manner set out in Paragraph 6 (i.e., as a broad-based test for denying treaty benefits generally) have not been adequately explained in the Discussion Draft.

13. Moreover, even if a purpose test was suitable for denying treaty benefits generally, a “one of the main purposes” test sets the wrong a standard. The concept of “one of the main purposes” is quite vague and ill-defined: what are the differences between a “main purpose” test, “one of the main purposes” test and “one of the purposes” test? How can a transaction have more than one “main purpose”? Indeed, the examples provided in the Discussion Draft itself seem to confuse the different concepts, suggesting that even the drafters of Paragraph 6 struggle to understand and articulate what the relevant standard is. This being so, how is a taxpayer supposed to be able to so finely categorize its purposes in entering into a transaction and then demonstrate into which category the obtaining of treaty benefits fits? It is not reasonable to expect that taxpayers will enter into cross-border commercial transactions on the basis of an over-arching treaty benefit denial rule as vague and uncertain as Paragraph 6. This provision simply does not meet an acceptable threshold for certainty, and constitutes a good example of where the costs of a provision’s over-breadth will be prohibitive and far exceed its benefits.

14. The examples accompanying Paragraph 6 are of relatively little assistance in interpreting its scope. As a general statement, these examples illustrate relatively extreme situations that do not reflect the “hard cases” where the level of uncertainty will be greater and which are more likely to be encountered from a practical perspective, viz., in Example D, a majority of RCo investors are State R residents, RCo annually distributes out its profits to investors, and no discussion exists as to why RCo was set up in State R in the first place. Put simply, it is impractical (and ultimately unfair) to create a vaguely-worded rule to be used as a general filter for separating “good” transactions from “bad” ones, and then reassure taxpayers that its structural deficiencies can be overcome with

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4 For discussion of the inherent difficulties with this concept in a Canadian context, see Boidman, “The Validity of ‘One of the Main Purposes’, CCH (forthcoming, April 2014).
5 See for example para. 25, which describes Paragraph 6 as being intended to ensure that treaty benefits are not provided to “arrangements whose main objective is to secure favourable tax treatment” [emphasis added], versus para. 31, which describes the standard established in Paragraph 6 as less than a “dominant purpose” threshold.
6 Indeed, in testimony before the United States Senate Committee on Foreign Relations in 1999, Joint Committee on Taxation Chief of Staff Lindy Paull testified that the proposed “main purpose” test for denying treaty benefits in the Italy-United States and Slovenia-United States treaties created considerable uncertainty by virtue of being vague and subjective, which can create difficulties for legitimate business transactions and hinder a taxpayer’s ability to rely on the treaty: Tax Analysts, World Tax Daily, October 25, 1999, 1999 WTD 208-38, JCX-76-99. These treaties were ultimately enacted after deleting the “main purpose” rule (see Tax Notes International, Jan. 4, 2010, p. 37 regarding the Italian treaty). A narrower “anti-conduit” rule was included in the United Kingdom-United States treaty.
more commentary and examples. The broader and more important the application of a rule is, the greater the need for interpretational clarity and certainty. Paragraph 6 falls far short of this standard.

15. Furthermore, the structure of Paragraph 6 essentially reverses the onus from what it should reasonably be. Having successfully run the gauntlet of the objective provisions of the LOB article, a taxpayer who meets the very low standard of having the claim of treaty benefits be merely “one of [its] main purposes” is then denied treaty benefits unless the taxpayer is somehow able to demonstrate that granting treaty benefits is consistent with the object and spirit of the relevant treaty provisions. Given that in order for Paragraph 6 to be relevant the taxpayer must have met of one or more of the other LOB tests, and given that knowledge of what the object and spirit is of the relevant treaty provisions lies primarily within the purview of tax authorities (who have the ability to draft technical explanations articulating that object and spirit and/or change the rules whenever they desire to do so), shouldn’t the onus be on the tax authorities to demonstrate an abuse of treaty provisions rather than on a taxpayer who satisfies one or more of the other LOB tests to show otherwise?

16. In summary, proposed Paragraph 6 of the LOB article should be deleted. The use of a “purpose” test as a general rule for denying treaty benefits does not meet an acceptable standard for certainty necessary for taxpayers to reasonably plan their affairs. The *prima facie* denial of treaty benefits based on the low threshold of a “one of the main purposes” test constitutes an overly-broad application of an ill-defined concept whose conceptual justification for this purpose has not been articulated in the Discussion Draft. Where a taxpayer has come within one of the other LOB tests for granting treaty benefits, the onus should be on the tax authority to show clearly why such benefits ought nonetheless to be denied, based on the object and spirit of the treaty provisions.

**Specific Anti-Avoidance Rules**

17. Where particular transactions are perceived as constituting treaty abuse, the creation of specific, readily-understandable anti-avoidance tests to establish a desired minimum threshold for granting treaty benefits is to be encouraged. For example, the proposed use of a minimum shareholding period for dividend treaty benefits described in para. 43 is a logical approach, although in order to prevent the undue denial of treaty benefits it is recommended that such a test include a residual clause allowing the grant of treaty
benefits where the source state is satisfied that doing so would not be inconsistent with the object and spirit of the treaty.\(^7\)

18. Similarly, the proposed rule described in paras. 47-49 with reference to Article 13(4) is a reasonable approach to preventing undue manipulation of the entity’s assets to temporarily fall below the 50% threshold, although again (1) a residual saving clause to allow treaty benefits as described in the preceding paragraph should be considered, and (2) in order to not deny treaty benefits in situations where legitimate and \textit{bona fide} uncertainties exist as to valuation (this being an imprecise exercise), consideration should be given to wording the rule along the lines of granting the exemption where “it is reasonable to conclude that” the shares or similar interests did not derive their value primarily from immovable property during the relevant holding period.

19. The proposed change in the treaty tie-breaker rule for corporate residence from a bright-line test to a competent authority determination described in para. 50 \textit{et seq.} is not recommended. In situations where both countries may claim fiscal residence exists, taxpayers need a clear basis upon which to make business decisions in a reasonable time frame. The proposed change in paragraph 3 of Article 4 leaves a taxpayer with no such basis, or indeed any certainty of a determination ever being made. The result is one that does not meet an acceptable standard of certainty, timeliness or practicality. It would be helpful to understand what form of “tax avoidance arrangements” tax administrators feel are being created by dual-resident corporations (para. 52), and why the appropriate response is not to deal directly with those situations in a more targeted form rather than choose an overly-broad response that essentially makes all potentially dual-resident entities fiscal pariahs unless and until determined otherwise (many such entities are not potentially dual-resident by choice).

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\(^7\) The minimum holding period approach is superior to a purpose-based approach, as the latter could conceivably (for example) deny treaty benefits where an individual resident in the Residence state and holding shares of a corporation resident in the Source state chose to transfer those shares to a corporation also resident in the Residence state, for whatever reason. It is difficult to see what abuse is occurring in these circumstances if the individual is willing to incur whatever consequences are involved in subjecting the subject shares to corporate-level taxation in the Residence state on a non-temporary basis, and a purpose-based approach would \textit{prima facie} call into question the grant of treaty benefits in these circumstances.
Studio Pirola’s observations

Studio Pirola Pennuto Zei & Associati welcomes the opportunity offered by the OECD to provide its comments to Document Beps action 6: preventing the granting of treaty benefits in inappropriate circumstances (the “Document”), of particular scientific and academic but also practical interest.

The OECD’s efforts are highly appreciated since improper use of the Treaties is one of the main causes for the loss of taxing rights by States and allows the implementation of aggressive tax planning practices through companies located in different jurisdictions, that are to be effectively combated. It is not by chance that during the latest G20 meeting in Moscow on 15 and 16 February 2013, some EU Member States (such as France and Germany) as well as Great Britain gave a political mandate to the OECD to combat international tax evasion and/or tax avoidance.

As part of this topic, it is particularly significant to focus on whether any specific and/or general domestic anti-abuse rules (SAARs and GAARs) and the Treaty anti-abuse rules are mutually exclusive or instead may be combined: this issue has been analysed in detail by experts, who have come to different conclusions, and by the international scientific community.

Specifically, we would like to make the following observations.

1. Practical examples

It is commendable that efforts have been made to provide practical examples, such as for instance those on page 13 of the Document concerning the possible cases of application Article X “Entitlement to benefits”.

Nevertheless, this could raise some critical issues due to the high complexity of the matter, which cannot be reduced to few practical examples, and to the need to evaluate all of the relevant facts and circumstances on a case-by-case basis. In other words, we are of the opinion that by its own nature the matter cannot be forced into rigid schemes that try and sum up all of the cases which could occur in practice by providing a number of examples.
2. Entitlement to benefits

We are of the opinion that the wording of Article X “Entitlement to benefits” should be amended to clarify and specify its scope of application.

The article reads as follows:

6. Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the main purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.

In our view, the terms used are ambiguous and give rise to doubts for the following reasons:

1) ....if it is reasonable to conclude....: the use of reasonable does not help clarify the matter since the term implies per se subjective and uncertain evaluations.

We believe that the entitlement to a benefit should be a matter of evidence, having regard to the actual facts and circumstances of the case, rather than a result of reasonable conclusions.

2) .....obtaining that benefit was one of the main purposes: the obtaining of a tax benefit should be the sole purpose, and not one of the main purposes, of the arrangement or transaction. In our view, there is treaty abuse (and non-entitlement to treaty benefits) only when the obtaining of a specific tax benefit is the sole and principal purpose of “any arrangement or transaction”. The existence of other (economic, strategic, business ...) purposes should rule out treaty abuse, even if the taxpayer derives a tax benefit as well.

3) ....that resulted directly or indirectly in that benefit: we believe that the tax benefit should only be a direct – and not also an indirect – result of a given transaction; in other words, there should be an evident and direct cause-effect relation between a transaction and the obtaining of a tax benefit.

Based on the foregoing, we would suggest amending the wording of Point 6 as follows:

6. Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income if it is reasonable to conclude, having regard to all relevant facts and circumstances, it can be concluded that obtaining that benefit was one of the main purpose of any arrangement or transaction that resulted directly or
indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.

Likewise, the same amendments should be made also in the Paragraphs of the Document with similar contents.

For example at point 32 on page 12:

32. “A purpose will not be a main purpose when it is reasonable to conclude, having regard to all relevant facts and circumstances, it can be concluded that obtaining the benefit was not a main consideration and would not have justified entering into any arrangement or transaction that has, alone or together with other transactions, resulted in the benefit. In particular, where an arrangement is inextricably linked to a core commercial activity, and its form has not been driven by considerations of obtaining a benefit, it is unlikely evident that its main purpose will not be considered to be the obtaining of that benefit”.

We believe that these provisions should be better coordinated to ensure content consistency throughout the Document.

Furthermore, it may be appropriate to highlight in the Commentary that no Treaty abuse occurs when an “arrangement is inextricably linked to a core commercial activity”, providing some examples.

3. Relationship between SAAR/GAAR and the DTTs

As mentioned in the introduction to our observations, the relationship between specific and/or general domestic anti-abuse rules (SAARs and GAARs) and Treaty anti-abuse rules has been dealt with by both experts and the international scientific community.

This is a complex issue which would deserve detailed and in-depth analysis. Here, we will simply note that in some cases (e.g. for dividends, interest, royalties, property income) some of the Treaties entered into with Italy do not contain general or specific anti-abuse rules, with the consequence that anti-abuse rules should not be applicable. In our opinion, however, a taxpayer that uses a Treaty which contains no such clauses does not commit abuse simply because it uses that very Treaty, on the grounds that at the time of its execution the Contracting States expressly omitted such clauses.

Therefore, we suggest that the Commentary to the Model Tax Convention should clearly specify that the absence in any Treaty of anti-abuse clauses prevents such Treaty from being applicable, it being immaterial that either of the States concerned consider these clauses to be implicit and, thus, applicable without exceptions.
Domestic SAARs should apply only if a Treaty expressly contains a clause along these lines:

*This Convention shall not preclude the application of domestic SAARs for the prevention of tax avoidance and/or tax evasion*

or, in more general terms

*State [A] and State [B] shall withdraw the benefit of this Convention in the case of an artificial arrangement or an artificial series of arrangements which has been put into place for the essential purpose of obtaining an improper tax advantage under this Convention and which defeats the object, spirit and purpose of the tax provisions invoked. A transaction, scheme, action, operation, agreement, understanding, promise, or undertaking is an artificial arrangement or a part of an artificial series of arrangements where it does not reflect economic reality.*
Comments of SwissHoldings to the Discussion Draft on BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

Dear Marlies,

The business federation SwissHoldings represents the interests of 58 Swiss based multinational enterprises from the manufacturing and service sectors (excluding the financial sector). SwissHoldings is pleased to provide comments on the OECD Discussion Draft entitled “BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, 14 March 2014 – 9 April 2014” (hereinafter referred to as the Draft).

A. General remarks

SwissHoldings agrees with the OECD that perceived inappropriate behaviour should be addressed. We believe that this should be done by means of specific and targeted Anti-Abuse provisions. Only this way, preventing the undesirable circumstances can be prevented with a minimum impact on bona fide business. The proposed Anti-Abuse rules are, however, too general in nature and not limited to abusive situations. In the current too widely framed wording they would hinder legitimate business activities. A combination of the proposed rules could have a detrimental effect.

Treaties should focus on the removal of double taxation and promoting business. With the suggested clauses they would instead prevent investment and employment. We would therefore like to reiterate the comments made by BIAC regarding the fact that for MNEs it is crucial that tax treaties facilitate cross border trade also in the future and that with the proposed rules this goal may be jeopardized.

In addition, we fully endorse all the comments made by BIAC. For the sake of restricting the length of our comments we will reiterate comments made by BIAC only on a case-by-case basis. In some instances we will merely make reference to the comments of BIAC without further details.
B. Specific remarks

General remarks regarding the purpose of double tax treaties
• The prevention of double taxation shall remain the prime objective of double tax treaties.
• Any provisions aiming at preventing tax evasion and tax avoidance shall not interfere with the objective of preventing double taxation. Anti-Abuse rules should have no impact on genuine business operations.
• Further clarification is needed with respect to what is to be considered abuse of treaty benefits.

General Anti-Abuse Rule
• The concerns with respect to the proposed General Anti-Abuse Rule (GAAR) are numerous and serious. We would like to endorse the concerns raised by BIAC.

General remarks regarding a combination of LOB provisions and GAAR
• We are deeply concerned about the proposal to insert not only a LOB provision but also a GAAR into the OECD Model Convention. We endorse the position outlined by BIAC that the layers of rules proposed will “add complexity, administrative costs and uncertainty of treatment”. It should therefore be made clear in the Draft that at most one of these two provisions for preventing treaty shopping shall be inserted in the OECD Model Convention. Applying both a LOB and a GAAR would result in uncertainty, administrative burden and complexity. Therefore, this should be avoided.

Treaty benefits for all legitimate business activities:
• We fully endorse BIAC’s position that anti-avoidance provisions (whether LOB or GAAR) should recognise that holding, financing and investment activities including licensing are normal and legitimate business activities.
• The draft intends that non-quoted multinational companies could qualify provided that they meet the “active conduct of a trade or business” test. It is difficult to understand that the managing of investments should not qualify for non-quoted companies, while this is the case for quoted companies, charities and pension funds. This seems to be in conflict with paragraph 7.4 of the OECD transfer pricing guidelines which recognizes that a MNE can organize itself differently: more centralized or decentralized. Therefore, the key parameter should be whether the adequate (people) functions are performed in relation the activity. Holding, financing and investment activities including licensing should not suffer blanket exclusions from Treaty protection, provided that the adequate substance related to these functions is available.
• Anti-abuse provisions should allow for bona fide commercial activities which do not involve treaty shopping (such as in example C [paragraph 33]).
Concerns regarding the proposed LOB provision in particular:

SwissHoldings opposes the LOB provision as currently drafted for the following reasons:

- **General introduction of LOBs:** It is mentioned in the Draft that a number of countries already include LOB provisions in their tax treaties. The fact that a number of countries choose to include a LOB provision in their treaties does not by itself justify a LOB provision to be inserted in the OECD Model Convention.

- **Different interests of countries:** Countries have different needs and priorities when negotiation tax treaties. Although a country may accept a certain LOB provision in relation to another country does not necessarily mean that it would be willing to have such an LOB in all of its treaties.

- **US LOBs unfit as worldwide model:** The proposed LOB provision is based on the LOB provision found in treaties concluded by the United States. The US LOB clauses have a scope that may lead to denial of treaty benefits in several instances while treaty eligibility would seem legitimate. One of the drawbacks of the US LOBs is that they produce by-catch. There are examples of other LOB provisions that do not have some of the significant draw-backs of the US LOB clauses (Japan-Netherlands treaty and Japan-Switzerland treaty).

- **Excessive treaty denial:** The proposed wording restricts the application of a Treaty where there is not treaty shopping.

- **Treaty denial by default:** The proposed LOB provisions deny treaty benefit by default. Only where explicitly stated would a resident enjoy the treaty benefits.

- **General assumption of aggressive tax planning:** The suggested language seems to imply that taxpayers, as a general rule, evade taxes and are engaged in aggressive tax planning. This is clearly not the case. Most businesses allocate substantial resources in order to comply with existing tax rules and struggle to overcome obstacles to cross border trade and investment.

- **Holding companies excluded from treaty benefits:** It appears inappropriate and disproportionate to exclude all holding companies from treaty benefits. The structures of holding companies may vary significantly and there may be a number of reasons as to why a holding company is being used. The LOB provision should take into account substance and purpose of the holding company, existence of substantive activities such as premises, employees in the holding state etc. Furthermore, political stability and geographical location could be factors that may warrant a regional holding company, thus rebutting claims of abusive behaviour.

- **Blanket exclusions for financing and investment activities including licensing:** Such activities may suffer blanket exclusions from Treaty protection.

- **“Derivate benefits” clause is missing:** The proposed wording based on the US LOB clauses restricts treaty benefits where there is clearly no treaty shopping. The mentioned Japanese treaties would not have this defect.

- **Unnecessary “base erosion” test:** The proposed wording based on the US LOB clauses requires unnecessarily a base erosion test in addition to the ownership test. The mentioned Japanese treaties would not have this defect.

- **Local stock exchange requirement in the publicly traded test:** This requirement is specific to the US LOB clause and is too restrictive. The Japan-Netherlands and Japan-Switzerland treaties are less protective in this regard.

- **Restrictive requirement of primary place of management:** The wording based on the US LOB clauses is too restrictive. The Japan-Netherlands and Japan-Switzerland treaties do not require the primary place of management of publicly traded companies to be in the state of their residence.
• **Focus of active trade or business:** As BIAC explains in full detail, that the requirement “derived in connection with or incidental to that trade or business” denies treaty protection to industries even though the taxpayer has a genuine economic substance at group level (separate company approach is unsatisfactory).

