# Platform Responses to First Set of Public Comments

Many comments made overlapping or similar points—both favorable and critical. This note categorizes the main points, and explains either how the new draft has responded, or –where the comments were not adopted, the reasoning for that. Comments are ascribed to the authoring organizations; a full list of commenters, with the acronyms used below, appears at the end.

*Purpose and status of the draft document*

Status of toolkit unclear, should not be treated as authoritative guidance (**CBI**; **USCIB**; **TEI**); its purpose should be providing guidance. It goes beyond this and thus should not be considered a toolkit (**USCIB**; **BIAC).** The draft proposes significant shifts in taxing rights and articulates new policy considerations; **c**hanges in taxing rights between source and residence countries should be resolved among countries in multilateral fora, not by IO's staff in a document intended to provide guidance (**Repsol; CBI**; **USCIB**; **ICC**)

**The revised draft explains the role of the requested toolkits by the Platform—that is, that no standards are set here, and that the toolkits do not represent the official views of any of the Partner organizations, but rather constitute staff analyses.**

**The revisions try to make clear that the allocation of primary taxing rights to source countries in the case of indirect transfers of immovable property derives from existing model treaty practice, expanded most recently in the BEPS process embodied in the multi-lateral convention; and has been also embodied in various forms, less or more expansively, in many countries' domestic laws already.**

**The draft does explore an expansion of the definition of "immovable property" to anchor the concept of taxing rights in an economic basis (ie., location specific rents derived from traditionally defined "immovable property" or from the grant of other rights by governments that yield location specific rents). The draft proposes several alternative definitions that countries could use whether or not they wish to expand the concept to a greater or lesser extent. This is a fundamental part of the economic analysis provided, which it is hoped could yield greater certainty in the adoption of taxing rights.**

The document appears to recommend taxation of OITs, rather than simply describing pros and cons of different options and letting countries decide what's best given their overall tax policy (**CBI**; **BIAC**)

**See previous answer.**

Toolkit does not help certainty (which should have been a guiding purpose)(**several**)

**The intention is to provide greater certainty, in explaining the two main models which—should a country wish to tax OITs—could be used and how they are structured.**

*Bottom line recommendations*

The document raises 'significant concerns' and should be *either* comprehensively redrafted following a more balanced approach and resubmitted for discussion (**CBI);** or simply withdrawn (**USCIB**; **SVTDG**; **Repsol**)

**The draft has been revised to place greater emphasis on non-binding nature of document and to make clear that it represents IO staff views on current practice and options for rationalizing and better implementing taxation of OITs. The revised version is being reposted for comment.**

The document is excellent; it should be broadened to include indirect transfers of all kinds of assets, without limitation to immovable assets. Language of the Models should be modified to make this clear. **(BMP).** Further, all countries should be urged to sign the MLI including article 9(4), without reserving on this inclusion of UN/OECD article 13(4). **(BMP)**

**These proposals were not adopted in the new draft.**

**The Draft document is being resubmitted for discussion as suggested (but not withdrawn).**

*Analytical bias*

Indirect holdings are a feature of modern business management and OITs are generally commercially motivated transactions, not a tax avoidance scheme (**CBI**; **SVTDG)**. The Draft overplays the connection between offshore gains and aggressive tax planning (**KPMG**).

**The revised draft introduces in text that idea that there are commercial reasons for OITs, and reduces the previous emphasis on tax avoidance and the rationale for taxing OITs as an anti-avoidance device. The text still notes that such structures can be designed, while commercially necessary, to pay less tax; one issue does not preclude the other.**

The Draft focuses on few public high profile cases and assumes that OIT are generally tax abusive, based on a very simplified example (**SVTDG**; **Repsol**; **BIAC**)

**The revised draft expands further on the fact that the cases described are indeed only a few high-profile situations, but illustrate—with publicly available detail--the problem which experience shows to be representative of a large number of transactions involving assets in lower income countries. Further, the cases show the possibility or likelihood of unilateral country actions—and accompanying increase in uncertainty—if more uniform guidance for taxing such transactions is not adopted.**

**Again, the emphasis on tax avoidance has been reduced.**

Many countries do not tax OIT's, and this option/fact is ignored (**Repsol**; **ITIC**)

**The text in the revision notes that this is the case, indicating the US and Norway as examples of a conscious decision (not) to do so. However, the text also notes that in many other countries the issue simply might have not been considered; the absence of taxation of OITs may not reflect a deliberate policy choice.**

No analysis of consequences of taxing OIT (e.g., decrease in FDI, survival of less efficient investors, negative impact on MNEs investment plans) especially given the lack of clarity on how countries would avoid double taxation. (**SVTDG**).

