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OECD DISCUSSION DRAFT: FOLLOW UP WORK ON BEPS ACTION 6, PREVENTING TREATY ABUSE

Dear Marlies,

Please find below BIAC's comments on the OECD Discussion Draft on ***Follow Up Work on BEPS Action 6: Preventing Treaty Abuse***, issued on 21 November 2014 ("Discussion Draft").

Firstly, thank you and your team for remaining open and flexible in your contacts with stakeholders, despite the intense pressures that you are under. In turn, in order to be as helpful as possible BIAC has again sought to draft a consensus document that represents business views more generally, rather than simply passing on views from our members.

We would like to start by saying that we feel there have been some positive developments in relation to Action Item 6, such as recognising the need to address specific issues faced by various forms of funds, and continuing the dialogue around certain Limitation on Benefit clauses. However, there is an underlying concern among BIAC members that many aspects of the proposals continue to risk removing treaty benefits in what are genuine commercial situations. We have already made representations in relation to this, and we are somewhat disappointed that our concerns have not been addressed in this new Discussion Draft. We have highlighted some of these points again in our response, below, so that we do not lose sight of these important issues.

Purpose of Action Item 6

BIAC continues to support 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.

We reiterate our view that the primary route to tackling avoidance should 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 the removal of Treaty benefits, where a structure has been artificially established solely for the purpose of obtaining Treaty benefits. However, again, it is important that there is protection for bona fide commercial arrangements.

BIAC continues to have concerns over the layers of rules currently being proposed, which include a Limitation on Benefits Article, a Principal Purpose Test, and a series of Specific Anti-Avoidance Rules. These will be in addition to current rules, such as those relating to 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 Principal Purpose Test approach should be adopted, but 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 (and as already noted), a more streamlined dispute resolution process is required, with, ultimately, a mandatory binding arbitration mechanism.

The Purpose of Treaties

Tax Treaties are principally entered into to promote global growth by removing the barriers to cross-border trade and investment caused by double taxation. Facilitating the development of a broad network of Tax Treaties has been one of the most significant of the OECD’s contributions to the expansion in international trade and investment over the past fifty years, and significantly altering Treaty protection should, we suggest, be approached with considerable caution.

In this regard, as I pointed out in our original submission, the proposed preamble devotes one line to the prevention of double taxation and three lines to the prevention of abuse. It is certainly entirely appropriate to prevent abuse of Treaties, but it is not the purpose of a Treaty to prevent that abuse. If we view Tax Treaties primarily as an anti-abuse tool, then we risk seriously damaging one of the OECD’s most successful instruments.

We hope that you find our comments useful. We look forward to participating in the public consultation on 22 January, and would also be happy to help in any other way that we can.

Sincerely,



Will Morris, Chair
BIAC Tax Committee

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High Level Observations¹

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, in order to continue to allow for alignment with other BEPS actions, 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 determine 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. The current PPT test (“one of the main purposes”) is widely framed. Even with the examples in the Commentary, there is a risk of misinterpretation, or misapplication by tax authorities. We would recommend focusing on substance. We would also recommend that if the two tax authorities have differing views, that there should be prima facie assumption that it is **not** reasonable to conclude that obtaining treaty benefits was one of the principal purposes.
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 business or activity is set up for genuine purposes. This aligns with our comment in 3 above, that more focus should be given to substance, and ensuring treaty benefits are available to bona fide commercial arrangements.
6. Tax avoidance should be addressed through coordinated 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.
7. We believe that the use of either a PPT or an LOB is appropriate, but a combination 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 PPT approach should be adopted, and not both. If they are well constructed and appropriately targeted against artificial structures, then they should in

¹ As previously noted

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”.

8. Tax incentives: where tax incentives are made available, and such incentives are not judged “harmful” on objective criteria (taking account of the OECD’s work on Action item 5), 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 domestic legislation; or by entering into a Protocol addressing the issue appropriately, rather than through one sided denial of Treaty benefits. 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 adverse effects on investment).
10. States should assess Treaty risks before entering into an agreement; and have an obligation to exit treaties in a controlled and transparent manner that are seen to be consistently abused in order to retain predictability of treatment, rather than seeking to apply them selectively.
11. 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 PPT 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.
12. 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.
13. 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. Enhanced dispute resolution mechanisms, including mandatory arbitration, should also be addressed in Action 14.