• **LOBs produce by-catch:** The proposed LOB clause is too general in nature and not limited to abusive situations.

In case a LOB provision should be included in the OECD Model Convention, SwissHoldings proposes redrafting of the proposed LOB clause as follows:

• **Bona fide operations:** Such clause must reflect the fact that most businesses are engaged in bona fide operations and not tax evasion and circumvention of tax provisions.

• **Derivate benefits:** To the extent a LOB article should be adopted, it is essential that a “derivate benefits” clause be included to avoid inappropriately restricting treaty benefits where there is no treaty shopping. We fully endorse BIAC’s position that the OECD should consider such a clause to take into account “equivalent beneficiary” ownership, where similar treaty benefits are provided under another treaty. The OECD should include substance considerations, in order to protect genuine commercial structures, where ownership or income requirements are not met under a proposed derivative benefits article.

• **Headquarter (“HQ”) companies:** The proposed LOB article should be does not contain a HQ company provision.
  - It is essential to include a provision for regional HQ companies to qualify for Treaty benefits, given the nature of regional business investments and trade, and the bona fide use of regional companies to manage such business.
  - Genuine headquarters of non-quoted multinational enterprises should qualify for treaty relief. This is not different for decentralized groups.

• **Treaty relief for charities:** Under the proposed LOB clause pension funds and persons who invest for the benefit of pension funds shall be eligible for treaty protection. However, a similar reference for charities is missing: Charities and the other persons of paragraph 2,d are not eligible for tax treaty protection unless they invest directly. There is no reason why charities should be treated differently than pension funds. This is of practical relevance to charities which generate their funds for charitable spending via investments. A LOB clause should therefore include indirect relief for persons operating exclusively for charitable purposes (similar to the indirect relief for pension funds).

In case a LOB provision should be included in the OECD Model Convention, SwissHoldings proposes the following:

• **No restriction to US LOB clause:** SwissHoldings would find it detrimental if countries were restricted to a LOB clause close to the existing US ones in case of adoption of a LOB in the OECD Model Convention. Rather Treaty Countries should be offered to choose a LOB clause more suitable to the needs of their bilateral relationship. If a LOB clause should be inserted in the OECD Model Convention, the choice of the Treaty Countries should include (i) the LOB provision of the Japan-Swiss treaty (similar to the LOB clause of Japan-Netherlands treaty) and (ii) the LOB provision of the Japan-Netherlands. The two LOB provisions are listed in Annexes I (Japan-Switzerland) and Annex II (Japan-Netherlands).
Furthermore, we endorse the following comments made by BUSINESSEUROPE:

- **Treaty benefits to be granted by default and denial only in case of abuse:** It would of course not be possible to cover all genuine business situations in a LOB provision. Neither would it be possible to cover all inappropriate circumstances in Specific Anti-Abuse provisions. The answer is however not to deem all situations abusive unless otherwise stated.

- **Listed entities and active trade or business should be granted treaty benefits always:** Instead of allowing treaty benefit only where explicitly stated, the Listed entities and entities controlled by listed entities as well as entities that conduct active trade or business should still be deemed low risk and always be granted treaty benefits.

- **Derivative Benefits provision to be part of the Model Convention itself:** The situations covered by the Derivate Benefits provision in the Draft should also be considered low risk and granted treaty benefits. Because there is no incentive to treaty shopping, the Derivative Benefits provision should be inserted in the OECD Model Convention itself and not as part of the Commentary if a LOB provision is adopted.

- **Such language would certainly be more reasonable,**
  - provide more clarity,
  - maintain the integrity and purpose of the convention,
  - be more fair and at the same time target cases of treaty shopping.

- **Targeted versus vague provision:**
  - From a business perspective, and a principal point of view, the objective should be to design a targeted provision that does not affect genuine business activities.
  - A vague and unclear General Anti-Abuse provision would certainly be harmful.
  - It would be extremely difficult for businesses to be certain whether treaty benefits will be granted.
  - Likewise, it would be difficult for governments to fully understand the scope of the tax treaty that is being negotiated.
  - Such uncertainty would undermine the very purpose of tax treaties and result in an increasing number of double taxation cases.
  - The effect would be very negative on investments, jobs and growth.
  - This in turn, would risk undermining sustainable tax revenue collection.
  - The lack of an impact assessment on private sector activities, administrative costs and revenue allocation between countries is deplorable and unacceptable.
  - Each proposal should be analysed carefully and its consequences should be presented to policy makers.

**Either LOB or GAAR – not both**

We endorse the following comment made by BIAC:

*The Model convention should be clear that either a Limitation on Benefits, or a General Anti-Avoidance Rule approach should be adopted, and not both. Whichever approach is taken, this should be simple and not overly restrictive, whilst providing protection against “treaty shoppers”.*

**Importance of Mandatory Binding Arbitration Procedure**

General Anti-Abuse Rules (GAARs) and LOBs inevitably lead to refusals of treaty protection where such would be legitimate unless resolution mechanism are put in place which also provide for mandatory binding arbitration. We fully endorse BIAC’s statement that for situations not anticipated by the Treaty it should be possible to (i) seek Competent Authority confirmation that the structure is not abusive and therefore
the anti-abuse provisions (whether LOB or GAAR) do not apply and (ii) failure to agree should result in a mandatory binding arbitration procedure.

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We hope that you find our comments useful as you consider modifications to the Discussion Draft. We are available at any time to discuss any questions you may have with regard to our comments. We look forward to the public consultation on the Discussion Draft.

Yours sincerely,

**SwissHoldings**  
Federation of Industrial and Service Groups in Switzerland

[signature] [signature]

Christian Stiefel  
CEO

Dr. Martin Zogg  
Member Executive Committee

cc - SwissHoldings Board  
- William Morris, Chair of the BIAC Tax Committee  
- Nicole Primmer, Senior Policy Manager, BIAC
Annex 1: Wording of the LOB clause of the Japan-Switzerland treaty

Article 22A

1. Except as otherwise provided in this Article, a resident of a Contracting State that derives income described in paragraph 3 of Article 10, subparagraph (c), (d) or (e) of paragraph 3 of Article 11, Article 12, paragraph 6 of Article 13 or Article 22 from the other Contracting State shall be entitled to the benefits granted for a taxable year by the provisions of those subparagraphs, paragraphs or Articles only if such resident is a qualified person as defined in paragraph 2 and satisfies any other specified conditions in those subparagraphs, paragraphs or Articles for the obtaining of such benefits.

2. A resident of a Contracting State is a qualified person for a taxable year only if such resident is either:
   (a) an individual;
   (b) a qualified governmental entity;
   (c) a company, if its principal class of shares is listed or registered on a recognised stock exchange specified in clause (i) or (ii) of subparagraph (c) of paragraph 8 and is regularly traded on one or more recognised stock exchanges;
   (d) a bank, an insurance company or a securities dealer that is established and regulated as such under the laws of the Contracting State of which it is a resident;
   (e) a person described in subparagraph (b) or (c) of paragraph 1 of Article 4, provided that in the case of a person described in subparagraph (b) of that paragraph as of the end of the prior taxable year more than 50 per cent of the person's beneficiaries, members or participants are individuals who are residents of either Contracting State; or
   (f) a person other than an individual, if residents of either Contracting State that are qualified persons by reason of subparagraph (a), (b), (c), (d) or (e) of this paragraph own, directly or indirectly, shares or other beneficial interests representing at least 50 per cent of the capital or of the voting power of the person.

3. Notwithstanding that a company that is a resident of a Contracting State may not be a qualified person, that resident shall be entitled to the benefits granted by the provisions of paragraph 3 of Article 10, subparagraph (c), (d) or (e) of paragraph 3 of Article 11, Article 12, paragraph 6 of Article 13 or Article 22 with respect to an item of income derived from the other Contracting State if that resident satisfies any other specified conditions in those subparagraphs, paragraphs or Articles for the obtaining of such benefits and shares representing at least 75 per cent of the capital or of the voting power of the company are owned, directly or indirectly, by seven or fewer persons who are equivalent beneficiaries.

4. Where the provisions of subparagraph (f) of paragraph 2 or paragraph 3 apply:
   (a) in respect of taxation by withholding at source, a resident of a Contracting State shall be considered to satisfy the conditions described in that subparagraph or paragraph for the taxable year in which the payment of an item of income is made if such resident satisfies those conditions during the twelve month period preceding the date of the payment or, in case of dividends, the date on which entitlement to the dividends is determined;
   (b) in all other cases, a resident of a Contracting State shall be considered to satisfy the conditions described in that subparagraph or paragraph for the taxable year in which the payment is made if such resident satisfies those conditions on at least half the days of the taxable year.

5. (a) Notwithstanding that a resident of a Contracting State may not be a qualified person, that resident shall be entitled to the benefits granted by the provisions of paragraph 3 of Article 10, subparagraph (c), (d) or (e) of paragraph 3 of Article 11, Article 12, paragraph 6 of Article 13 or Article 22 with respect to an item of income described in those subparagraphs, paragraphs or Articles derived from the other Contracting State if:
   (i) that resident functions as a headquarters company for a multinational corporate group;
   (ii) the item of income derived from that other Contracting State is derived in connection with, or is incidental to, the trade or business activity referred to in clause (ii) of subparagraph (b); and
   (iii) that resident satisfies any other specified conditions in those subparagraphs, paragraphs or Articles for the obtaining of such benefits.
   (b) A resident of a Contracting State shall be considered a headquarters company for a multinational corporate group for the purposes of subparagraph (a) only if:
(i) that resident provides a substantial portion of the overall supervision and administration of the group or provides financing for the group;
(ii) the group consists of companies which are resident in and are engaged in an active trade or business in at least five countries, and the trade or business activities carried on in each of the five countries generate at least 5 per cent of the gross income of the group;
(iii) the trade or business activities carried on in any one country other than that Contracting State generate less than 50 per cent of the gross income of the group;
(iv) no more than 50 per cent of its gross income is derived from the other Contracting State;
(v) that resident has, and exercises, independent discretionary authority to carry out the functions referred to in clause (i); and
(vi) that resident is subject to the same income taxation rules in that Contracting State as persons described in paragraph 6.

(c) For the purposes of subparagraph (b), a resident of a Contracting State shall be deemed to satisfy the gross income requirements described in clause (ii), (iii) or (iv) of that subparagraph for the taxable year in which the item of income is derived if that resident satisfies each of those gross income requirements when averaging the gross income of the three taxable years preceding that taxable year.

6.(a) Notwithstanding that a resident of a Contracting State may not be a qualified person, that resident shall be entitled to the benefits granted by the provisions of paragraph 3 of Article 10, subparagraph (c), (d) or (e) of paragraph 3 of Article 11, Article 12, paragraph 6 of Article 13 or Article 22 with respect to an item of income described in those subparagraphs, paragraphs or Articles derived from the other Contracting State if:
(i) that resident is carrying on business in the first-mentioned Contracting State (other than the business of making or managing investments for the resident's own account, unless the business is banking, insurance or securities business carried on by a bank, insurance company or securities dealer);
(ii) the item of income derived from the other Contracting State is derived in connection with, or is incidental to, that business; and
(iii) that resident satisfies any other specified conditions in those subparagraphs, paragraphs or Articles for the obtaining of such benefits.

(b) If a resident of a Contracting State derives an item of income from a business carried on by that resident in the other Contracting State or derives an item of income arising in the other Contracting State from a person that has with the resident a relationship described in subparagraph (a) or (b) of paragraph 1 of Article 9, the conditions described in subparagraph (a) of this paragraph shall be considered to be satisfied with respect to such item of income only if the business carried on in the first-mentioned Contracting State is substantial in relation to the business carried on in the other Contracting State. Whether such business is substantial for the purposes of this paragraph shall be determined on the basis of all the facts and circumstances.

(c) In determining whether a person is carrying on business in a Contracting State under subparagraph (a) of this paragraph, the business conducted by a partnership in which that person is a partner and the business conducted by persons connected to such person shall be deemed to be conducted by such person. A person shall be connected to another if that person owns, directly or indirectly, shares or beneficial interests representing at least 50 per cent of the capital or of the voting power of the other person, or a third person owns, directly or indirectly, shares or beneficial interests representing at least 50 per cent of the capital or of the voting power of each person. In any case, a person shall be considered to be connected to another if, on the basis of all the facts and circumstances, one has control of the other or both are under the control of the same person or persons.

7.A resident of a Contracting State that is neither a qualified person nor entitled under paragraph 3, 5 or 6 to the benefits granted by the provisions of paragraph 3 of Article 10, subparagraph (c), (d) or (e) of paragraph 3 of Article 11, Article 12, paragraph 6 of Article 13 or Article 22 with respect to an item of income described in those subparagraphs, paragraphs or Articles shall, nevertheless, be granted such benefits if the competent authority of the other Contracting State determines, in accordance with the laws or administrative practice of that other Contracting State, that the establishment, acquisition or maintenance of such resident and the conduct of the operations of such resident are considered as not having the obtaining of such benefits as one of the principal purposes.
8. For the purposes of this Article:

(a) the term "qualified governmental entity" means the Government of a Contracting State, any political subdivision or local authority thereof, the Bank of Japan, the Swiss National Bank or a person a majority of the capital of which is owned, directly or indirectly, by the Government of a Contracting State or a political subdivision or local authority thereof;

(b) the term "principal class of shares" means the class or classes of shares of a company which represent a majority of the capital or of the voting power of the company;

(c) the term "recognised stock exchange" means:

(i) any stock exchange established by a Financial Instruments Exchange or an approved-type financial instruments firms association under the Financial Instruments and Exchange Law (Law No. 25 of 1948) of Japan;

(ii) any Swiss stock exchange on which registered dealings in shares take place;


(iv) any other stock exchange which the competent authorities of the Contracting States agree to recognise for the purposes of this Article;

(d) the term "equivalent beneficiary" means:

(i) a resident of a state that has a convention for the avoidance of double taxation between that state and the Contracting State from which the benefits of this Convention are claimed such that:

(aa) that convention contains provisions for effective exchange of information;

(bb) that resident is a qualified person under the limitation on benefits provisions in that convention or, where there are no such provisions in that convention, would be a qualified person when that convention is read as including provisions corresponding to paragraph 2; and

(cc) with respect to an item of income referred to in paragraph 3 of Article 10, subparagraph (c), (d) or (e) of paragraph 3 of Article 11, Article 12, paragraph 6 of Article 13 or Article 22 that resident would be entitled under that convention to a rate of tax with respect to the particular class of income for which the benefits are being claimed under this Convention that is at least as low as the rate applicable under this Convention; or

(ii) a qualified person by reason of subparagraph (a), (b), (c), (d) or (e) of paragraph 2;

(e) the term "gross income" means the total revenues derived by an enterprise from its business, less the direct costs of obtaining such revenues."
Annex 2: Wording of the LOB clause of the Japan-Netherlands treaty

Article 21
Limitation on benefits

Taxation of Intercompany Dividends under Tax Treaties and EU Law

1. Except as otherwise provided in this Article, a resident of a Contracting State that derives income from the other Contracting State described in paragraph 3 of Article 10, paragraph 3 of Article 11 or Article 12, 13 or 20 shall be entitled to the benefits granted for a taxable year by the provisions of those paragraphs or Articles only if such resident is a qualified person as defined in paragraph 2 and satisfies any other specified conditions in those paragraphs or Articles for the obtaining of such benefits.

2. A resident of a Contracting State is a qualified person for a taxable year only if such resident is either:
   a) an individual;
   b) the Government of a Contracting State, any political subdivision or local authority thereof, the Bank of Japan, the Central Bank of the Netherlands or a person that is owned, directly or indirectly, by the Government of a Contracting State or a political subdivision or local authority thereof;
   c) a company, if the principal class of its shares is listed or registered on a recognised stock exchange and is regularly traded on one or more recognised stock exchanges, provided that, if the shares are listed or registered on a recognised stock exchange specified in clause (iii) or (iv) of subparagraph c) of paragraph 8, the primary place of management and control of the company is in the Contracting State of which it is a resident;
   d) a person that is either:
      i) a person as described in subparagraph b) or c) of paragraph 1 of Article 4, provided that in the case of a person described in subparagraph b) of that paragraph:
         aa) as of the end of the prior taxable year more than 50 per cent of the person's beneficiaries, members or participants are individuals who are residents of either Contracting State; or
         bb) more than 75 per cent of the contributions made to the person is derived from residents of either Contracting State which are qualified persons; or
      ii) a bank, an insurance company or a securities company that is established and regulated as such under the laws of the Contracting State of which it is a resident; or
   e) a person other than an individual, if residents of either Contracting State that are qualified persons by reason of subparagraph a), b), c) or d) of this paragraph own, directly or indirectly, shares or other beneficial interests representing at least 50 per cent of the voting power of the person.

3. Notwithstanding that a company that is a resident of a Contracting State may not be a qualified person, that company shall be entitled to the benefits granted by the provisions of paragraph 3 of Article 10, paragraph 3 of Article 11 or Article 12, 13 or 20 with respect to an item of income described in those paragraphs or Articles derived from the other Contracting State if that company satisfies any other specified conditions in those paragraphs or Articles for the obtaining of such benefits and shares representing at least 75 per cent of the voting power of that company are owned, directly or indirectly, by seven or fewer persons who are equivalent beneficiaries.

4. Where the provisions of subparagraph e) of paragraph 2 or paragraph 3 apply:
   a) in respect of taxation by withholding at source, a resident of a Contracting State shall be considered to satisfy the conditions described in that subparagraph or paragraph for the taxable year in which the payment of an item of income is made if such resident satisfies those conditions during the twelve month period preceding the date of the payment or, in the case of dividends, the date on which entitlement to the dividends is determined; and
   b) for all other cases, a resident of a Contracting State shall be considered to satisfy the conditions described in that subparagraph or paragraph for the taxable year in which the item of income is derived if such resident satisfies those conditions on at least half the days of the taxable year.
5.a) Notwithstanding that a resident of a Contracting State may not be a qualified person, that resident shall be entitled to the benefits granted by the provisions of paragraph 3 of Article 10, paragraph 3 of Article 11 or Article 12, 13 or 20 with respect to an item of income described in those paragraphs or Articles derived from the other Contracting State if:

(i) that resident is carrying on business in the first-mentioned Contracting State (other than the business of making or managing investments for the resident's own account, unless the business is banking, insurance or securities business carried on by a bank, insurance company or securities company);

(ii) the item of income derived from that other Contracting State is derived in connection with, or is incidental to, that business; and

(iii) that resident satisfies any other specified conditions in those paragraphs or Articles for the obtaining of such benefits.

b) If a resident of a Contracting State derives an item of income from a business carried on by that resident in the other Contracting State or derives an item of income arising in the other Contracting State from any of its associated enterprises carrying on business in that other Contracting State, the conditions described in subparagraph a) shall be considered to be satisfied with respect to such item of income only if the business carried on in the first-mentioned Contracting State is substantial in relation to the business carried on in the other Contracting State. Whether such business is substantial for the purposes of this paragraph shall be determined based on all the facts and circumstances.

c) In determining whether a person is carrying on business in a Contracting State under subparagraph a), the business conducted by a partnership in which that person is a partner and the business conducted by persons connected to such person shall be deemed to be conducted by such person. A person shall be connected to another if one owns, directly or indirectly, at least 50 per cent of the beneficial interest in the other (or, in the case of a company, shares representing at least 50 per cent of the voting power of the company) or a third person owns, directly or indirectly, at least 50 per cent of the beneficial interest (or, in the case of a company, shares representing at least 50 per cent of the voting power of the company) in each person. In any case, a person shall be considered to be connected to another if, on the basis of all the facts and circumstances, one has control of the other or both are under the control of the same person or persons.