**Text expands upon possible decision by countries choosing not to tax such transactions as a way of ensuring or attracting FDI—analogously to other tax incentives for investment—but points out that unless taxing rights are allocated to them, they will not have the choice to make.**

Report should recommend countries to include in their treaties a provision based on article 13 (5) of the UN model, as well as 13 (4) of OECD/UN Models (**BMG**).

**Report now addresses this point, and does not say it is redundant.**

No difference should be made between movable and immovable assets; OITs should be recognized as an abuse of treaties and domestic law in the same way as treaty shopping has been recognized under BEPS **(India**).

**This broader application has not been adopted in the revised draft.**

*Economic Rationale for Taxing OITs*

*Capital gains as double taxing corporate income*. Taxing OITs represent effectively economic double taxation of subsequent rents (**CBI**, p.5, par 2; **SVTDG**, p.A-3, par 5-6; **Repsol**, p. 3, par 3; **TEI**, p.3, par 6).

**See Box 1; footnote 17 for explanations. But as noted, the paper does not attempt to provide a general discussion of the rationale for the capital gains tax.**

*Alternative for taxing rents*. Should consider other ways to tax economic rents, e.g. specific anti-abuse measures (e.g. tax only when transaction happens in tax haven), or excises (**CBI**, p.5, par 5 & p.6, par 5; **SVTDG**, p.3, par 2, b. 6; **BIAC**, p.4, par 1; **ITIC**, p.1, par 2; **TEI**, p.7, par 4). **PwC** (p.2, par 3) also favors alternative approaches to taxing OITs, such as royalties, export taxes, or removing tax holidays, or even specific anti-abuse measures for high profile cases, but **Deloitte** (p.5, par 5) prefers detailed rules for taxing OIT to application of anti-avoidance legislation.

**See new second paragraph under "efficiency" heading; new bullet on page 27 for a caveat. The paper acknowledges that there are other ways to reach rents, but holds that at minimum taxing offshore transfers represents a useful back up where they are not so reached.**

*Residence country right to tax*. Rationale for residence based taxation ignored (**CBI**, p.5, par 8; **USCIB**, p.1, par 3 (1); **SVTDG**, p.A-3, par 7).

**See new footnote 22; change to bullet 3 on page 24 for clarifying language. However, some of the comments represent differing views on the basic merits of rights to impose OI taxation as embodied presently in article 13(4) of the two primary model treaties, and the new multi-lateral instrument.**

*Unhelpfully expansive definition of immovable (taxed) property*. Uncertain expansion of definition of immovable property, or too broad. Abandons definition of treaties, without justification; prescription for double tax. Concept of location specific rents not helpful (**CBI**, p.2 par1, b 2 & p.4, par 4; **BIAC**, 3, par 4; **TEI**, p.7, par 6; **TEI**, p.8, par 1). Non-wasting assets, even if concerning natural resources, should be treated differently (i.e., exempt from OIT tax). Also, regulated activities should not be necessarily associated with rents; for example, regulation could lead to lower profits when protecting the consumer (**KPMG**, p. 3, par 1). Government licenses should be considered intangible property (thus aligned with transfer pricing concepts) instead of immovable property (**TPED**).

**See response on "taxing rents," above.**

<u>*Nominal revenue over time*</u>. Disagree with paragraph indicating that nominal revenue effect over time of capital gains tax on OITs is neutral (**SVTDG**, p.A-3, par 8(21); **PwC**, p. 2, par 6).

**See revisions on page 20 for (it is hoped) a clearer explanation.**

*Political considerations*.