BIAC consensus responses to OECD Discussion Draft

A. Issues related to the LOB provision

1. Collective investment vehicles: application of the LOB and treaty entitlement

Issues on which comments are invited

- *Whether the recommendations of the 2010 CIV Report continue to be adequate for widely-held CIVs*
- *Whether any improvements should be made to the conclusions included in that Report*
- *Comments, for example, on whether to provide a single preferred approach for the application of the LOB to CIVs, and if so, what that should be*

Overall

BIAC believes, based upon our leadership of the business delegation to the informal consultative group that developed the CIV Report, that the recommendations of the 2010 CIV Report are sound.

We also believe, based upon our ongoing discussions with representatives for the widely-held CIVs addressed in the Report, that the recommendations should not be modified.

While a single approach, on the surface, has the appeal of simplicity, the variables in the structures, investor base, and investment policies of CIVs make a single approach impractical and would deny treaty access to numerous CIVs that should have access to treaty benefits.

Background Discussion

The CIV Report was the result of a concerted effort to provide CIV investors, regardless of how their CIV was structured or sold, with the opportunity to enjoy the benefits and efficiencies of collective investment without being penalised by the loss of the treaty relief that they would have received if investing directly. The effort was undertaken because, in general, only those investors in CIVs that are treaty entitled in their own right (as persons, residents, and the beneficial owners of their income) were receiving treaty benefits. The other options provided by the Report, such as allowing a CIV to claim treaty relief on behalf of its eligible investors and allowing a fund to be treated as transparent, were designed to extend treaty relief to investors in fund structures that are pass-through in nature. This improvement could benefit CIVs that, for example, are distributed in multiple countries or, alternatively, only to pension funds.

Another important aspect of the CIV Report involves procedures for establishing the treaty eligibility of CIV investors. In some cases, the Report notes, it may be appropriate to treat the CIV as satisfying any applicable limitation on benefits provision because the CIV's investors are predominantly resident in the CIV's residence country; this situation could arise, for example, if the CIV were distributed only within its country of residence, particularly if the resident country's CIV tax regime provided adverse tax treatment to non-resident investors. When interests in a CIV are distributed only within its own country of residence, we believe treaty benefits should be available without the administrative burdens and costs of collecting and verifying proof of investor eligibility. When "proof" of investor treaty eligibility is necessary, to alleviate the potential material administrative burdens, such proof generally should be required only annually and never more

frequently than quarterly. Moreover, the CIV Report notes, countries should accept “practical and reliable” approaches for identifying investors.

In discussing “eligible” investors, the CIV Report noted that many CIVs are distributed in multiple countries with which a source country has a treaty. Many CIVs, for example, are distributed widely in European countries that have broad treaty networks. In situations such as these, BIAC believes, it is appropriate to treat all CIV investors who are resident in countries with which the source country provides treaty relief as treaty-eligible; these investors would receive treaty relief had they invested directly, rather than through a CIV, in the source country. CIVs exist to provide efficient access to the capital markets for all investors and provide economies of scale; by their very nature, they never are formed for the purpose of attaining treaty benefits. Equivalent beneficiary treatment is essential to ensuring appropriate treaty relief for investors in CIVs that are marketed globally and that investors are not penalised by higher taxation by reason of choosing this efficient means of investment.

The CIV Report’s rationale for proposing various alternative approaches – rather than a single method – for allowing a CIV to establish treaty eligibility remains sound. CIVs are not the same – in structure, in operation, in investor base, or in distribution strategy. The Report provides mechanisms for all CIVs – regardless of their differences – to secure treaty relief for their eligible investors when the alternative standards are met. Were only a single method advanced, treaty relief for many investors (*e.g.*, those in CIVs that are treaty entitled in their own right) would be denied and many CIVs would have to be restructured in costly and inefficient ways to avoid penalising their investors by the loss of treaty benefits to which they would otherwise be entitled.