6.a) Notwithstanding that a resident of a Contracting State may not be a qualified person, that resident shall be entitled to the benefits granted by the provisions of paragraph 3 of Article 10, paragraph 3 of Article 11 or Article 12, 13 or 20 with respect to an item of income described in those paragraphs or Articles derived from the other Contracting State if:

(i) that resident functions as a headquarters company for a multinational corporate group;

(ii) the item of income derived from that other Contracting State either is derived in connection with, or is incidental to, the business referred to in clause (ii) of subparagraph b); and

(iii) that resident satisfies any other specified conditions in those paragraphs or Articles for the obtaining of such benefits.

b) A resident of a Contracting State shall be considered a headquarters company for a multinational corporate group for the purpose of subparagraph a) only if:

(i) that resident provides a substantial portion of the overall supervision and administration of the group or provides financing for the group;

(ii) the group consists of companies which are resident in, and are carrying on business in, at least five countries, and the business carried on in each of the five countries generates at least 5 per cent of the gross income of the group;

(iii) the business carried on in any one country other than that Contracting State generate less than 50 per cent of the gross income of the group;

(iv) no more than 50 per cent of its gross income is derived from the other Contracting State;

(v) that resident has, and exercises, independent discretionary authority to carry out the functions referred to in clause (i); and

(vi) that resident is subject to the same income taxation rules in that Contracting State as persons described in paragraph 5.

c) For the purpose of subparagraph b), a resident of a Contracting State shall be deemed to satisfy the gross income requirements described in clause (ii), (iii) or (iv) of that subparagraph for the taxable year in which the item of income is derived if the resident satisfies each of those gross income requirements when averaging the gross income of the three taxable years preceding that taxable year.
7. A resident of a Contracting State that is neither a qualified person nor entitled under paragraph 3, 5 or 6 to the benefits granted by the provisions of paragraph 3 of Article 10, paragraph 3 of Article 11 or Article 12, 13 or 20 with respect to an item of income described in those paragraphs or Articles shall, nevertheless, be granted such benefits if the competent authority of the other Contracting State determines, in accordance with its laws or administrative practice, that the establishment, acquisition or maintenance of such resident and the conduct of its operations did not have as one of the principal purposes the obtaining of such benefits.

8. For the purposes of this Article:
   a) the term "principal class of shares" means the class or classes of shares of a company which in the aggregate represent a majority of the voting power of the company;
   b) the term "shares" shall include depository receipts of shares or trust certificates of shares;
   c) the term "recognised stock exchange" means:
      (i) any stock exchange established by a Financial Instruments Exchange or an approved-type financial instruments firms association under the Financial Instruments and Exchange Law (Law No. 25 of 1948) of Japan;
      (ii) any regulated market established in the Netherlands subject to regulation by the Authority for the Financial Markets (or its successor) under a license as meant in paragraph 1 of Article 5:26 of the Act on Financial Supervision (or its successor) of the Netherlands;
      (iii) the Irish Stock Exchange, the London Stock Exchange, the Swiss Stock Exchange and the stock exchanges of Brussels, Dusseldorf, Frankfurt, Hamburg, Hong Kong, Johannesburg, Lisbon, Luxembourg, Madrid, Mexico, Milan, New York, Paris, Seoul, Singapore, Stockholm, Sydney, Toronto and Vienna and the NASDAQ System; and
      (iv) any other stock exchange which the competent authorities of the Contracting States agree to recognise for the purposes of this Article;
   d) the term "equivalent beneficiary" means:
      (i) a resident of a state that has a convention for the avoidance of double taxation and the prevention of fiscal evasion between that state and the Contracting State from which the benefits of this Convention are claimed such that:
         (aa) that convention contains provisions for effective exchange of information;
         (bb) that resident is a qualified person under the limitation on benefits provisions in that convention or, when there are no such provisions in that convention, would be a qualified person when that convention is read as including provisions corresponding to paragraph 2; and
         (cc) with respect to an item of income referred to in paragraph 3 of Article 10, paragraph 3 of Article 11 or Article 12, 13 or 20 that resident would be entitled under that convention to a rate of tax with respect to the particular class of income for which the benefits are being claimed under this Convention that is at least as low as the rate applicable under this Convention; or
      (ii) a qualified person by reason of subparagraph a), b), c) or d) of paragraph 2;
   e) the term "associated enterprises" means enterprises which have a relationship with each other as described in subparagraph a) or b) of paragraph 1 of Article 9; and
   f) the term "gross income" means the total revenues derived by an enterprise from its business, less the direct costs of obtaining such revenues.
Dear sir/madam,

Re: Taxand responds to the OECD invitation for public comments on the proposals produced with respect to Action 6 (Prevent Treaty Abuse) of the BEPS Action Plan

Further to the publication of the OECD’s invitation for public comments on the discussion draft outlining the proposals produced with respect to Action 6 (Prevent Treaty Abuse) of the BEPS Action Plan, Taxand is honoured to provide written comments based on the practical experience we have as tax advisors.

We would like to salute the efforts of the OECD Committee of Fiscal Affairs for its continual and vast work on laying down the cornerstones for the ambitious and comprehensive Action Plan aimed at addressing base erosion and profit shifting in an open format that allows all stakeholders to provide their views.

The consultation of the preventing of the granting of treaty benefits in inappropriate circumstances is a key initiative of the BEPS Action Plan, which we support. This is particularly important in light of the fragmentation of domestic approaches to treaty shopping and multiplication of different treaty interpretation issues on abuse, leading in some cases to divergent national case law. We are concerned that some of the proposals to change the Commentaries to the OECD Model Convention may be a step in the wrong direction regarding the balance of existing tax treaties, which could stimulate further non-inclusive domestic anti-abuse legislation as instruments towards addressing treaty entitlement issues. Such draft provisions, as they currently stand, could also create significant uncertainty for international businesses operating cross-border.

We also believe that issues such as potential retrospective/retroactive application and interpretation of proposed rules raises a number of challenging legal and policy issues that require further analysis and guidance.

We also look forward to welcoming practical solutions for addressing the scope of treaty shopping and other perceived abuses, and hope that the OECD continues to develop quantification data on the perceived fiscal loss arising from BEPS practices, including if any of the measures under analysis may have the potential to impair foreign direct investments and trade.

We appreciate this opportunity to provide comments to the OECD Committee of Fiscal Affairs and would be pleased to discuss this further and to participate in any further discussion on these matters.

More information on how to contact Taxand is provided as Appendix I. Taxand is wholly committed to supporting the OECD Committee of Fiscal Affairs and we look forward to contributing to further debate.

Yours faithfully,
ABOUT TAXAND

Taxand provides high quality, integrated tax advice worldwide. Our tax professionals, more than 400 tax partners and over 2,000 tax advisors in nearly 50 countries - grasp both the fine points of tax and the broader strategic implications, helping you mitigate risk, manage your tax burden and drive the performance of your business.

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Our responses to the issues posed by this discussion draft, are set out as:

- some initial observations on the option for introducing a limitation on benefits provision and technical issues of design and interpretation.

- We then review the main issues arising from incorporating a treaty GAAR into the OECD Model.

- We finally address other recommendations to incorporate specific anti-abuse provisions into the OECD Model and the issues arising from the proposed savings clause.

1. Comments on the inclusion of a comprehensive limitation on benefits provision

We agree with the overall statement that a treaty-based response to the perceived problem of treaty shopping is better than perusing domestic anti-abuse legislation.

Enacting a treaty "limitation on benefits" (LOB) provision is a key feature of the OECD three-pronged approach towards countering treaty shopping.

We understand that those provisions are essentially targeting cases of perceived lack of sufficient economic or business "nexus" with the treaty country. This results in limiting entitlement to treaty benefits even when such recipients would otherwise: be residents of a treaty country; beneficially own the income; and are liable to tax on that income.

From the outset, we would like to express our initial concerns on clarity and the capacity to administrate the incorporation of a general or multilateral provision towards limiting treaty entitlement of residents into the OECD Model (and actual tax treaties).

The underlying premise of the LOB is setting "objective tests" for determining when a resident of a non-treaty country has legitimate reasons for deriving income through a treaty country entity. Once one of such "objective tests" is met there is an assumption that there is sufficient "nexus" to the treaty country to warrant treaty entitlement. The use of LOB provisions boils down to the question of whether it is fair to presume that the legal entity seeking treaty entitlement is a "real" taxpayer in the jurisdiction it claims to be resident.

The insertion into the OECD Model of assumptions that a taxpayer who satisfies one of the tests has likely a "business purpose" or a defensible "nexus" is a significant change of practice that requires careful review of how each of those tests is applied in practice.

The U.S. is perhaps the only country with significant experience in negotiating and administering LOB provisions in its tax treaty network. The experience of the U.S. may be difficult to export to the remaining OECD and non-OECD countries. The U.S. experience has also demonstrated that each tax treaty has its own LOB provision adjusted to the circumstances of each bilateral negotiation, emphasising the bilateral nature of this provision. A comprehensive LOB provision in all tax treaties (enacted by renegotiation or via a multilateral instrument) is a high threshold to achieve and could face consensus issues.

This option, if pursued by the OECD, should be drafted to afford to the best extent possible predictability to taxpayers and to help avoid unexpected barriers to the flow of cross-border investment. Taking into account the already widespread administrative barriers encountered by businesses looking to take advantage of treaty benefits (eg treaty forms), we support a less restrictive structure more targeted towards the exact cases of
perceived abuse identified by treaty partners (for example the UK tax treaty approach targeting the dividends, interest and royalties).

We would also like to express some degree of concern that a comprehensive LOB proposal in combination with other proposed changes to the OECD Model may be read by countries as a "carte blanche" and justifying domestic laws targeting or substantiating criteria for "bona fide residents" which ultimately will not qualify as a treaty override (as challenging treaty shopping become the "ends that justifies its means").

In that regard, we believe that OECD administrative guidance on the application of tax treaties through relief at source should be reinforced. This could help to prevent situations where countries enact unilateral administrative procedures that may prevent tax treaties from achieving their main purpose.

Despite our reservation on the effectiveness of a complex LOB standard into all tax treaties (framed in the U.S. tax policy experience), and being mindful that a detailed Commentary is also yet to be released, we consider useful to set out some particular comments on the specific "tests" included on the proposed LOB provision.

1.1 Publicly Traded Test provision

Paragraph (2)(c)(i) provides that a company is entitled to treaty benefits if its shares is "regularly traded on a recognised stock exchange" or if at least 50% of its shares is owned directly or indirectly by a company (resident in either country) that meets this requirement. In addition, the company may only be treaty entitled if the "primary place of management and control" is located in the residence country.

The inclusion of this test into the OECD Model raises several points:

- Should the term "regularly traded" which is not defined in the draft text of the Article (as opposed to the terms "principal class of shares" or "disproportionate class of shares") be further addressed in the text of the provision? We believe there are arguments towards considering that such key operational term should not be left to be defined by reference to the tax laws of the source/residence country.

- Should the "indirectly traded" or "qualifying subsidiary" test set out in paragraph (2)(c)(ii) of the publicly-traded company be simplified, as there appears to be no apparent policy reason for example for limiting the number of shareholders on this cases to “five or fewer companies”? The complex organisational structure of groups warrants a flexibilisation of this "qualifying subsidiary" test.

- Should the OECD Model incorporate into the LOB (especially after the proposed changes to Article 4) a rather new concept of "primary place of management and control" regardless of this concept potentially being analogous to the more commonly applied "place of effective management"? \(^1\) Place of effective management is currently used as a test of corporate residence under the domestic law of several OECD Members. We recommend that the OECD Model should not deviate from definitions which through time have acquired some degree of “international fiscal meaning” not directly derived from the domestic laws of contracting states.

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\(^1\) Paragraph 5(d) provides that “primary place of management and control” will take into account both where “executive officers and senior management employees exercise day-to-day responsibility for more of the strategic, financial and operational policy decision making for the company (including its direct and indirect subsidiaries)" and also where “staff of such persons conduct more of the day-to-day activities necessary for preparing and making those decisions".
1.2 Investment vehicles provision

Paragraph (2)(d)(iii) provides a test for persons that are “constituted and operated to invest funds” for the benefit of other persons if the following requirements are met:

(i) the beneficial interests in the investor (and recipient of the income from the source country) is owned in more than 50% by individuals resident in either source or residence country;

(ii) that “substantially all” the income of the investor is derived from investments made for the benefit of these persons.

We highlight that the broad treaty wording suggested for entitlement to benefits could have a detrimental effect on how such investment funds/entities operate. A typical investment vehicle would generally not be considered as a “qualified person” as the (beneficial) interests in the given investment vehicle are in many instances not owned by more than 50% by persons who are resident in the country where the investment vehicle is resident.

Collective investment vehicles (CIVs) are set up in a way to work efficiently for a wide range of potential investors and investment classes. The jurisdiction and corporate form is in most cases chosen to meet predominantly legal and regulatory requirements. Tax considerations are generally taken into account mostly to limit the application of multiple levels of tax accruing at source, fund and investor level and not driven towards treaty entitlement of the fund. CIVs should not be categorised as “treaty shopping” vehicles.

The 2010 OECD Report and the additions to the Commentary to article 1 of the OECD Model represented a move forward towards clear guidelines for treaty benefits for CIVs. Not taking into account the particularities of this industry on the discussion draft represents a back track of those efforts and potentially lead to an additional tax burden for CIVs investing cross-border.

The inclusion of a particular test for CIVs into the OECD Model raises several points:

- Should the reference to “persons referred to in subdivision ii)” be redrafted to make it clear that it does not apply only to investment vehicles that are substantially held by pension funds?

- Should the OECD opt to clarify further the activities that are considered covered by the term “invest funds”? We recommend that it is made clear that investment vehicles include REITs – ie persons whose activities essentially include “carrying on a property rental business including development with a view to holding the property as an investment” for the benefit of (individual) investors. We are available to discuss with the OECD the potential advantages of framing a clear safe-harbor for both the fund and REIT industries.

- Should a CIV not directly controlled (which is typically the case) be treated instead as a publicly traded company entitled to treaty benefits without regard to the residence of its investors? Alternatively, should instead a wider criteria of “qualified investor” or “good investor” be drafted that either: a) looks at investors resident in jurisdictions without a tax treaty with the source country (pro-rata entitlement based on a “look-through approach”) or b) sets a reasonable ownership threshold for which those “qualified investors” would have qualified for rates as low as those claimed by the
We refer also to our comments on the derivative benefits test for a less stringent rule for "good investors".

Should the "substantially all" income requirement be substituted with a reference to a more objective test of entities whose sole objective is collective investment in transferable securities, real estate property or in other liquid financial assets for the benefit of investors and/or subject to prudential supervision in the home country?

Finally, should a "subsidiary test" (similar to the one included in Paragraph (2)(c)(ii) be included to address situations of investment vehicles that may position particular participations in wholly-owned separate entities in the same jurisdiction of the investment vehicle?

We believe that a balanced policy to be adopted by the OECD needs to take into account the nature and idiosyncrasies of the investment fund industry to establish a more effective carve-out or safe-harbour rule applicable to this type of entity.

1.3 Ownership/Base Erosion provision

Paragraph (2) (e) also provides that a company (or other entity) is eligible for treaty benefits if it satisfies a two-part test. First, the "ownership" test requires at least 50% of each class of shares of the entity to be owned on at least half the days of the year by persons who themselves are eligible for treaty benefits (under the main rules). The "base erosion" test requires that less than 50% of the entity's gross income for the taxable year be paid or accrued in the form of tax deductible payments at recipient level and made (directly or indirectly) to non-residents of either treaty country (the so-called "base-erosion payments").

The inclusion of this test into the OECD Model raises several points:

Should the "base erosion" test be set at a particular threshold of the entity's gross income (50% as proposed) or instead at the level of "acceptable" tax deductible payments be left open for bilateral negotiations?

Should the "base erosion" test be strictly linked to a particular notion of a gross income under the country of residence of the entity deriving the income or also take into account if and to what extent withholding taxes are levied on the outbound payments made by that entity?

Should the "base erosion" test be applied on a standalone basis or should it take into account group taxation regimes or other preferences in the residence country of the entity?

1.4 Active Trade or Business provision

Paragraph (3) provides that certain income derived by a treaty country resident from the other treaty country is eligible for treaty benefits (regardless of having "failed" qualifying for the tests above) if the following requirements would be met:

(i) the entity is engaged in the "active trade or business activity";

As the investor base of CIVs fluctuates widely a less burdensome requirement should be considered to accommodate those instances. We refer for example to paragraph 6 of Article 28 of the 2006 Replacement Protocol of the German/US tax treaty.
(ii) the income derived from the source country is “connected” with, or “incidental to” that same trade or business; and

(iii) the trade or business in its residence country is "substantial" comparing to the activity derived in the source country.

The inclusion of this test into the OECD Model raises several questions:

- Should the treaty provision also define the term "active trade or business" or leave this definition to the source state? The OECD Model uses “enterprise” as the treaty expression and the term “trade” may be understood as being narrower than the term “business”. As such, we recommend revisiting the choice of the term “trade or business” as this is not found in domestic laws of several countries (such as civil law countries).

- Should the term "active" have a direct relation to the role, functions and level of involvement of officers and/or employees of the company and where to draw a bright-line test to consider that “active” test fulfilled? Should this be left to the OECD Commentaries?

- Should the active trade or business test be applied on an item-by-item basis (leading to different results as regards treaty entitlement) or instead be reformatted and applied merely on the nature of the business of the entity leaving aside unclear concepts such as "connected with" or "incidental to"?

- Should the "active trade or business" test be supplemented by an additional requirement of "substantial" based on "all the facts and circumstances" or instead objective ratios/factors based on "nexus" to the residence country be included on the "active trade or business" test?