Political economy argument should be dropped (**SVTDG; TEI**)

**This argument has been much toned down.**

*Technical issues*

<u>**Complexity understated:**</u> ***several commenters*** felt that the analysis understated or failed to address adequately the complexity of taxing OITs, overlooking problems including:

<u>***Overarching comment on technical issues***</u>

**The model provisions included in both drafts constitute a *simplified* set of legislative provisions that do not purport to deal comprehensively with more complex issues such as corporate reorganizations, minority shareholders, joint venture arrangements, valuation difficulties, listed securities, the treatment of losses, and other double taxation issues that might arise under a given set of circumstances. This caveat was expressed in the initial draft and has now been reemphasized in the revised draft. More specifically, the ultimate (full) set of provisions to be adopted by the location country will need to be adapted to reflect the individual circumstances of the country concerned, including its domestic and international tax policy settings. It is not feasible for the sample legislative provisions to deal with these issues comprehensively. However, where appropriate, the revised draft now includes some more specific guidance relating to a number of the more technical issues raised in order to incorporate the feedback received.**

<u>*Valuation and apportionment. B*</u>oth models should have an apportionment rule, so they tax only immovable and domestic portions contributing to value of asset sold. (**CBI**; **USCIB**; **Deloitte; TPED)**

**This point is now discussed in the revised draft by recognizing that—in practice—valuation exercises are complex to undertake, particularly where relevant assets relating to the underlying immovable property derive their value from commodity prices, centrally provided inputs (e.g. management and technical expertise) and other group shareholdings.**

<u>*Treatment of losses*</u> (**CBI**; **USCIB**; **BIAC**)

**This point is now discussed in text by explicitly noting that to the extent that a loss arises (instead of a gain), that loss should also be recognized in the location country and be subject to appropriate loss utilization rules.**

<u>*Double taxation*</u> (**SVTDG)**

**The relative double taxation sensitivities, as compared between model 1 and model 2, were discussed in the initial draft. The revised draft notes more explicitly that taxpayers would take steps to adopt a commercial sale transaction structure which minimizes the double taxation issues (consistent with empirical evidence). Further, the revised draft now observes that one policy option would be for the location country to only tax the gains on a proportionate basis (e.g. taxing only those gains attributable to the local immoveable property, as distinct from the entire gain). This would also further reduce the relative double taxation sensitivities.**

<u>*Internal reorganizations should be exempted*</u> (**TEI**; **PwC**)

**This point is now discussed in text rather than in a footnote—though pointing out that many countries do not exempt cross-border reorganizations. The revised draft includes some additional guidance about providing tax relief/exceptions in the event of a technical direct change of control because of a corporate reorganization.**

<u>*Minority holdings/shareholders*</u> (**USCIB**)

**This is not comprehensively dealt with in the revised draft, but the issue is noted as one to be taken into account by the location country when developing the ultimate (full) set of provisions to be adopted.**

<u>*Frontloading tax*</u> (**TEI)**

**This is not dealt with in the revised draft, as being too detailed for this purpose. However, this could be taken into account by the location country as a design option when developing the ultimate (full) set of**

**provisions to be adopted.**

<u>*Listed companies should be exempted*</u> (**TEI**)

**The unique circumstances of listed companies were discussed for example under the agency taxation model, which excludes listed shares from local agency liability. In addition, the revised draft now notes that the circumstances of listed companies should be more fully considered by the location country when developing the ultimate (full) set of provisions to be adopted.**

<u>*Treatment of joint ventures*</u> **(ITIC**; **TEI**)

**Not comprehensively dealt with in the revised draft—however, the issue is noted as one to be taken into account by the location country when developing the ultimate (full) set of provisions to be adopted.**

<u>*Neutrality, so that offshore gains are not taxable where same gain onshore is exempt (e.g.) due to participation exemption*</u> (**KPMG)**

