

Paris, 9 April 2014

OECD DISCUSSION DRAFT ON BEPS ACTION 6: PREVENTING THE GRANTING OF TREATY BENEFITS IN INAPPROPRIATE CIRCUMSTANCES

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.

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,

A handwritten signature in black ink that reads "Will Morris". The signature is written in a cursive, slightly slanted style.

Will Morris
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BIAC consensus responses to OECD Discussion Draft

A.1. Cases where a person tries to circumvent limitations provided by the treaty itself

a) Treaty Shopping

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, BIAAC 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, BIAAC 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.

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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. BIAAC 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. BIAAC 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 substance 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. BIAAC 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. BIAAC 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 directly¹.
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.

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- 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.

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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...".