- Should the safe-harbour of “other than the business of making or managing investments for a resident own account” be further developed in order to clearly state that collective investment vehicles (not fulfilling previous test) are deemed to fulfill this prong of the active and business test?

1.5 Discretionary relief provision

Paragraph 4 provides that a treaty country resident that is not eligible for treaty benefits may nonetheless be granted benefits if the competent authority of the source country so decides.

We are concerned that the inclusion of a competent authority discretion provision will serve to increase cases leading to complex mutual agreement procedures and ultimately further confusion regarding treaty entitlement. In making a tax treaty analysis, some competent authorities may be tempted to use domestic principles and guidance that could lead to a pervasive number of conflicting interpretations.

We propose that alternatively the competent authority provision is amended to include objective criteria that provides bona-fide entities with a clearer understanding of how to achieve treaty entitlement.

These objective criteria would clearly need to be devised and discussed. We may nonetheless recommend that the OECD revisits some of the objective criteria outlined in a
1992 proposal from the American Law Institute (ALI Report).\textsuperscript{3} The ALI Report suggested a set of objective criteria to determine whether an entity is engaged in treaty shopping activities. These objective tests included:

- Whether the overall level of taxes imposed on the income has been significantly reduced through the imposition of the legal entity;
- Whether, even if there was a reduction, the treaty country imposes a substantial level of taxation on the income;
- Whether, if the owners of the entity are resident in a country with a tax treaty with the source country, the same or similar treaty benefits would have been available had the investment been made directly through an entity resident in such country;
- Whether the entity is newly formed or long standing and whether it arose through an acquisition or merger;
- Whether the invested capital was generated in the normal course of business or was borrowed;
- Whether the entity holds investments or conducts activities in other countries which are similar or related to the investment activity in the source country; and
- Any other factors suggesting that business considerations dictated the creation or utilisation of the legal entity.

We are aware that some or a similar set of objective tests to qualify as “bona fide” transactions (when applying the discretionary relief provision) have been added to particular memorandum of understandings on the application of several U.S. based treaties. There are very good reasons for them to be defined and provide further clarity and certainty to taxpayers.

The OECD should consider merging this “objective test” rule with the general anti-abuse rule proposed in paragraph 6 (complementing therefore a “principal purpose” test with clearly defined weight factors that would be indicative of treaty shopping instead of a more broad and inconclusive “main purpose” test). See our further comments on the general anti-abuse rule on point 2 below.

1.6 Derivatives benefits provision

A "derivative benefits" provision is ultimately designed to ensure, when a particular entity owned by "equivalent beneficiaries" fails the main LOB tests, that it may nonetheless qualify for treaty benefits on a particular item of income where: (i) a specified percentage of its shares is owned (directly or indirectly) by "equivalent beneficiaries"; and (ii) those "equivalent beneficiaries" would have been entitled to equivalent or more favorable treaty benefits if they had directly derived the income in question from the source country.

We would also like to point out that treaty shopping should not be confused with taking advantage of a particular beneficial regime in the domestic law of the residence state (as the reference to tax treatment of dividends in paragraph 14 of the discussion draft may be read to imply). The same reasoning applies to the example provided in paragraph 15 of the discussion draft, as concerns regarding the taxation at a preferential rate should be

addressed primarily by State T rules (country of the ultimate parent) and not by State S (source country).

We believe that the inclusion of a derivatives benefits test is an important “safety-valve” towards cases where taxation of an item of income in the hands of the equivalent beneficiary would be “comparable” to the taxation established in the tax treaty being applied and therefore no abusive behavior may be perceived to exist.

For example, the version of the provision the OECD is considering provides for the inclusion of the "at least as low as" requirement also found in U.S. tax treaties. This "at least as low as" requirement addresses specifically the case of whether the third state resident is “tapping” into a more favorable/reduced source withholding tax than it would otherwise be available in a direct investment scenario.

As recommended below, we consider nonetheless that drafting should aim at limiting instances of outright denial of treaty benefits though the derivatives benefit test, namely when the equivalent beneficiary would itself be treaty entitled under its own tax treaty with the source country. We suggest this approach is more in line with the logic and purposes of tax treaties.

The inclusion of a derivatives benefits provision raises therefore several points:

- As currently drafted the "at least as low as" requirement either results in the test being satisfied and treaty benefits being available or the test being not satisfied and treaty benefits not available and domestic withholding tax applicable. This “all or nothing” rule may be said to be too strict. Could treaty shopping concerns be better addressed under a “higher of the possibly applicable tax rates” rule whereby the entity claiming derivative treaty benefits would be entitled to a reduced withholding rate equal to the higher of the tax rates to which such entity and its equivalent beneficiaries would be entitled under the respective treaties with the source country?4

- Concerns regarding recurrent geographical restrictions of who may be qualified as “equivalent beneficiary” found in existing U.S tax treaties have been addressed by enlarging the scope to mean a resident of any other State that would be a treaty entitled person in a tax treaty with the source country. The provision nonetheless is poised to raise uncertainties as it takes a restrictive position by requiring that such “equivalent beneficiaries” are either: (i) individuals; (ii) State; (iii) publicly traded company; (iv) charitable organisations, pension funds or investment funds.

- Should the purpose of allowing treaty benefits in cases where there is no treaty shopping objective include also those corporate entities fulfilling the remaining LOB tests should also qualify as “equivalent beneficiaries”? We recognise that this may raise additional administrative burdens but the mechanics of a comprehensive LOB as a means to target treaty shopping should not stop perceived abuse enquiries merely because it may be impractical or raise additional burdens for the tax authorities.

- Finally a further point may also be raised: rather than limiting this provision to situations on withholding taxes at source, should the derivatives benefit provision should not extend its application also to cases of capital gains (article 13 of the OECD

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4 We believe that an alternative “look-through rule” - whereby the entity claiming derivative treaty benefits would be entitled (proportionally) to a reduced withholding rate based on the reduced withholding rates to which its equivalent beneficiaries would have been entitled under their respective tax treaties with the source country – to be slightly less practical.
Model) generated in the source jurisdiction? We believe there are technical arguments in favour of considering this item of income alongside dividends, interest and royalties for purpose of treaty entitlement restrictions.

We would also note that despite outside the OECD mandate it remains questionable if under EU Law restrictions as regards “equivalent beneficiaries” or even general restrictions on treaty eligibility could well be considered discriminatory and constitute a restriction of the freedom of capital when drafted broadly and without meaningful objective tests. Interaction of tax treaties with EU Law should therefore be also carefully addressed.

2. Inclusion of a general anti-abuse rule in tax treaties

According to the GAAR, treaty benefits would not be available, if (i) one of the main purposes of arrangements or transaction is to secure a benefit under a treaty and (ii) obtaining such benefit under these circumstances would be contrary to the object and the purposes of the relevant provisions of the treaty.6

The Commentary of the proposed GAAR raises significant concerns, in particular paragraphs 27 to 32. Their terms are too broad and vague, they mention in particular that “it is not necessary to find conclusive proof of the intent of a person concerned with an arrangement or a transaction, but it must be reasonable to conclude, after an objective analysis of the relevant facts and circumstances, that one of the main purposes of an arrangement or transaction was to obtain the benefits of the tax convention.”

Tax is often one of the significant elements taken into account when a transaction is entered into. The purchase of securities by a company takes into account the taxation of the capital gains and other income generated by securities. To refuse the benefit of a tax treaty because the purchaser benefits from a lower withholding tax or no withholding would be surprising, unless the purchase was only motivated by such tax benefit. The choice of the location of a subsidiary, a joint-venture or an investment fund takes into account numerous elements, such as in particular, company law, labour law, local taxes and treaty network. The ability to benefit from a good treaty network will be taken into account before the set-up of any company holding foreign assets or entering into international transactions.

If such a GAAR provision was to be adopted, it could create major fiscal uncertainty for international business. It should also be noted that according to the proposed Commentary, such provisions may also apply independently of the LOB clause.

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5 Even anti-abuse rules targeting “sandwich structures” may also raise issues. For example, in a recent infringement procedure (Case No 2011/4002), the European Commission has requested a EU Member State to amend its domestic anti-abuse tax rules for non-resident companies that are directly or indirectly more than 25% owned by resident taxpayers. The issue being that by targeting a foreign company merely due to the fact that it is directly or indirectly held by a resident of the source country this rule may apply to situations that have business rationale or put the other shareholders (resident in other jurisdictions) in worse situations than if they had invested directly: LOB rules in practice have the potential to raise similar concerns.

6 The Discussion draft proposes to include a paragraph 6 in the entitlements benefits provision which reads as follows: “Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the main purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.”
We believe that there is a significant risk that the above GAAR provision may also violate certain principles of constitutional value of various states, in particular European States. For example, the case law of the French Supreme Court ("Conseil constitutionnel") has clearly stated that tax provisions should not be vague. It has recently stroke down various tax provisions that were too vague.7

Such provision could also constitute a violation of the principle of legal certainty recognized by the European Court of Justice.8 The opinion of the advocate general to the ECJ on the prohibition of abuse is clear: “The prohibition of abuse, as a principle of interpretation, is no longer relevant where the economic activity carried out may have some explanation other than the mere attainment of tax advantages against tax authorities”.

In addition, it may be also be useful to recall the comments from the U.S. Senate on the inclusion of the “one of the main purposes” test in connection with the approval of proposed treaties with Slovenia and Italy. The U.S. Senate Committee made several observations that remain relevant today. The Committee mentioned that the main purpose tests were subjective, vague and added uncertainty to the treaty. Such uncertainty could create difficulties for legitimate business transactions, and could hinder a taxpayer’s ability to rely on the treaty. The tests are subjective and dependent upon the intent of the taxpayers which is difficult to evaluate. The Committee also mentioned the test did not adequately distinguish between legitimate business transactions and tax avoidance transactions. Another concern raised by the Committee was that subjective tests could be used by treaty partners to deny treaty benefits for legitimate business activity.

The use of the term “main” also raises uncertainties as whether this refers to a set of significant purposes rather than to any individual purposes of the taxpayer and how to interpret this in practice on a case-by-case analysis. In addition, one may also understand the reference to “main” as a mere quantitative measure to find the predominant purpose as some case-law in other domestic anti-abuse laws have considered. We believe that addressing the operation of this rule with further examples may help to clarify the extreme cases (outside or inside the scope of the rule). There will remain, however, a significant level of uncertainty since there are always specific circumstances that need to be addressed.

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7 Case n°2013-685 DC, December 29, 2013, the French Supreme Court stroke down various tax provisions that were too vague, one of them cancelled a provision that was amending the abuse of law article of the French tax code. According to the cancelled provision, a transaction was an abuse of law, “if its main purpose” was to reduce or avoid taxes. It was considered as being too vague.

8 ECJ December 14, 1980, case n°110/99 Emsland-Stäke, Rec. I-11569. ECJ February 21, 2006 case n° 255/02, gr. Ch., Halifax plc: ECJ February 21, 2008 case n°425/06, Part Service, Rec. I-897. ECJ May 22, 2008, case 162/07, Ampliscientifica, Rec I-4019; CJUE December 22, 2010, case n° 103/09 the Commissioners for her Majesty’s revenues and Customs c/Weald Leasing Ltd, Rec. I-13589. According to Mr Poiares Maduro, advocate general to the ECJ “The prohibition of abuse, as a principle of interpretation, is no longer relevant where the economic activity carried out may have some explanation other than the mere attainment of tax advantages against tax authorities. In such circumstances, to interpret a legal provision as not conferring such an advantage on the basis of an unwritten general principle would grant an excessively broad discretion to tax authorities in deciding which of the purposes of a given transaction ought to be considered predominant. It would introduce a high degree of uncertainty regarding legitimate choices made by economic operators and would affect economic activities which clearly deserve protection, provided that they are, at least to some extent, accounted for by ordinary business aims.” Paragraph 89 of its opinion delivered on April 7, 2005, ECJ, case n° 255/02, Halifax plc.
In short, we believe that considerations should be given to an alternative definition of GAAR such as the definition of the ECJ or of the French Tax Code where the anti-abuse provision would only apply if the transaction is motivated exclusively to avoid or reduce taxes.

3. **Inclusion of specific treaty anti-abuse rules**

The discussion draft also addresses other perceived cases of abuse (i.e. where a person tries to circumvent limitations provided by the treaty itself) beyond the main case of treaty shopping. In that regard, the OECD considers the inclusion of specific anti-abuse rules. The following situations were analysed:

3.1 **Dividend Transfer Transactions - Dividend WHT and minimum shareholding period**

The discussion draft proposes to amend the provision of Article 10 paragraph 2 subparagraph a) of the OECD Model. Dividend distributions made by resident corporations to non-resident shareholders can be subject to lower withholding tax (WHT) rates than 15%. However, under the current OECD Model no special holding period is required to benefit from these lower tax rates.

The proposal for an amendment in the Discussion draft provides for a minimum shareholding period and additional anti-abusive rules (for the inappropriate use of intermediaries) in order to be eligible for the reduced source-country tax on dividends (5% or 0%).

We believe that the proposed amendment of Article 10 of the OECD-Model is a correct step towards hindering companies from circumventing or misusing treaty provisions, since some OECD Member States have already had positive experiences with minimum shareholding periods under national tax laws in such cases.

We are of the opinion that the concept of introducing such a minimum shareholding period, could be seen as an effective attempt to prevent forms of abuse by temporarily shifting companies’ ownership structures.

As regards the appropriate length of the required shareholding period, it should be noted that some OECD States have already implemented comparable time periods for the recipient of dividends, where e.g. a holding period of 12 months is required. It might also be considered that the European Parent-Subsidiary-Directive, which also provides for benefits for dividend payments between corporations within the European community, also establishes a maximum of an uninterrupted holding period of at least two years (despite the majority of EU countries applying holding period of 12 months).

It should be discussed whether the relief is also granted if the holding requirement is not met at the date of the dividend distribution, but is completed at a later point (e.g. acquisition of shares five months before the dividend distribution, however, the shares are held for example for more than 12 months). In such cases a refund for the tax withheld at source should be granted as the later completion of the holding period indicates that the shares were not acquired as a short term investment.
3.2 Tie-breaker rule for companies

According to the discussion draft, it is proposed to amend the provision of Article 4 paragraph 3 of the OECD Model (so-called residence tie-breaker rule) in order to determine the treaty residence of dual-resident companies. The “competent authorities” of the respective Contracting States shall be encouraged to determine the residence of dual-resident entities by way of “mutual agreements” on a case-by-case basis.

The fact that the OECD addresses the topic of dual-resident companies indicates that dual residency has become a more and more relevant topic and is not limited to singular cases. The more important it is to give the taxpayer guidance and certainty with regard to potential double taxation issues in advance. However, the proposed amendment avoids establishing clear rules, but refers the taxpayer to the mutual agreement procedure between the Contracting States involved.

As mutual agreements have to be reached in every single tax case, this approach runs the risk of being impractical. In the absence of an abstract rule, it is impossible to predict the outcome of such mutual agreement which makes business planning almost impossible. Furthermore, the dual resident entity is excluded from the treaty benefits until the states have reached an agreement. In practice, a mutual agreement procedure might take a couple of years.

From a procedural perspective, it should be noted that the taxpayer is not a direct party to the negotiations of the mutual agreement procedure and that it is in the discretion of states to consider or to neglect certain circumstances. Furthermore, the mutual agreement procedure does not oblige the states to reach an agreement and, therefore, the taxpayer cannot claim a decision.

We anticipate a risk that the initial purpose of the mutual agreement procedure, which is in principle to serve as an appeal in case of disputes regarding the applicability of a rule, is changed to releasing the states from the obligation to define proper rules.

We would recommend that the OECD revisits the 2003 discussion draft on the place of effective management concept where proposals either to refine the place of effective management or introduce hierarchy of tests in the form of a tiebreaker rule for companies were suggested. We consider that all reasonable efforts should be made by all stakeholders to determine if a consensus solution for a more effective tiebreaker rule is possible before embarking into an overkill solution.

3.3 Anti-abuse rule for permanent establishments situated in third States

The OECD states that the source country “should not be expected to grant treaty benefits” with respect to certain cases where income is derived from shares, debt-claims, rights or property attributable to permanent establishments which offer preferential treatment to the income from such assets.

We understand the general concern of source countries on the potential for extension of exemption or reduced withholding taxes under a treaty agreed between the source and residence country simply because the income is paid to permanent establishment in a third country. In any case, we believe this concern warrants concrete action only in cases where the third country does not levy a “meaningful level of tax” on such income, and the structure was, as the OECD indicates in its Commentaries to Articles 10, 11 and 12, “set
up solely for that purpose”.

The inclusion of a triangular provision into the OECD Model raises therefore several points:

- Should this provision, rather than be inserted in Article 1 be covered on the specific article covering “eligibility to treaty benefits”? We understand that for sake of coherence with other rules limiting treaty entitlement, that this triangular provision should be included on the comprehensive LOB rule. In addition, we also believe that the OECD should seek to limit the application of this rule to cases where the third country permanent establishment “was organised with the principal purpose to reduce income taxes payable on the income with respect to which relief of taxation under the tax treaty is claimed”.

- Should the test to apply this provision be based on a “combined aggregate effective rate of tax” on the overall profits of two countries, or for simplicity reasons make reference to a minimum standard rate applicable to that item of income (e.g. 10%)? We refer to the fact that withholding taxes are generally applicable on gross income and residence, and third country taxation on net taxation. If this triangular provision is essentially designed to answer concerns of the source country (and not the residence country that may have a tax treaty with the third state and other mechanism to trawl any abuse), we would prefer that the source country would commit itself to a level of agreed nominal taxation or as the OECD refers a “normal” taxation on the third country.

- Should the test to apply this triangular provision refer to the “general rate of company tax” applicable in the residence country? As noted above, we believe that a simpler and more direct mechanism could be developed to eliminate the need for a theoretical comparison of combined and general rates and the setting of an arbitrary threshold percentage (60% in the case of the OECD proposed rule), according to which the anti-abuse rule is triggered.

- Should the triangular provision take into account situations where the residence state has an anti-deferral mechanism to reinstate or recapture the profits attributable to the third state permanent establishment?

- Finally, should a case of non-treaty entitlement under the triangular provision be also subject to discretionary relief provision? We understand that one of the benefits of integrating this specific anti-abuse rule into the LOB provision would be the flexibility and coherence on the application of the underlying principles.

4. **Cases where a person tries to abuse the provisions of domestic tax law using treaty benefits and implementing a “saving clause”**

The discussion draft describes cases where a person tries to abuse the provisions of domestic tax law using treaty benefits. The discussion draft recommends the addition of a provision similar to the US “saving clause” which allows the contracting state not to apply the treaty to its resident. Such saving clause should provide for specific exemptions taking into accounts the specificities of each relevant tax systems.