**See last response above.**

*Implementation considerations—model 1 v. model 2*

- No preference should be expressed for model 1 or 2 **(numerous comments)**

  - Many preferred model 2 (e.g. **CBI**) because:
    - model 1 inevitably increases incidence of double taxation,
    - company taxed does not receive proceeds of sale,
    - transfer of funds may be a challenge as equity injection may change participation when there are minority shareholders.
    - Better to tax real rather than deemed transactions.
    - Model 2 is also more aligned with legal and treaty perspectives.
  - Not enough evidence provided for preference for either model (**BIAC**).
  - Draft approach inconsistent with UN approach ("*Note on capital gains taxation and taxation of indirect asset transfers"*), which discusses various alternatives for taxing OITs rather than the single policy choice found in 'toolkit' (**Repsol**; **TEI**).
  - Preference for model 1 on implementing OIT taxation has not been evenly argued. The tax consequences of model 1 were not evaluated for multiple transfers under multi-tier structures, contrary to model 2 evaluation (**China**)

- Model 1 is to be preferred to Model 2. It will be more usable by countries. **(BMP)**

**The draft has been amended to express no preference as between models 1 and 2, and simply to give pros and cons of each.**

*Step-up in basis*

Little guidance on step-up in the tax base, and on how it would apply to depreciation/amortization **(ITIC**)

**Detailed proposed rules are not provided. However, the text points out more clearly that under Model 1, there is automatically a basis adjustment in the assets deemed to be disposed of, including for tax depreciation purposes. There is no need for further basis adjustment on shares traded or in lower offshore tiers, as they are out of scope of the taxing provision; this would be the same result if the asset were sold directly.**
**Under Model 2, shares *actually traded* get basis adjustment (to market value, presuming they are sold at an arm's length price). Further basis adjustments (that is, to shares in lower offshore tiers) would not take place in the current international system, regardless of the features of this toolkit, as a typical tax system would recognize separate legal entities. It would also be unusual to consolidate offshore entities (even for those jurisdictions that have tax consolidation); a possible third alternative (which is mentioned) is China's system which removes the basis issue by essentially collapsing the holding structure.**

*Linkages to transfer pricing concepts* (**TPED)**

- Draft document is not explicit enough regarding the exact nature of the assets included in the extended definition of immovable property, and whether these are to be deemed "intangibles;" the definition of "intangible" in the draft is not aligned with either the OECD or UN definition.

- The concept of a location specific rent has been elaborated in the transfer pricing context as Location Specific Advantages. OECD and UN commentary both indicate that these are not intangibles per se but should be taken into account in TP analysis. Exclusively relying on LSRs to justify source taxation in the local country may create confusion (as it would not justify this in TP analysis).

**Not changed in current version; draft makes clear that the definitions used are not necessarily those used anywhere else in domestic laws or international documents.**

*Only first tier parent should be considered **(CBI)** in taxing transfers.*

**Did not adopt this.**

*There should be no retroactive rules (grandfather OITs)* (**CBI**); retroactivity should be avoided by revaluing asset to market benchmark when introducing OIT tax **(KPMG**).

**The draft has been amended to note that, unless there are strong reasons to do otherwise, either model should only be implemented on a prospective (and not retroactive) basis (e.g. to transactions taking place after the change is announced, as opposed to applying to tax years before the announced change), and appropriate transitional arrangement could also be considered (e.g. deemed market value cost base of relevant assets at the time of commencement of the new taxing model).**

## Commenting organizations and persons

**BIAC** The Business and Industry Advisory Committee at OECD

**BMG** Base Erosion and Profit Shifting Monitoring Group (a consortium of 7 civil society organizations)

**CBI** Confederation of British Industry (London)

**China** (State Administration of Taxation, P.R. China)

**Deloitte LLP** **(**London)

**ICC** International Chamber of Commerce

**India** (Government)

**ITIC** International Tax and Investment Center (US and other)

**Jubilee USA** (an alliance of 700 faith groups--US)

**KPMG** KPMG International (UK)

**Philip Baker** (UK)

**PwC** PricewaterhouseCoopers International Limited (London)

**Repsol** (Spain)

**Sergio Guida** CPA (Italy)

**SVTDG** Silicon Valley Tax Directors Group (US)

**TEI** Tax Executives Institute (US)

**TPED** Transfer Pricing Economists for Development (Paris and Vienna)

**USCIB** United States Council for International Business (US)