According to the discussion draft, it is proposed to add a so-called “saving clause” corresponding to the “saving clause” Model in US treaties to Article 1 paragraph 3 of the OECD Model. The brief message is that tax treaties should not in general affect the taxation by a contracting state of its own residents.
Our understanding of the proposal is that the contracting states should be allowed to “override” a treaty by using domestic anti-abusive provisions in situations where a taxpayer might otherwise rely on a tax treaty to limit his tax burden. Thus, a third barrier in addition to the LOB clause and the proposed GAAR would be set up which would add even more complexity to the applicability of double taxation agreements.

In general, Taxand has certain reservations about the fact that the proposed “saving clause” may grant a national treaty override provision priority of the provisions of the treaty. Furthermore, if a saving clause authorises a state to impose taxes on the basis of national tax provisions (which a tax treaty may exclude), it should be clarified whether such a taxation right needs to be technically reflected in Articles 23 A and 23 B.

Taxand believes that the relation of national treaty override provisions on the one hand and treaty provisions on the other, should be evaluated and clarified. However, doubts remain whether the proposed saving clause is the correct answer to that question.

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We appreciate this opportunity to provide comments to the OECD Committee of Fiscal Affairs and would be pleased to discuss this further and to participate in any further discussion on these matters.

More information on how to contact Taxand is provided as Appendix I. Taxand is wholly committed to supporting the OECD Committee of Fiscal Affairs and we look forward to contributing to further debate.

Yours faithfully,

Taxand
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8 April 2014

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RE: Discussion Draft on BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

To Whom It May Concern:

On 19 July 2013, the OECD published an Action Plan on Base Erosion and Profit Shifting (hereinafter the Action Plan or the Plan) setting forth 15 actions the OECD will undertake to address a series of issues that contribute to the perception that individual countries’ tax bases are being eroded or profits shifted improperly. Pursuant to Action 6 of the Plan, “Prevent treaty abuse,” the OECD issued a public discussion draft on 14 March 2014 on BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances (hereinafter the Discussion Draft or Draft). The Discussion Draft sets forth several recommendations to modify the provisions of the OECD’s Model Tax Convention on Income and Capital (Model Treaty) to address whether treaty benefits were granted in inappropriate cases.

The OECD requested comments on the Discussion Draft no later than 9 April 2014. On behalf of Tax Executives Institute, Inc. (TEI), I am pleased to respond to the OECD’s request for comments.

TEI Background

TEI was founded in 1944 to serve the needs of business tax professionals. Today, the organisation has 55 chapters in Europe, North America, and Asia. As the preeminent association of in-house tax professionals worldwide, TEI has a significant interest in promoting tax
TEI Comments

TEI believes that a more balanced approach would be conveyed in the Draft if the OECD were to acknowledge explicitly that the vast majority of taxpayer claims to treaty benefits are bona fide, rather than treating any claim to treaty benefits as automatically suspect. This approach would be in accord with the general (and original) purposes of bilateral treaties to promote cross-border trade and investments by eliminating double-taxation and to prevent illegal fiscal evasion. Combatting legal (but disfavored) tax avoidance or eliminating double non-taxation are objectives that seem to be outside these primary purposes. Treaties accomplish these purposes by, in part, allocating taxing jurisdiction between the Contracting Parties. The perspective evidenced by the Draft, however, would move treaties from a general position of granting taxpayers certain rights to curbing such rights and potentially subjecting income to tax under a treaty where it may have been untaxed in the absence of the treaty. TEI appreciates the statement that tax treaties are not intended to give rise to double non-taxation. However, if tax treaties lead, or contribute, to double non-taxation, the provisions of the treaties themselves should be changed without resorting to the potential paradigm shift in the focus of the Model Treaty that the Discussion Draft portends.

Specific Provisions of the Discussion Draft

“Treaty Provisions and/or Domestic Rules to Prevent the Granting of Treaty Benefits in Inappropriate Circumstances”

TEI commends the OECD for recommending changes to the language of its Model Treaty to address concerns with respect to tax treaty abuse under BEPS Action 6. Too often changes to the official OECD commentary to the Model Treaty (Official Commentary) have been made that could be interpreted in a manner that effectively amends the language of the Model, and thus greatly influence the interpretation of the various bilateral treaties that use the

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1 Discussion Draft at p.27-28.
2 Id. at p.3-26.
Model as their base. By recommending changes to language of the Model Treaty itself, countries that use the Model as a base will need to renegotiate their treaties and come to an agreement with the other contracting state (or states if the mechanism developed under BEPS Action 15 is utilised) on the meaning and interpretation of the new language. This will provide the certainty for taxpayers and tax authorities that is lacking when the OECD changes only the Official Commentary, which is more likely to lead to differing interpretations between taxpayers and tax authorities and between the competent authorities of the parties to a bilateral treaty.

With respect to the recommended changes to prevent granting treaty benefits inappropriately, the Discussion Draft distinguishes two sets of circumstances: (i) cases where a person tries to circumvent limitations provided by the treaty itself, and (ii) cases where a person tries to circumvent the provisions of domestic law using treaty benefits. With respect to the former, the OECD further categorises the issues as either “treaty shopping” or “other situations where a person seeks to circumvent treaty limitations.” To address treaty shopping, the OECD recommends a three-pronged approach. First, the Discussion Draft recommends that the Model Treaty include a clear statement in the preamble and title that the contracting states wish to prevent tax avoidance and avoid creating opportunities for treaty shopping. Second, the Draft recommends including a specific anti-abuse rule in the Model Treaty based on the limitations-on-benefits provisions of treaties concluded by the United States and a few other countries (LOB provision). Third, the Draft recommends the inclusion of a more general anti-abuse rule, which will, in part, incorporate the principles of the Official Commentary to Article 1 of the Model Treaty, “according to which the benefits of a tax treaty should not be available where one of the main purposes of the arrangements or transactions is to secure a benefit under a tax treaty and obtaining that benefit in these circumstances would be contrary to the objective and purpose of the relevant provisions of the tax treaty . . . .” (hereinafter referred to as the treaty anti-abuse rule).

The LOB Provision

The Discussion Draft sets forth a highly detailed LOB Provision as paragraphs 1-5 of a new “Article ‘X,’ Entitlement to Benefits.” The Discussion Draft notes that a “detailed Commentary will explain the main features of this rule” and discusses some alternatives to, and additional issues that may be presented by, an LOB Provision (including the inclusion of a “derivative benefits” provision).

In TEI’s view, the inclusion of an LOB Provision similar to that set forth in the Draft is preferable to the inclusion of a treaty anti-abuse rule, as also recommended by the Draft. The LOB Provision, while complicated and detailed, is at least an objective standard that can be

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3. *Id.* at p.5.
4. *Id.* at p.5-9.
measured and verified. This approach provides the certainty that multi-national enterprises (MNEs) need to plan and conduct their international business operations. An LOB Provision permits an MNE to confidently take into account the application of a treaty and its associated benefits when making its business decisions. In contrast, the treaty anti-abuse rule is inherently subjective and would present MNEs with great uncertainty with respect to the cross-border tax consequences of their operations. Thus, TEI strongly recommends that any additions to the Model Treaty that would erect additional barriers to accessing the benefits of a treaty be in the form of an objective LOB Provision similar to the one set forth in the Discussion Draft.

With respect to the Draft’s recommended version of the LOB Provision, TEI has the following comments. First, as the Discussion Draft notes, the LOB Provision is modeled on a similar provision included in the United States’ model income tax treaty. The provision therefore inherently reflects U.S. domestic policy concerns, which may not be applicable on a global basis. If a U.S.-style LOB Provision is to be incorporated into the Model Treaty, the question arises whether the Official Commentary to the Treaty should also include the additional U.S. guidance interpreting the U.S. limitation-on-benefits provision (e.g., the technical explanation of the U.S. model treaty released by the U.S. Treasury Department). TEI recommends that, if the OECD substantially adopts the U.S. LOB approach, the OECD should also substantially adopt the additional U.S. guidance in the Official Commentary. This would permit taxpayers to draw upon a generally well developed, known, and accessible body of regulatory and other guidance when applying the new LOB Provision of the Model Treaty.

Second, the LOB Provision includes various tests that, if satisfied, will entitle a person to treaty benefits if that person is entitled to benefits under the remaining provisions of the Model Treaty, including meeting the provisions of any treaty anti-abuse rule. These tests include a public company subsidiary test⁵ and a base erosion test.⁶ As drafted, these tests would deny treaty benefits if there is an intermediate entity in the chain of ownership that is not a resident of the same Contracting State as the public company or the persons otherwise entitled to treaty benefits that directly or indirectly own the person being tested.

This limitation does not recognise the global nature of MNE operations, which in many cases may have subsidiary ownership chains that cross back and forth between borders. Thus, the LOB Provision would deny treaty benefits to many subsidiaries where there does not appear to be a principled reason for the denial. TEI recommends that the OECD remove the requirement that intermediate entities be resident in the same Contracting State in the publicly traded subsidiary and base erosion tests. The other provisions of these tests (i.e., the required direct and indirect ownership percentages and/or base erosion limitations) should be sufficient to ensure that treaty benefits are appropriate for such entities.

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⁵ See Discussion Draft, Section 2.(c) of proposed Article “X” (pages 5-6).
⁶ See id. at Section 2.(e), (page 6).
Third, TEI commends the inclusion of paragraph 4 of proposed Article “X,” which permits a resident of a Contracting State not otherwise entitled to the benefits of the treaty to nevertheless obtain the relevant treaty benefit if the Competent Authority of the other Contracting State determines that establishment and conduct of the resident “did not have as one of its principal purposes the obtaining of benefits” under the treaty (hereinafter the Discretionary Benefits Provision). This provision provides an “escape hatch” and needed flexibility for MNEs that conduct bona fide business operations in a Contracting State, but nevertheless fail the specific tests of the LOB Provision. On the other hand, an MNE availing itself of the Discretionary Benefits Provision is likely to face a time-consuming and unpredictable process with an overburdened competent authority. Therefore, it would be preferable to relax the tests in the LOB Provision to permit more residents to qualify for the treaty under those tests. In the absence of a relaxed test, the efficacy of the Discretionary Benefits Provision would be improved by including a list of factors and several examples that the relevant competent authority should consider when deciding whether to grant discretionary benefits. In addition, competent authorities should be obligated to complete a request for discretionary benefits within a set period of time.

Finally, TEI recommends the inclusion of a derivative benefits provision in the Model Treaty. The Discussion Draft does not specifically include such a provision in the LOB Provision set forth in proposed Article “X.” Instead, the Draft provides language for a derivative benefits provision, but then sets forth an example where such a provision “could result in the granting of treaty benefits in the case of base eroding payments in situations that have given rise to BEPS concerns.” It appears that the objectionable portion of the example is that one Contracting State provides a preferential tax rate on certain income (royalties in the example), causing the company in the example to shift its operations from a relatively high tax country to the country with the preferential rate, even though treaty benefits are the same in both countries. If the OECD believes the low country tax rate is the objectionable feature, the situation in the example should be addressed by BEPS Action 5 on harmful tax practices, rather than in the revised Model Treaty. Doing so would permit the OECD to adopt the derivative benefits provision in the LOB Provision of a new Model Treaty. As important, in TEI’s view, if two countries agree that their bilateral income tax treaty should have a derivative benefits provision (or not), then that should be the end of the matter. A derivative benefits provision should not be considered objectionable, or subject to attack, because it is to the detriment of a third country that is not a party to a treaty with such a provision.

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7 Id. at p.7.
8 Id. at p.9.
The treaty anti-abuse rule

In addition to the LOB Provision, the Draft provides a separate treaty anti-abuse rule that would deny treaty benefits in cases where “it is reasonable to conclude . . . [that] one of the main purposes” of an arrangement or transaction was to obtain the treaty benefit “directly or indirectly,” unless “it is established that granting that benefit . . . would be in accordance with the object and purposes of the relevant provisions” of the treaty. If applicable, this rule would deny treaty benefits to a person even if the person was a “qualified person” within the meaning of the LOB Provision. Similarly, the Draft provides that the LOB Provision can apply to deny benefits in cases where the treaty anti-abuse rule would not. In other words, both provisions must be satisfied for a taxpayer to claim the benefits of a treaty.

TEI opposes the inclusion of the treaty anti-abuse rule in the Model Treaty. In contrast to the objective LOB Provision, the treaty anti-abuse rule is highly subjective and susceptible to inconsistent and unpredictable interpretations by tax authorities. Further, paragraphs 24-32 of the Discussion Draft make clear that the treaty anti-abuse rule should be read broadly to include any type of benefit under a treaty and any type of arrangement if “one of” the main purposes (i.e., not the sole or dominant purpose) will result, directly or indirectly, in a treaty benefit – subject only to the exception for granting benefits “in accordance with the object and purpose” of the relevant treaty provisions.

For these reasons, a treaty anti-abuse rule would inject a high degree of uncertainty into the determination of whether a taxpayer is entitled to treaty benefits. This would increase the difficulty of making informed business decisions and arranging an MNE’s operations because the resulting tax burden cannot be predicted with certainty.

Further, if taxpayers are not put on notice of what actions may be objectionable, even if not abusive, then it is difficult to see how a “main purpose” test can be applied. The examples set forth in the Discussion Draft are unhelpful in delineating what kinds of actions are subject to the main purpose test from those that are not, as the examples are based on extreme circumstances and are difficult to generalise from. In fact, it appears from the Discussion Draft

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9 Id. at p.10.
10 For example, paragraph 28 of the Draft states that changing the location of the meetings of the board of directors of a company to a different jurisdiction to claim that the company has changed its residence is an example of an “arrangement” that may be subject to the treaty anti-abuse rule. Historically, the location of the board of directors meeting has long been held by courts to be where the management of the company resides. The example thus runs counter to these decisions and will cause confusion and uncertainty for businesses when determining the location of a company’s management. This example also fails to take into account that it is now common for a company’s Board to have individual directors who reside in different jurisdictions and therefore at least some directors must necessarily travel to different jurisdiction to attend Board meetings.
that the “abuse” being policed is access to treaty benefits, which calls into question the reason for entering into tax treaties in the first place. Indeed, under the broad reach of the proposed treaty anti-abuse rule as described in the Draft, the operational structures of many MNEs that have been accepted by tax authorities under the current rules would be considered inappropriate and taxpayers would be denied the benefits of a treaty.

While TEI is strongly opposed to the inclusion of a treaty anti-abuse rule, if the OECD is determined to include one then TEI recommends that the LOB Provision be excluded from the Model Treaty (bearing in mind that our primary preference with respect to particular anti-treaty shopping provisions is to include an LOB Provision and exclude a treaty anti-abuse rule). Taxpayers should not have to go through the complicated and difficult process of determining whether they satisfy a treaty’s LOB Provision only to have treaty benefits denied under a treaty anti-abuse rule.

Similarly, if a treaty anti-abuse rule is included in the Model Treaty, the Treaty should also include an effective process through which a taxpayer could receive a timely administrative decision on whether the rule applies if asserted by a government. The uncertain rule should not be exacerbated by an unwieldy and lengthy process to determine the rule’s proper application, including drawn out mutual agreement procedures in cases where competent authorities disagree on the rule’s application. In addition, the wording of the test should be changed from “a” main purpose to “the” main purpose to provide taxpayers with additional certainty and require evidence that the dominant purpose of the transaction is to obtain treaty benefits. Finally, the examples to be included in the detailed Official Commentary regarding the application of this provision, as promised by the Discussion Draft, should be clear and universally applicable.

Exclusion of third country permanent establishments

The Discussion Draft proposes a new paragraph 4 to Article 1 “Persons Covered” of the Model Treaty to address the use of permanent establishments (PE) in third countries to obtain preferential treatment of certain income. In particular, the Draft refers to the potential abuse that may result from the transfer of assets to a third country PE set up solely for the purpose of the transfer to obtain a low rate of tax on the assets’ income. “Where the state of residence exempts, or taxes at low rates, profits of such [PEs] situated in third States, the State of source should not be expected to grant treaty benefits with respect to that income.”11 The Draft proposes a targeted anti-abuse rule to address this situation if the tax rate on the relevant income is less than 60 percent of the general rate of company tax applicable in the residence state. The rule is subject to certain exceptions, including for income derived from the active conduct of a trade or business of the third country PE.

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11 Discussion Draft at p.19.
TEI is not opposed to a targeted anti-abuse rule in this circumstance. The suggested rule is objective and clear, and as long as it is consistently applied, it should not present the type of uncertainties presented by the treaty anti-abuse rule.

“Saving clause” provision

The Discussion Draft also proposes a “saving clause” in new paragraph 3 of Article 1, which would provide that “This Convention shall not affect the taxation, by a Contracting State, of its residents” except with respect to certain treaty benefits enumerated in the new paragraph. This addition to the Model Treaty is “to prevent interpretations intended to circumvent the application of a Contracting State’s domestic anti-abuse rules (as illustrated by the example of controlled foreign company rules).” The Draft states that this provision corresponds to the practice in the United States with respect to its treaties.

TEI is not generally opposed to savings clauses in treaties, as long as they are objective and it is clear how they apply. TEI would oppose a savings clause that introduces an element of subjectivity to the determination of whether a resident of a Contracting State can avail itself of the benefits of a treaty.

Corporate residence tie-breaker

The current corporate residence tie-breaker rule in paragraph 3 of Article 4 “Residence” of the Model Treaty determines the residence of a dual-resident company by reference to the company’s “place of effective management.” The Discussion Draft would replace the current rule with a case-by-case determination of residence through mutual agreement of the Contracting States’ competent authorities. Factors to consider in this determination are the place of effective management of the company, the place where it is organised, and any other relevant factors. If the competent authorities cannot come to an agreement, then the company would not be entitled to the benefits of the relevant treaty unless the competent authorities otherwise agree. The Draft notes that the reason for this change is that “the view of many countries was that cases where a company is a dual-resident often involve tax avoidance arrangements.”

In TEI’s view, the issue of companies with dual residencies should be addressed by domestic law. If the domestic law of a Contracting State permits a corporation to, e.g., change the place where it is organised to become resident in more than one country for tax avoidance purposes, then the State should change its law to either not permit such a reincorporation or look to the company’s place of effective management for determining residence. That is, if a country objects to dual-resident companies, then that country’s law should not allow them.

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12 Id. at 24.
13 Id. at 17.
Proposed new Article 4(3) of the Draft further pushes tax treaties toward a new paradigm of combating tax avoidance by creating taxation where there would otherwise be none.

**Dividends: source country intermediary company**

The Draft recommends that an anti-abuse rule (or rules) should be included in Article 10 “Dividends” to address “cases where certain intermediary entities established in the State of source are used to take advantage of the treaty provisions that lower the source taxation of dividends.”14 The Draft notes that “a specific anti-abuse rule might be drafted to address situations where a non-resident company makes indirect portfolio investments into domestic companies through a domestic investment company that is not taxed on dividends it receives from such other domestic companies.”15

TEI opposes the inclusion of vague and subjective anti-abuse rules that look to the “purpose” of a transaction, e.g., “to take advantage of” lower source taxation of dividends, because of the resulting uncertainty. Anti-abuse rules should be objective, narrow, and targeted. In the particular case cited of indirect portfolio investments via investment companies, a simpler solution that would not require modifications to the Model Treaty would be to change the law of the Source state so that the dividends received by the investment company would be taxable in that company’s hands.

**Effective Date, Transition Rules & Grandfathering, and Interpretation**

As noted, the changes proposed by the Discussion Draft will cause many currently acceptable MNE business structures to fail to qualify for treaty benefits, causing significant disruption to MNEs that planned their operations based on the availability of such benefits. TEI therefore recommends that the OECD provide an effective date for the recommended changes in the Draft (e.g., two years from when a treaty enters into force). In addition to an effective date, the OECD should provide transition or grandfathering rules to give taxpayers time to change their existing operations to comply with the new rules, or to provide certainty that their current structures can remain in place. Finally, these rules should be accompanied by a directive that a “main purpose” or similar test should only be applied by tax authorities prospectively to arrangements and transactions that arise after the effective date. Otherwise, tax authorities may be tempted to use the test to invalidate structures put in place before the existence of the test.

**Conclusion**

TEI appreciates the opportunity to comment on the OECD’s Discussion Draft on BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances. These

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14 *Id.* at 16.
15 *Id.*
comments were prepared under the aegis of TEI’s European Direct Tax Committee, whose Chair is Nick Hasenoehrl. If you have any questions about the submission, please contact Mr. Hasenoehrl at +352 26 20 77 46, nickha@herbalife.com, or Benjamin R. Shreck of the Institute’s legal staff, at +1 202 638 5601, bshreck@tei.org.

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Ladies and gentlemen:

TD appreciates the opportunity to submit comments on the OECD’s Discussion Draft on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances issued on March 14, 2014.

Tax treaties are an essential part of the infrastructure that allows global trade and investment to flourish. Treaties provide rules for the allocation of income when economic activity occurs cross-border. Treaties provide rules for assigning primary and secondary rights to tax income. Treaties prevent what can be excessive taxation by reducing withholding taxes that are imposed on gross (rather than net) income. Treaties provide rules regarding the threshold level of activity in a country that will bring a foreign company within that country’s tax net in the same manner as a local company. Moreover, treaties provide mechanisms for resolving any disputes that arise notwithstanding the forgoing network of rules regarding the division of taxing jurisdiction. For all these reasons, treaties are critically important in reducing or eliminating the risk of double taxation which otherwise would be a substantial barrier to cross-border trade and investment.

Clarity and certainty in all tax rules are vital to companies both in understanding the tax consequences of their activities and in understanding and satisfying their tax compliance obligations. This is the case with respect to the tax law of the home country of the company. This is the case with respect to the tax law of the foreign countries where the company has operations. And it is equally or more the case with respect to the tax treaties that serve to mesh the domestic and foreign tax systems affecting the company’s global activities.

A tax treaty is a negotiated deal between two countries for the benefit of companies and tax administrations alike. Clear and certain rules are necessary to memorialize the deal effectively
and ensure that the treaty is applied consistent with the intent of both countries. Vagueness or uncertainty in the rules could mean that one tax administration’s interpretation is not consistent with the deal that was struck by the countries. Moreover, vagueness and uncertainty could lead to different interpretations of a treaty in different cases or over time.

We appreciate the need to ensure that tax treaty benefits inure to residents of the two countries that are parties to the treaty and not to those without a real connection to either of the treaty countries. However, in crafting anti-treaty shopping rules, it is important that such rules are not so burdensome as to deny effective access to treaty benefits to the intended beneficiaries. Indeed, uncertainty about the availability of treaty benefits can be tantamount to a denial of benefits. Thus, we urge the use of clear rules and objective tests for purposes of addressing the potential for treaty shopping.

**Main Purpose Test**

The Discussion Draft recommends the use of two different approaches to addressing treaty shopping to be applied together so that in order to qualify for treaty benefits both tests would need to be satisfied. The first test, which is the more objective of the two, would be a form of prescriptive limitation on benefits provision. The second test, which is significantly more subjective, is a form of treaty-based general anti-abuse rule. We are concerned that application of this subjective test, which would apply in combination with the more objective limitation on benefits provision, would be a dangerous departure from the clarity and certainty that are essential to the effective operation of treaties. Therefore, we focus our comments in particular on this second test.

The Discussion Draft recommends a standard that looks to whether “one of the main purposes of the arrangement or transaction” is the obtaining of treaty benefits. This standard is both overly broad and overly subjective. Companies would not know when they are considering an investment or a transaction whether the application of treaty benefits to the arrangement might be subject to challenge under this standard. The uncertainty is exacerbated by the fact that it is the interpretive standards of the foreign country, not the home country, that generally would be relevant to a company seeking to assess whether it would be entitled to treaty benefits or not. Moreover, as noted above, these interpretive standards could well change over time and companies would need to know the current – and in many cases, the future – standards of the relevant foreign country.

The second prong of this main purpose test would allow benefits if “it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.” The inclusion of this exception is helpful, but this standard similarly is overly vague and uncertain. Companies would not know whether a contemplated investment or transaction might be eligible for this exception. Countries would not know how their treaty partners apply this exception, and such application also could change over time.
We agree with the suggestion in the Discussion Draft regarding the need to supplement any main purpose test with detailed commentary and examples. However, we do not believe that more explanation and illustrative examples would be sufficient to overcome the uncertainty and subjectivity of the test as currently crafted. In this regard, it is particularly troubling that the explanation contained in the Discussion Draft is largely aimed at broadening the reach of the main purpose test rather than at better targeting it.

In considering the merits of inclusion of a main purpose test in tax treaties, we believe the OECD and countries should evaluate the potential harmful macro-economic impact of the uncertainty that such a test would create and the negative implications for cross-border trade and investment. The implications of these harms should be weighed against the expected benefits of such a test as a tool to address unspecified treaty shopping concerns. Moreover, this cost-benefit analysis should also reflect the additional compliance costs for both taxpayers and tax administrations from such a subjective test. It should be noted that these increased costs will further exacerbate the inefficiency of the corporate income tax, which the OECD has already identified as a relatively inefficient tax as compared to other forms of taxation.

If the OECD does not reconsider its recommendation of a main purpose test, which we think would be the right path, we urge the OECD to modify the proposed formulation of the test in order to clarify the exceptions to such a test in order to ensure the availability of treaty benefits to active business operations. In this regard, we note that the Canadian government is conducting a consultation regarding the possible adoption of a unilateral main purpose test for Canadian tax treaties. In connection with that consultation, the Canadian government has proposed for consideration a series of safe harbor presumptions under which it would be presumed, absent proof to the contrary, that none of the main purposes for a transaction was the obtaining of treaty benefits. The proposed presumptions would cover situations where:

1) The person seeking treaty benefits carries on itself, or through a related person, an active business in the treaty partner country, with a requirement that, if the income is derived from a related person in Canada, such business be substantial relative to the Canadian business that gives rise to the income;

2) The person is not controlled by another person or persons that would not have been entitled to an equivalent or greater benefit if such other person had received the income directly; or

3) The person is a corporation or trust that is regularly traded on a recognized stock exchange.

These exceptions are similar to rules contained in limitation on benefits provisions. The inclusion of exceptions of this type as part of the OECD recommendations would help alleviate the inherent subjectivity of a main purpose test and provide some more certainty to global companies. However, we note that the Canadian proposals would not effectively address this concern, because these presumptions would be rebuttable based on unspecified subjective factors.
The Canadian consultation document also recognizes that taking into account the potential for treaty benefits is a natural and appropriate consideration when structuring a cross-border investment. Indeed, as the document notes, this is to be expected as one of the objectives of tax treaties is to encourage trade and investment. Therefore, the main purpose test under consideration in Canada would not apply “in respect of an ordinary commercial transaction solely because obtaining a tax benefit was one of the considerations for making an investment.” This is an important concept and we encourage the OECD to make this an explicit part of its recommendations.

In this regard, we are concerned in particular about the comments in paragraph 32 of the Discussion Draft:

A purpose will not be a main purpose when it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining the benefit was not a main consideration and would not have justified entering into any arrangement or transaction that has, alone or together with other transactions, resulted in the benefit. In particular, where an arrangement is inextricably linked to a core commercial activity, and its form has not been driven by considerations of obtaining a benefit, it is unlikely that its main purpose will be considered to be the obtaining of that benefit.

In our view, this paragraph illustrates the serious problem with this type of approach, since it would only be “unlikely” that treaty benefits would be denied (and thus still possible) even where an arrangement is “inextricably linked to a core commercial activity, and its form has not been driven by considerations of obtaining a benefit”. We believe that it should be crystal clear that treaty benefits would not be denied in such circumstances.

At a bare minimum, the OECD’s recommended formulation of the main purpose test should be revised. Instead of the loose standard of “one of the main purposes” and explanatory language indicating that there can be multiple main purposes (which seems contrary to the plain meaning of the words used), the standard should be tightened to “the” main purpose and the explanatory language should make clear that there can be only one main purpose.

Finally, we urge the OECD to couple action in this area with the work on Action 14 on improving the mutual agreement process. Reliance on a subjective standard like the main purpose test – let alone the proposed standard of “one of the main purposes” – would necessarily create significant controversy and therefore the need for better mechanisms for resolving disputes would be greater than ever. If a main purpose test is to become a determining factor with respect to qualification for treaty benefits, taxpayers should have the protection of a mandatory arbitration provision.

As an additional safeguard against the imposition of excessive and potentially destructive gross-basis taxation, we would urge the OECD to recommend the introduction of a clear derivative benefits provision alongside any provision(s) designed to limit benefits. Any provision adopted under the guise of addressing treaty shopping should not have a penal effect on taxpayers, nor should it inordinately expand the taxing jurisdiction of the source country and thereby inevitably undermine the tax base and other economic interests of the country in which the stakeholders of an intermediary entity are resident. If warranted, other BEPS concerns (as posited in paragraphs
15 and 16 of the Discussion Draft) should be addressed under the rubric of Action 3 (Strengthen CFC Rules) and Action 5 (Counter harmful tax practices more effectively, taking into account transparency and substance). With respect to concerns over treaty shopping, it seems contradictory to restrict benefits for an intermediary entity on the basis of the residence of its stakeholders and yet to not grant the benefits that these very same stakeholders would be entitled to if the income were received by them directly. A measure to address treaty shopping should either treat the intermediary entity as a legitimate treaty beneficiary in its own right (in which case full benefits should be granted) or should treat it as an instrumentality of its stakeholder (in which case derivative benefits should be granted), consistent with the approach taken in relation to the “beneficial ownership” requirement.

**Targeted Specific Anti-Abuse Rules**

In addition to the general anti-treaty shopping rule in the form of the main purpose test (as well as the more objective limitation on benefits provision), the Discussion Draft recommends the use of targeted specific anti-abuse rules to address qualification for benefits under particular treaty provisions or in particular circumstances. The Discussion Draft notes that these rules provide greater certainty than the more general anti-abuse rule. We agree with that assessment.

We believe that the better approach to addressing potential treaty shopping while ensuring proper access to treaty benefits would couple a more objective overall rule for qualification for treaty benefits with targeted specific anti-abuse rules that are tailored to particular provisions within a treaty rather than with an overall general anti-abuse rule. We urge the OECD to give further consideration to such an approach as a way of addressing areas of concern without imposing excessive risks and burdens with respect to the claiming of treaty benefits.

**Domestic Law General Anti-Abuse Rules**

As a final note, we also are concerned that the Discussion Draft could be read as an endorsement of the use of domestic law general anti-abuse rules to override treaties and deny treaty benefits. Greater use of such overrides around the world would be extremely disruptive to the ability to rely on the availability of treaty benefits. With such overrides, companies are not able to anticipate a potential denial of treaty benefits which would have retroactive effect. We are concerned that this aspect of the Discussion Draft is something that could be cited by countries as supporting denial of benefits under existing treaties, without a bilateral negotiation or the incorporation of any new standards into a treaty agreement.

We urge the OECD to specifically reject the use of general anti-abuse rules of domestic law to override the provisions of a tax treaty. In this regard, we would further recommend that this issue of preventing treaty abuse be considered in connection with the work on Action 15, because the multilateral treaty abuse approach could be an effective avenue for providing a treaty-based solution, rather than a domestic-law solution, to the potential for inappropriate use of tax treaties.
Closing

We appreciate the opportunity to provide these comments on key issues with respect to the Discussion Draft on addressing treaty abuse. We would be happy to respond to questions or to provide any further information that would be useful as the OECD continues its work in this important area.

Sincerely,

Peter van Dijk
Senior Vice President, Tax
TD Bank
April 4, 2014

VIA EMAIL

Mr. Pascal Saint-Amans
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(Pascal.SAINT-AMANS@oecd.org / taxtreaties@oecd.org)

Re: USCIB Comment Letter on the OECD Discussion Draft on BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

Dear Mr. Saint-Amans,

The OECD, through its Commentaries on the Model Tax Convention on Income and on Capital, has long recognized the importance of preventing the abuse of tax treaties through both treaty provisions and appropriate domestic law anti-abuse rules. USCIB\(^1\) accepts and endorses these efforts and the role of BEPS Action 6 to revisit treaty abuse standards in today’s environment. We have serious concerns, however, that the Discussion Draft on BEPS Action 6 has a singular focus on combating treaty abuse without due regard for the impact it would have on the vast majority of potential beneficiaries of income tax treaties that do not engage in abusive practices and that, due to the broad reach and vagueness of the Discussion Draft’s proposals would, in many cases, lose access to tax treaties and, in any event, will be deprived of the certainty and predictability that is a fundamental goal of tax treaties.

For decades, the OECD had led the way in establishing a robust network of bilateral income tax treaties that play a vital role in the promotion of international trade and investment. The Discussion Draft proposals would seriously erode this accomplishment by creating unacceptable levels of uncertainty and seriously narrowing what enterprises will have access to tax treaties to mitigate excessive taxation and double taxation. Domestic tax laws work imperfectly in the international context and often may lead to excessive taxation (such as the case when gross income is subjected to a 30% rate of tax as under U.S. domestic law) or double taxation, creating artificial barriers to international trade and investment. Tax treaties play a vital role in

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\(^1\) 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 leading international business organizations, USCIB provides business views to policy makers and regulatory authorities worldwide, and works to facilitate international trade and investment.
removing these obstacles to international trade and investment by providing accepted standards for the avoidance of excessive taxation and double taxation and, most importantly in the context of the Discussion Draft, provide the business and investment community with the degree of clarity and predictability needed to operate effectively and efficiently in international commerce. The introduction to the BEPS Action Plan recognizes this and underscores the importance of establishing “agreed international rules that are clear and predictable, giving certainty to both governments and businesses.” The recommendations in the Discussion Draft would seriously undermine these basic principles by adding overly restrictive criteria for access to treaty benefits and, in addition, adding vague and subjective anti-abuse standards.

We want to be very clear that, in our view, the recommendations in the Discussion Draft would fundamentally change the role of tax treaties by effectively depriving bona fide enterprises and business transactions of the protection accorded by tax treaties from excessive and double transaction, at serious cost to the global economy. This is even reflected in the title to the proposed new article “Entitlement to Benefits” rather than “Limitation on Benefits.” Action Plan 6 should start with the premise that the vast majority of beneficiaries of tax treaties are bona fide and then recommend solutions to treaty abuse that are focused, objective, and administrable. We believe a more balanced approach is necessary: one that recognizes the fundamental purpose of treaties while recognizing and addressing legitimate issues of abuse of tax treaties. We suggest specific changes below to help achieve this balance.

USCIB also believes that these problems are due at least in part to the speed at which the OECD is attempting to accomplish these changes. We understand the political imperatives under which the OECD believes it is operating; nevertheless complex issues require the time and care to work through the analysis and study the repercussions of any changes. Failure to take the time necessary to do this will result in faulty rules which governments and businesses will spend years, if not decades, undoing. We also believe that the speed at which the OECD is attempting to move is contributing to the complexity of all of the recently released discussion drafts. It seems because there is no time to resolve differences of opinion among the delegates; the discussion drafts must include all the possible options. It is then up to commentators to make the case for removal of bad options. Given the short comment periods, it is impossible for business to give the careful thought necessary to identify and comment on all the issues in each of these proposals. In our view, the OECD should be taking the time to work through ideas and reject bad ideas. A bad idea is not like a fine French wine: it does not improve with age. The current process could seriously undermine the OECD’s reputation for careful, analytical work that supports the foundation of sound tax policy.

We strongly urge the Working Group on Action 6 to:

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2 Because we believe limitation on benefits is the more appropriate concept, we will use that term throughout this comment letter.

3 In particular, the timing on this action item may be wrong. It would be appropriate to look at treaty abuse after other action items are completed. For example, if Action 4 significantly reduces the scope for base eroding interest payments, then the rules proposed in Action 6 may be excessive and their primary impact might be to impose undue restrictions on legitimate cross-border investment.
1. Reject the overly restrictive standards in the proposed “Entitlement to Benefits” article that is patterned after the current U.S. Limitation on Benefits (LOB) article and adhere more closely (with modifications discussed below) to the version that already appears in the Commentaries;

2. Reject subjective main purpose or general anti-avoidance treaty solutions but, either use specific treaty measures to address concerns about conduit financing, or, direct countries to revisit their domestic law anti-abuse rules to assure that they are (1) effective in today’s environment, (2) focused on identified abuses, (3) administrable and (4) do not impede legitimate business and investment activities;

3. Provide that, if the decision is made to retain a main purpose test, enterprises that meet any of the other criteria for eligibility for the benefits of the treaty under the LOB article should be presumed not to fail the main purpose test unless the relevant Competent Authority establishes by clear and convincing evidence that the test should apply, providing clearly that such evidence cannot take into account the status of the owners of the enterprise as nonresidents of the enterprise’s state of residence, and that persons denied benefits should have access to MAP with binding arbitration; and

4. In the course of endorsing effective anti-abuse measures, provide a clear mandate for countries to adhere to the fundamental precept already recognized in the Commentaries that, consistent with the goal of promoting bi-lateral trade and investment through establishing rules that provide the greatest degree of certainty and predictability for bona fide beneficiaries of tax treaties, rules that create subjectivity and uncertainty, or that rely on cumbersome pre-clearance procedures straining the resources of tax administrators are to be avoided.

Specific Comments

USCIB believes there are two kinds of “treaty shopping.” One is use of a treaty by a third country person who simply sets up an entity in a treaty state (usually one that has very low taxation or that can be base-stripped to achieve low taxation). This is addressed by a limitation on benefits clause. The other type of “treaty shopping” is a conduit financing type case. Conduit financing cases can and should be dealt with by domestic law and concepts of beneficial ownership, which the OECD has addressed elsewhere. Layering a main purpose test on top of limitation on benefits provision is excessive; a limitation on benefits clause is enough.

Comments on the Proposed Limitation on Benefits Provisions

1. In our prior submission to the Working Group we commented that a well drafted, simplified general Limitation on Benefits article that is targeted and not overly restrictive provides tax administrators with protection against claims for unintended benefits by “treaty shoppers” while providing bona fide enterprises with certainty regarding the availability of treaty benefits. The proposed article does not meet this standard for three reasons:
• It is unduly restrictive, patterned after recent versions of the U.S. LOB article whose provisions are influenced by U.S. domestic policy considerations.
• It omits a clause commonly relied upon in the U.S. experience, namely the derivative benefits test.
• It includes a main purpose test which totally undermines the principal benefit to taxpayers – their ability to rely on an objective set of standards providing the needed certainty and predictability.

We have attached as an appendix to this comment letter a formulation of the article that meets the standards we have recommended. We would be happy to discuss this in more detail with the Working Group and provide here a few examples that reflect the U.S. experience.

2. There are numerous circumstances where enterprises that are clearly not treaty shopping would be deprived of access to the benefits of the treaty:
• The restriction found in the subsidiary of a publicly traded company test, the ownership/base erosion test, and the sample (but not accepted) derivative benefits test that precludes their application if there is an intermediate entity that is not resident in one of the Contracting States (or, in the derivative benefits test, an equivalent beneficiary) fails to recognize the reality of how multinational enterprises are organized in a global economy, usually based on a regional or operating units structure, the result of which is that a great many MNE subsidiaries would be precluded from qualification even though each intermediate entity conducted bona fide activities in its own country. This restriction does not, in our view, further any anti-abuse goal, particularly in the context of the ownership/base erosion and derivative benefits tests that include a base erosion criterion for qualification under these tests. USCIB also believes that this restriction violates EU freedom of establishment rules.
• The inclusion in the publicly traded test of a substantial presence criterion based on either the shares being traded on a local exchange or the vague standard of the primary place of management being in the country of residence would deprive many publicly traded companies of access to the treaty because their shares are listed on regional exchanges that provides the greatest marketability and their management is decentralized. The Discussion Draft fails to recognize that part of being a publicly traded company is not having control over the residence of the persons that purchase the shares.
• The requirement in the ownership prong of the ownership/base erosion test that at least 50% of the shares of the tested entity be owned by local residents means that a joint venture company exclusively owned by residents of the two Contracting States would fail to qualify if residents of the source Contracting State own a majority of the shares even though, clearly in this example, no third country resident is accessing the treaty. If a resident of the
source State is considered to be inappropriately reducing source State tax, then that should be dealt with under appropriate CFC or PFIC rules.

- The restriction in the base erosion tests that treats ordinary course of business payments (for example, interest or royalties) as base eroding payments when paid to a local corporation that is not publicly traded could cause an enterprise to fail this test even though the enterprise operates on an exclusively local basis.

3. The Discussion Draft discusses the possible inclusion of a derivative benefits standard for eligibility for treaty benefits but raises concerns about “base eroding” payments that give rise to BEPS concerns. It illustrates this by an example in which a State S company (the tested company) is wholly owned by a parent company that is a qualified resident and the State S company makes a royalty payment to a sister company in State R. The State R company qualifies as an equivalent beneficiary. The BEPS concern identified in the example is that State R provides a preferential rate of tax on royalties. We question whether this benefit, which is unrelated to any treaty provision, is a concern that should preclude the inclusion of a derivative benefits in an LOB. The purpose of a derivative benefits clause is to permit treaty benefits where the ultimate owner – here the parent company – would be entitled to the same treaty benefit with respect to an item of income whether it earned the income directly or earned it through an equivalent beneficiary. That is the parent has achieved no further treaty benefit by transferring income-producing property to its State R subsidiary.

The OECD has repeatedly stated in the context of the BEPS project that BEPS is not about tax rate competition, yet the Discussion Draft cites a preferential tax rate as the reason for omitting a derivative benefits test. We note that all three companies in the example would be entitled to the same source country tax reduction under the relevant treaties, so the establishment of the tested company in State S does not provide any treaty benefit that would not otherwise be available. We further note that the Parent in State T could also pay a royalty to the affiliate in State R and that apparently does not raise BEPS concerns. If the preferential tax regime for royalties in State R is considered a BEPS concern, then the proper avenue for addressing it is in the harmful tax practices Action Item. If the preferential rate is not considered to constitute a harmful tax practice, then the appropriate response is for State S to take this into account in its treaty with State R. If the preferential regime is not harmful and State S has considered it in the context of the treaty with State R, then there is no reason to consider that preferential regime in determining whether derivative benefits are appropriate. Consideration should also be given to whether the absence of a derivative benefits test is another instance in which the proposal would violate the EU freedom of establishment rules.

Derivate benefits clauses serve as an appropriate escape hatch from the strict LOB provisions in cases not involving treaty shopping. For example, assume that a 50/50
joint venture between a resident of State A and a resident of State B is set up in State C; State C could be a neutral choice for any number of reasons having nothing to do with treaty shopping. In this example, the State C entity may earn income from source State D. If there is a tax treaty between State D and each of States A and B that provides equivalent benefits to those provided under a tax treaty between State D and State C, there is no reason to believe that the residents of States A and B are treaty shopping.

4. Paragraph 4 of the proposed LOB article would provide an important safety net for companies that do not qualify under any of the objective tests and we endorse its inclusion. However, we would note from the U.S. experience that the discretionary grant of treaty benefits based on this standard is a lengthy and cumbersome process in which a company will not know whether it is eligible for treaty benefits until the end of the process. In other words, it would not be a realistic response to the restrictive nature of the proposed article.

5. To make Paragraph 4 more practical, we suggest (i) that the relevant Competent Authority be compelled to complete the process within a reasonable time frame, say six months, with the automatic grant of the requested benefits if the time requirements are not met and (ii) the OECD provide guidelines for the factors to be considered by the Competent Authority, including examples. The examples could include: (i) a company that is acquired by private equity interests that met the LOB criteria prior to the acquisition, (ii) the privatization of a former governmental entity, (iii) a family owned company that met the 7 or fewer requirement of the derivative benefits standard but now has more than 7 owners due to the expansion of the family ownership, and (iv) a company that is created by the legislative body of its country of residence.

Other forms of Treaty Abuse

Footnote 3 of the Discussion Draft states that where a resident of a Contracting State that is the source State seeks to obtain treaty benefits through use of an entity resident in the other Contracting State, this could also be viewed as a form of treaty shopping. USCIB does not believe this is a form of treaty shopping as treaty shopping is the use of a bilateral treaty by residents of a third jurisdiction. Thus, trying to tackle this kind of structure using rules designed to deal with treaty shopping will complicate the treaty shopping rules and lead to incorrect outcomes. For example, a resident of the Contracting State that is the source State should be able to enter into a joint venture with a resident of the other State without being concerned about the limitation on benefits rules. If a source State resident is obtaining a benefit that is viewed as inappropriate, the proper recourse is the domestic laws of the source State. In the United States, for example, our CFC rules and our PFIC rules address this concern. These are inherently domestic policy concerns that should be addressed domestically, not through treaty limitation on benefits provisions. Alternatively, if a narrow anti-abuse rule is needed, that should be addressed explicitly in a particular article.

Comments on the Main Purpose Test
1. As noted, the inclusion of a main purpose rule in the treaty would eliminate the principal benefit of a LOB article, providing certainty and predictability, and seriously erode the role of tax treaties in promoting bilateral trade and investment. The uncertainty and subjectivity of the main purpose test is underscored by the Discussion Draft’s explanation of the test in paragraphs 24 through 31 which makes clear its broad and uncertain scope. A large part of the concern about treaty shopping can be mitigated in the standards a country applies in deciding to enter into a treaty relationship. Decisions on which countries are appropriate treaty partners and restraints built into individual treaties to address areas of concern based on the domestic laws of the potential treaty partner can go a long way towards alleviating concern about treaty shopping. This is a far better way to address the concern than adopting a broad, subjective test of taxpayer intent.

Further, a main purpose test puts too much discretion in the hands of tax authorities; this invites abuse of that discretion in two ways. At one extreme, countries may agree to a main purpose test which they have no intention of enforcing. Thus, it seems that there are restrictions on the use of the treaty but these would be illusory. In another example, if a country A has a treaty in place with country B that it knows is used primarily by non-residents of country B for tax planning purposes, should country A be able to single out one company or a handful of companies and deny benefits? Why this company and not that company? Does the longstanding nature of these arrangements argue that the country A is estopped from denying benefits because it has acquiesced in the use of the treaty to access its markets?

2. The main purpose test has been proposed in U.S. tax treaties and soundly rejected by the U.S. Senate, the legislative body whose approval is required for U.S. ratification of a tax treaty. The rejection was explained by the Senate committee with jurisdiction over tax treaties as follows:

“The new main purpose tests in the proposed treaty are subjective, vague and add uncertainty to the treaty. It is unclear how the provisions are to be applied. In addition, the provisions lack conformity with other U.S. tax treaties. This uncertainty could create difficulties for legitimate business transactions, and can hinder a taxpayer's ability to rely on the treaty.

In the past, the United States has determined that subjective tests are not appropriate in the treaty context. For example, older U.S. treaties containing limitation on benefits provisions (which address an abuse of a treaty whereby residents of third countries try to take advantage of the treaty provisions through what is known as treaty shopping) applied broad subjective tests looking to whether the acquisition, maintenance, or operation of an entity did not have "as a principal purpose obtaining benefits under" the treaty. These subjective

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4 USCIB strongly supports the addition of the new section C to the Commentary. A careful look at how two countries tax laws interact should be a part of the preparation for any income tax treaty negotiation between two countries.
tests have been replaced in recent treaties (including the proposed treaty) with limitation on benefits provisions that apply clear, bright-line objective tests (such as ownership and base erosion tests, public company tests, as well as active business tests). The reasons for moving away from subjective standards are illustrated by a statement in the Technical Explanation to the limitation on benefits provision of the proposed treaty that acknowledges in connection with a principal purpose test that a "fundamental problem presented by this approach is that it is based on the taxpayer's motives in establishing an entity in a particular country, which a tax administrator is normally ill-equipped to identify." Although this criticism is specific to a principal purpose test with respect to an anti-treaty shopping provision, the same concern applies with respect to subjective tests in general.

The main purpose standard in the relevant provisions of the proposed treaty is that "the main purpose or one of the main purposes" is to "take advantage of" the particular article in which the main purpose tests appear. This is a subjective standard, dependent upon the intent of the taxpayer, that is difficult to evaluate. Such a standard is inconsistent with present U.S. treaty policy. In addition, the Committee is concerned that a broad standard based on whether one of the main purposes of a taxpayer is to take advantage of a particular treaty provision does not adequately distinguish between legitimate business transactions and tax avoidance transactions. While it is true that under U.S. domestic law, "a principal purpose" test is used as an anti-abuse rule in a variety of contexts, its use generally has been limited to circumscribed situations. The Committee is concerned that the circumstances for inclusion of a main purpose test in the proposed treaty are not well-defined and that the standard potentially has much broader implications in the treaty context than in its analogs under U.S. domestic law. The Committee believes that consideration should be given to alternative formulations of anti-abuse standards including objective standards such as those contained in the limitation on benefits provisions of modern U.S. income tax treaties.

It is also unclear how the proposed main purpose tests would be administered. The Technical Explanation indicates that the tests are intended to be self-executing. In the absence of a taxpayer applying the tests to itself, the tax authorities of one of the countries may, on review, deny the treaty benefits. The Committee is concerned that the Treasury Department has not provided adequate assurances that the tests will not be used by treaty partners to deny treaty benefits for legitimate business activity.

3. The Discussion Draft states that it is intended that the main purpose test be supplemented by detailed Commentary that would explain its main features and provide examples. Perhaps this is to suggest that the subjectivity of the test could be mitigated by the detailed Commentary. However, if it is really possible to provide greater objectivity and certainty of result by standards expressed in the Commentary,
we suggest those standards, after public consideration, should be the rule, rather than an explanation of the rule.

4. The examples set forth in the Discussion Draft are examples at either end of the spectrum and, therefore, do not add clarity but rather add more questions regarding its scope. The examples illustrating where the main purpose would apply involves facts that should be addressed by domestic anti-abuse rules. The examples illustrating where it does not apply may infer its application in similar circumstances that are not within the scope of the example. For example, Example C involves a decision by a company regarding where to locate manufacturing facilities to take advantage of lower labor cost and concludes that including in its considerations the availability of treaty benefits does not violate the main purpose test. This example raises the question of whether the same result should apply if the activity, rather than manufacturing, is the common practice of multinational enterprises to concentrate holding company and financing center operations in separate companies for reasons unrelated to taxation. If an MNE chooses to locate its affiliate that performs the financing center function in a jurisdiction that has a favorable network of tax treaties, is that a violation of the main purpose test? We submit it should not be but absent an example confirming this analysis, a multinational enterprise would, in effect, be penalized for placing its holding company or treasury center in a jurisdiction with a broad network of tax treaties. Countries should also adopt appropriate rules dealing with the assignment of income, which would deal with many of the abusive cases identified in the Discussion Draft.

The main purpose test also could have a chilling effect on cross-border mergers and acquisitions. When one MNE group purchases other legal entities, the group structures may not be compatible. Structures that might have incurred little or no withholding tax prior to the acquisition may become subject to substantial withholding tax. Will it be possible to reorganize following such an acquisition or will such a reorganization be considered to run afoul of the main purpose test?

5. Appropriate domestic laws can address treaty abuse that is not addressed by the limitations on benefits provisions. The Commentary should be clarified to confirm that, in order to be compatible with treaty obligations, domestic law anti-abuse rules can be considered consistent with treaty obligations only if those rules legitimately operate within general domestic law principles to determine the true facts on which tax liability arises.

6. The main purpose test fails to recognize that treaties are not used solely by multinationals. Treaties are equally important in allocating taxing jurisdiction with respect to investment income. The best known example involves a resident of Country X investing in an investment fund organized under the laws of Country Y which may earn dividends or other income from an investment in a company resident in Country Z. For any number of reasons, a main purpose test does not work well in this fact pattern. All countries agree that the goal in such cases should be to tax the ultimate
investors/beneficial owners only once. The unfortunate reality is that sometimes treaties have to be used to attain that goal. In such cases, the fund might literally be said to have as its main purpose claiming treaty benefits, but nothing about that is abusive.

7. The Discussion Draft equates two very different formulations of the test: Paragraph 29 states that it applies if “obtaining that benefit was one of the main purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.” However, the paragraph twice phrases the test as “where one of the main purposes of certain transactions or arrangements is to secure a benefit under a tax treaty and obtaining that benefit in these circumstances would be contrary to the object and purpose of the relevant provisions of the tax convention.” Under the first formulation, if you have the proscribed main purpose, the test automatically applies unless you can show that getting treaty benefits is somehow consistent with the treaty. It is a rebuttable presumption with the burden of proof on the taxpayer. But under the second formulation, the test does not apply until you fail both prongs of the test – you have to have a main purpose and you have to be inconsistent with the treaty. Here, the burden clearly seems to be on the treaty country wishing to deny treaty benefits. It would have to explain why what the taxpayer did was in some way inconsistent with the treaty. This is far more workable.

8. If it is ultimately concluded to recommend a main purpose test, the OECD needs to recommend effective procedures so that the uncertainty of such a test is not magnified by a lengthy period of uncertainty regarding the propriety of its application. A taxpayer should have the right to know what its tax responsibilities are without having a lengthy process for resolving whether the application of the main purpose test is appropriate. If this uncertainty cannot be resolved by an effective advance ruling process or an expedited process for dispute resolution after a government claim that it applies, the cost to the business and investment community will be excessive. We further recommend that if an enterprise meets any of the other criteria in a LOB article for eligibility for treaty benefits, the burden be placed on the tax authority challenging the access to treaty benefits to demonstrate by clear and convincing evidence that the main purpose test applies, and that such evidence not take into account the status of the owners of the enterprise as nonresidents of the enterprise’s State of residence, since that factor is comprehensively addressed under the other provisions of the LOB article. In addition, to ensure that a single Competent Authority does not violate the spirit of the main purpose test by aggressive interpretation of the standards, a decision by a Competent Authority to apply the main purpose test should require acceptance of that decision by the Competent Authority of the treaty partner with mandatory binding arbitration to resolve disputes. Finally, to mitigate the unpredictability of reliance on the judgment of each tax authority as to taxpayer intent, changing a main purpose to the main purpose would provide taxpayers a measure of protection against over-zealous use of this tool by tax authorities.
Comments on Changes to the Preamble to Treaties

1. In our introductory comments we noted our fundamental concern about the lack of balance in the Discussion Draft; that is, it is singularly focused on combating tax abuse without due regard for the impact overbroad anti-abuse rules would have on enterprises that are not engaging in abusive practices. This concern carries over to the proposed change in the Preamble language which makes clear that preventing abuse of treaties, including treaty shopping, is a basic tenet of tax treaties. Accordingly, we recommend that the balance be restored by rewording the recommended change to the Preamble as follows:

Desiring to further develop their economic relationship and the promotion of bilateral trade and investment by removing artificial barriers and promoting greater certainty and predictability of tax results to residents and to enhance their cooperation in tax matters,

Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty shopping arrangements aimed at obtaining reliefs provided in this Convention principally for the indirect benefit of residents of third States)…

Comments on Targeted Anti-Abuse Rules

1. The Discussion Draft recommends that cases of dual residency be resolved by agreement between the Competent Authorities. This approach is practical only to the extent the procedures for reaching a Competent Authority agreement are practical. In the United States, a mutual agreement procedure can take two years or more to reach a conclusion. We are aware that many jurisdictions have resource limitations on their ability to expeditiously handle a mutual agreement procedure. We urge that the OECD provide a discipline to the procedure so that taxpayers are not left with uncertainty for an inordinate amount of time. If a dispute cannot be resolved within a reasonable period of time, mandatory binding arbitration should be required. Guidelines for resolution of dual residency issues, together with mandatory time limits, would be helpful.

2. In endorsing the use of domestic anti-abuse rules, the OECD should make clear that it is not acceptable for a State to override its treaty obligations in the guise of an anti-abuse rule. A clear distinction should be drawn between domestic laws that address treaty abuse and domestic laws that reflect a change in policy that is in conflict with its treaty obligations.

Comments on Tax policy considerations that, in general, countries should consider before deciding whether to enter into a tax treaty with another country
USCIB agrees with this section of the Discussion Draft. That is, tax treaties are entered into for purposes of promoting bilateral trade and investment and other geo-political reasons. However, tax considerations should play a key role in determining whether a treaty is appropriate and the scope of that treaty.

USCIB would also like to point out that the concern with double non-taxation is undercut when countries insist on including tax sparing clauses in their treaties. Consistency in this regard would require that such requests be dropped.

Sincerely,

William J. Sample
Chair, Taxation Committee
United States Council for International Business (USCIB)
APPENDIX

ARTICLE X
LIMITATION ON BENEFITS

1. Except as otherwise provided in this Article, a resident of a Contracting State shall not be entitled to the benefits of this Convention otherwise accorded to residents of a Contracting State unless such resident is a “qualified person” as defined in paragraph 2.

2. A resident of a Contracting State shall be a qualified person for a taxable year if the resident is:

a) an individual;

b) a Contracting State, or a political subdivision or local authority thereof, or a statutory body, agency or instrumentality of such State, political subdivision or local authority;

c) a company, if:

i) the principal class of its shares (and any disproportionate class of shares) is regularly traded on one or more recognized stock exchanges,\(^5\) or

ii) at least 50 percent of the aggregate voting power and value of the shares (and at least 50 percent of any disproportionate class of shares) in the company is owned directly or indirectly by five or fewer companies entitled to benefits under subdivision i) of this subparagraph

d) a person, other than an individual, that

i) was constituted and is operated exclusively for religious, charitable, scientific, artistic, cultural, or educational purposes,

ii) was constituted and is operated exclusively to administer or provide pension or other similar benefits, provided that more than 50 per cent of the beneficial interests in that person are owned by individuals there were resident in either Contracting State at the time they became participants in the plan, or

iii) was constituted and is operated to invest funds for the benefit of persons referred to in subdivision ii), provided that substantially all the income of that person (not including fees for administering or managing the plan or its funds) is derived from investments made for the benefit of these persons.

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\(^5\) While we urge that a substantial presence test not be included, if the decision is made to include such a test the criteria should be as follows: “A) its principal class of shares is primarily traded on one or more recognized stock exchanges located in the same economic region as the Contracting State of which the company is a resident; or B) the company’s governing board normally meet, and the chief executive officers predominately exercise their responsibilities, in the Contracting State of which it is a resident.”
e) a person other than an individual, if:

i) on at least half the days of the taxable year, persons who are residents of a Contracting State and that are entitled to the benefits of this Convention under subparagraph a), subparagraph b), subdivision i) of subparagraph c), or subparagraph d) of this paragraph own, directly or indirectly, shares or other beneficial interests representing at least 50 percent of the aggregate voting power and value (and at least 50 percent of any disproportionate class of shares) of the person, and

ii) less than 50 percent of the person’s gross income for the taxable year is paid or accrued, directly or indirectly, to persons who are not residents of either Contracting State entitled to the benefits of this Convention in the form of payments that are deductible\(^6\) for purposes of the taxes covered by this Convention in the person’s Contracting State of residence (but not including arm’s length payments in the ordinary course of business for services or tangible property).

f) The resident is engaged in the active conduct of a trade or business in the Contracting State of which it is resident (other than the business of making or managing investments for the resident’s own account, unless these activities are banking, insurance or securities activities carried on by a bank, insurance company or registered securities dealer respectively),

i) substantially all of its income is derived in connection with, or is incidental to, that trade or business\(^7\), and

ii) If a resident of a Contracting State derives an item of income from a trade or business activity conducted by that resident in the other Contracting State, or derives an item of income arising in the other Contracting State from an associated enterprise, the trade or business activity carried on by the resident in the first-mentioned Contracting State is substantial in relation to the trade or business activity carried on by the resident or associated enterprise in the other Contracting State. Whether a trade or business activity is substantial for the purposes of this paragraph will be determined based on all the facts and circumstances.\(^8\)

\(^6\) If the OECD adopts something along the lines suggested in the recently issued Discussion Draft on Tax Challenges in the Digital Economy which would limit interest expense to interest paid on external debt, then interest should not be considered a base eroding payment for these purposes because the ability to erode a particular jurisdiction’s tax base would be eliminated.

\(^7\) Note we have altered this test to provide that the test is met if substantially all of the resident’s income is derived from the active conduct of its trade or business rather than limiting its application to income that is connected to the trade or business to simplify the test, with the added value that business connected income must be substantially all of the income of the tested entity and, for that reason, have added this to the category of qualified persons. To provide greater certainty in applying this, we recommend that substantially all be defined as at least 75% of the entity’s gross income. Guidance on this provision should make clear that a look-through approach would apply for dividends and interest received from connected persons.

\(^8\) We recommend the explanation of the substantiability test contained in the U.S. Treasury Technical Explanation to treaties be included in guidance on this standard. That explanation importantly makes clear that it is included to prohibit an enterprise from creating a nominal presence in the resident country in order to access the benefits of the treaty.
iv) For purposes of applying this paragraph, activities conducted by persons connected to a person shall be deemed to be conducted by such person. A person shall be connected to another if one possesses at least 50 percent of the beneficial interest in the other (or, in the case of a company, at least 50 percent of the aggregate vote and value of the company’s shares or of the beneficial equity interest in the company) or another person possesses at least 50 percent of the beneficial interest (or, in the case of a company, at least 50 percent of the aggregate voting power and value of the company’s shares or of the beneficial equity interest in the company) in each person. In any case, a person shall be considered to be connected to another if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same person or persons.

3. A company that is a resident of a Contracting State shall also be entitled to the benefits of this Convention if:

   a) at least 95 percent of the aggregate voting power and value of its shares (and at least 50 percent of any disproportionate class of shares) is owned, directly or indirectly, by seven or fewer persons that are equivalent beneficiaries, and

   b) less than 50 percent of the company’s gross income for the taxable year is paid or accrued, directly or indirectly, to persons who are not equivalent beneficiaries, in the form of payments (but not including arm’s length payments in the ordinary course of business for services or tangible property) that are deductible for the purposes of the taxes covered by this Convention in the company’s State of residence.

4. If a resident of a Contracting State is neither a qualified person pursuant to the provisions of paragraph 2 nor entitled to benefits with respect to an item of income under paragraph 3 of this Article, the competent authority of the other Contracting State shall nevertheless treat that resident as being entitled to the benefits of this Convention, or benefits with respect to a specific item of income, if such competent authority determines that the establishment, acquisition or maintenance of such person and the conduct of its operations did not have as one of its principal purposes the obtaining of benefits under this Convention.

5. For purposes of the preceding provision of this Article:

   a) the term “recognized stock exchange” means:

      i) the__________ Stock Exchange (of Contracting State A);

      ii) the_______ Stock Exchange (of Contracting State B); and

      iii) any other stock exchange agreed upon by the competent authorities of the Contracting States;

   b) the term “principal class of shares” means the ordinary or common shares of the company, provided that such class of shares represents the majority of the voting power and value of the company. If no single class of ordinary or common shares represents the majority of the aggregate voting power and value of the company, the “principal class of shares” are those classes that in the aggregate represent a majority of the aggregate voting power and value of the company;
c) the term “disproportionate class of shares” means any class of shares of a company resident in one of the Contracting States that entitles the shareholder to disproportionately higher participation, through dividends, redemption payments or otherwise, in the earnings generated in the other Contracting State by particular assets or activities of the company.

d) the term “equivalent beneficiary” means a resident of any other State, but only if that resident

i) would be entitled to the benefits of a comprehensive convention for the avoidance of double taxation between that other State and the State from which the benefits of this Convention are claimed, provided that if such convention does not contain a comprehensive limitation on benefits article, the person would be entitled to the benefits of this Convention if such person were a resident of one of the States under Article 4 of this Convention; and

ii) with respect to income referred to in Articles 10, 11 and 12 of this Convention, the rate of tax that would be available under such convention to a company resident in such other State and eligible for benefits under such convention (and otherwise comparable to the company claiming benefits under this Convention) with respect to the particular class of income for which benefits are being claimed under this Convention is at least as low as the rate being claimed under this Convention. ; or

iii) is a resident of a Contracting State that is entitled to the benefits of this Convention by reason of paragraph 2 of this Article.

6. In the application of any general anti-avoidance rule of domestic laws of a Contracting State, a resident of a Contracting States that is entitled to the benefits of this Convention by reason of this Article X shall be presumed not to have a principal or main purpose of attaining the benefits of this Convention unless the Competent Authority of that Contracting States, with reasonable advance notification to the resident, determines by clear and convincing evidence, which shall not be based upon the residence status of such resident’s owners, that such a principal or main purpose exists after consultation with Competent Authority of the other Contracting State and concurrence by that Competent Authority that the determination is reasonable.
Comments to the OECD “Discussion Draft on Action 6: preventing the granting of treaty benefits in inappropriate circumstances”, March 14, 2014

General Comments

1. Introduction

The “Discussion Draft on Action 6: preventing the granting of treaty benefits in inappropriate circumstances” (“Discussion Draft”), issued on March 14, 2014, includes proposed provisions to:

a) develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances;

b) clarify that tax treaties are not intended to be used to generate double non-taxation;

c) identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country.

The Discussion Paper starts by addressing cases where a person tries to circumvent limitations provided by the treaty itself and those where a person tries to abuse the provisions of domestic tax law using treaties.

The discussion draft also clarifies that tax treaties are not intended to be used to generate double non-taxation and provides tax policy considerations.

2. Importance of preventing treaty-abuse

It is clear that globalisation, new transnational integration of business, and re-organization of the value-chains at the worldwide level increased the opportunities for “improper” use of tax treaties by companies. This transnational integration of business and the increasing sophistication of
international tax planning render it particularly difficult to assess what is acceptable and what is unacceptable in treaty abuse matters.

Valente Associati GEB Partners welcomes and supports any initiative aimed at addressing treaty abuse, provided that effectiveness, certainty and consistency are ensured for taxpayers.

In order to operate across borders, taxpayers need a level playing field; thus, clear and consistent rules that ensure some level of predictability for taxpayers are required. Taxpayers’ and tax administrations’ needs shall both be taken into consideration. While taxpayers require clear provisions to understand, apply and comply with, tax administrations need to be able to manage them easily.

Moreover, the new provisions should be proportional vis-à-vis the need to prevent treaty abuse and the aim of tax treaties (i.e. preventing double taxation and fostering foreign investment). An unbalanced and not proportional measure could affect efficiency, growth and competiveness.

In view of ensuring the desired clarity, efficiency and consistency, Valente Associati GEB Partners favours that anti-treaty shopping rules be included in domestic tax laws, rather than in tax treaties.

Besides, the Discussion Paper’s proposals are broader than what would be advisable. By accumulating anti-abuse provisions, undesired uncertainty and double taxation could be engendered, with considerable negative effects and extra compliance costs for businesses, especially for the majority of them that do not make an improper use of tax treaties. Therefore, any measure to be implemented should take this into account and allow only one of the suggested measures, either the LoB Clause or the Main Purpose Clause, to counteract abusive practices.

In addition, taking into consideration the main goal of the Discussion Paper, proper consideration should be given to the concepts of and to what constitutes “artificiality” and “abuse”. Examples of the latter would be welcome. In Valente Associati GEB Partners’ view, the approach adopted by the Discussion Paper in defining a transaction as “abusive” (based on “one of the main purposes”) is too broad and can give rise to further complexities and uncertainty in terms of its practical implementation.

Furthermore, the compatibility of some of the proposed measures with EU Law and the free movement provisions need to be taken into consideration, so that the proposed model can also be implemented in the EU.
Finally, in order to minimize uncertainty and reduce conflicts, consistency among States in the implementation of the proposed measures and mandatory binding arbitration need to be safeguarded.

The Proposal is broad and seems to go further than what is required and what would be desirable vis-à-vis its aim.

3. Specific Comments to the Issues Outlined in the Discussion Draft

A. Treaty Provisions and/or Domestic Rules to Prevent the Granting of Treaty Benefits in Inappropriate Circumstances

1. Cases where a person tries to circumvent limitations provided by the Treaty itself

The discussion paper recommends a three-pronged approach to address treaty shopping situations (page 4 of the Discussion Paper):

a) specific insertion in tax treaties title and preamble of a clear statement that the Contracting States, when entering into a Treaty, wish to prevent tax avoidance and, in particular, intend to avoid creating opportunities for treaty shopping;
b) include a specific anti-abuse rule in tax treaties based on limitation-on-benefits (LoB) provision;
c) add a more general anti-abuse rule for all other forms of treaty abuse, including treaty shopping situations that are not covered by the specific anti-abuse rule (LoB).

a) Preamble (recommendation is included in Section B of the Discussion Paper)

The replacement of the title of the convention (including its footnote) by “Convention between (State A) and (State B) for the elimination of double taxation with respect to taxes on income and on capital and the prevention of tax evasion and avoidance” seems inadequate and too broad taking into consideration the main scope of treaties, which is not preventing tax evasion and avoidance. The same applies to the preamble. The aim of tax treaties should continue to be focused on avoiding double taxation and fostering foreign investment, and it should not be seen or used as an anti-avoidance instrument. Treaty benefits should not be granted only in those cases where an arrangement has been artificially set up exclusively for that purpose.

b) Include a specific anti-abuse rule in tax treaties based on limitation-on-benefits (LoB) provision
As mentioned earlier, the accumulation of anti-abuse measures in the Discussion Paper seems counter-productive and could foster uncertainty.

In addition, experience shows the difficulty and complexity of applying an LoB clause. If its implementation is agreed upon, detailed guidance should be provided in the Commentary. The application of the LoB test should depend on objective rules that can be realistically applied and understood by taxpayers and tax authorities.

The proposed LoB provision indirectly treats non-listed and listed companies differently, since it would require that non-listed companies would have to rely only on the active trade or business criteria to access treaty benefits (disfavouring SMEs).

Art. 3 a) of the proposal mentions “active trade”. Examples or further guidance should be provided on the concept.

As for as Art. 3 b) of the proposal, the term “substantial” is uncertain, vague and can itself give rise to further disputes.

Taking into consideration that an LoB clause may deny treaty benefits to a company that is established in one of the contracting States but owned by residents of a third country, the proposed LoB provision lacks a “derivative benefits” safe harbour. The inclusion of such provision is, in our opinion, advisable so as to avoid to affect cases where there is no treaty shopping.

In addition, a recognized headquarter company provision should also be included in the draft of the LoB provision.

Thus, a re-drafting of the LoB provision should be considered.

Finally, specific measures and instructions should be issued to help both taxpayers and tax administrations manage all those situations in which there is no treaty abuse, but the treaty is inapplicable due to its restrictive provisions.

c) add a more general anti-abuse rule for all other forms of treaty abuse, including treaty shopping situations that are not covered by the specific anti-abuse rule (LoB) – “Rules aimed at arrangements one of the main purposes of which is to obtain treaty benefits”

The proposal includes a “main purpose” test that is similar to the one used in a GAAR.

As previously mentioned, the proposed LoB clause should not be complemented with such a “main purpose” test, as the burden placed on
taxpayers is too heavy and not proportional, and it increases undesired legal uncertainty and contradicts the aim of tax treaties. Besides, the wording used in §18 – 33, “reasonable to conclude” and “main purposes”, does not provide certainty of treatment, and it does not make it simpler for taxpayers and tax administrations to implement and apply this clause. The burden of proof that the taxpayer faces is much wider than the one on tax administrations. Even if many consider this main purpose test a relatively objective fact-finding rule and one that is simple to apply, the subjective element of such rule should also be taken into consideration. A sufficient level of predictability should be ensured to taxpayers. The introduction of this test would probably increase the scope and number of disputes between taxpayers and tax administrations. In addition, clarity and consistency on the definitions of what constitutes abuse should also be provided.

b) Other specific examples

vi) Tie-breaker rule for determining the treaty residence of dual-resident persons other than individuals

The proposed change to the tie-breaker rule will, in our opinion, increase legal uncertainty, and it is difficult to apply, since it empowers tax authorities to determine residence or agree on the residency, without providing a coherent and consistent set of rules to be followed by them. The “effective management test” used in tax treaties has proved to work, and therefore it should be kept. The proposed mutual agreement process is time-consuming, uncertain, and brings high compliance costs which result in a burden for taxpayers with considerable effects on competitiveness. Dual residence cases should be addressed by domestic provisions.

vii) Anti-abuse rule for permanent establishments situated in third states

One important factor should be outlined: businesses, when using country-specific tax incentives designed to boost a Country’s competitiveness, should not be penalized with the conjecture that the structure has been set for tax avoidance purposes. Therefore, further consideration should be given to paragraph 56 of the Discussion Paper.

2. Cases where a person tries to abuse the provisions of domestic tax law using treaties

Paragraph 58 of the Discussion Paper reverts to the work that is being carried out by the OECD in specific areas and that has been covered in Actions 2, 3, 4, 8,9 and 10. This is welcomed.
Changes to local law should be included in the new protocols of tax treaties.

Examples provided under this section are a mere consequence of the existence of a treaty and not necessarily an abuse of domestic law.

**B. Clarification that tax treaties are not intended to be used to generate double non-taxation**

Considerations on the preamble and title are provided above in section A.1.a).

Notwithstanding our previous comments, we would like to also mention that in certain cases Contracting States have deliberately sought such double non-taxation so as to attract foreign investment.

**C. Tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country**

The Discussion Paper also addresses tax policy considerations that Contracting States should make whenever deciding to enter into a tax treaty. Undoubtedly, policy considerations and their implications must be carefully assessed by States prior to conclude a tax treaty.

Paragraph 15.3 should be re-worded, so as to ensure that it does not favour the use of unilateral measures instead of the conclusion of a tax treaty.

As previously mentioned, tax treaties’ aim should not be jeopardised. The mention inserted under Paragraph 15.6 “an important objective of tax treaties being the prevention of tax avoidance and evasion” should, in our opinion be cancelled.

It is the Countries’ role to manage and set their treaties framework and to weight tax policy considerations. The treaty network of the States reflects such considerations and such choices.

It is worthwhile to note that Italy includes a specific “subject to tax” clause in the Protocol of the Convention for the Avoidance of Double Taxation of Income and Capital and for the Prevention of Fiscal Evasion and Fraud between the Government of the French Republic and the Government of the Italian Republic, signed on 05.10.1989, in its Article 15 “In the cases where, in accordance with the provisions of this Convention, income must be exempted by one of the States, the exemption shall be granted if and to the extent such income is taxable in the other State”. The Treaty signed with Germany for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital and for the
Prevention of Fiscal Evasion concluded in the same year, only a few days later, does not include it.