CIVs also are not the same as other investment vehicles. The CIV Report was limited, expressly and purposefully, 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.” The rationale for this limitation was the need to address the distinct burdens of establishing treaty eligibility for individuals – typically numbering in the tens or hundreds of thousands – who invest in CIVs through intermediaries such as banks or brokers that may choose to hold their clients’ investments in nominee (or “street name”) accounts.

Ensuring appropriate treaty eligibility for investors in other types of investment vehicles should be pursued actively by the OECD – perhaps by adopting the same approach that was used to develop the CIV Report. Because of differences between CIVs and other investment vehicle types, however, this work should not impact in any way the CIV Report or hinder the implementation of its conclusions.

The OECD also should continue its strong support for the Treaty Relief and Compliance Enhancement (TRACE) implementation package. TRACE’s investor documentation and reporting mechanisms will provide countries with additional assurances that the claims investors make for treaty relief are appropriate.

2. Non-CIV funds: application of the LOB and treaty entitlement

Issues on which comments are invited

- *Whether the Discussion Document accurately describes the treaty entitlement issues of Sovereign Wealth funds, pension funds, and alternative funds/private equity funds*
- *As regards more specifically the situation of pension funds:*
 - *whether and how the issue of the treaty residence of pension funds should be addressed*
 - *whether changes should be made to paragraph 69 of the Commentary on Article 18*
 - *whether drafting changes should be made to the alternative provision included in paragraph 69 of the Commentary on Article 18 (e.g. restricting its application to portfolio investment income)*
 - *how the 50% ownership test could be modified in order to address cases where it may produce inappropriate results, without creating opportunities for treaty-shopping*
 - *how the description of pension funds found in subparagraph 2 d) of the LOB rule (“person that...was constituted and is operated exclusively to administer or provide pension or other similar benefits”) could be clarified*

Overall

Focus on Pension Funds

Pension funds help individual wage-earners achieve long-term financial security. Society at large benefits from these funds because the resulting financial security of the elderly reduces the need to raise tax revenue from the public at large to support them.

In the typical arrangement, a relatively small portion of a worker’s total compensation is contributed to the plan by the employer and/or the employee. The contributed amounts, along with the plan’s earnings, grow over an extended time period.

Countries typically provide their local pension funds with favourable tax treatment, *e.g.*, no current tax on a pension fund’s income. This favourable treatment is provided not only because it enhances the value of the fund and further promotes long-term financial security but also because pension funds are not viewed as “tax-abusive” vehicles. By treating such funds as deemed compliant for FATCA purposes, for example, the US government effectively concluded that such funds do not raise tax avoidance concerns.

Those pension funds that diversify their risk by investing globally, however, face potential negative withholding tax consequences. To address these concerns, and promote risk diversification, many treaties now exempt from withholding tax the income and gains of resident pension funds. As noted in the public discussion draft, however, difficult treaty entitlement issues may arise if the pension fund invests through a third-country vehicle or has beneficiaries resident in third countries.

Given the valuable role performed by pension funds and the limited prospect for tax avoidance, BIAC questions the need for such funds to be subjected to LOB or principal purpose tests. Any time that two countries have agreed to exempt each other’s pension funds from tax, they have acknowledged the social good that such funds provide.

In the “typical” situation – in which the pension fund participants and beneficiaries reside in the same country as the business that established the plan – the BEPS 6 recommendations should have no impact. In this typical situation, the pension fund’s residence is the same without regard to whether residence is determined based upon the country in which the business operates or the country in which the plan is established. The only caveat on this “no impact” assessment is that any procedures for establishing treaty eligibility must be applied reasonably.

For businesses operating globally, however, the BEPS 6 recommendations may create some issues. Such funds, for example, are more likely to include workers resident in multiple countries. Even if separate plans are created for workers in each country, employees from one country working in another may return home to retire and become “non-resident beneficiaries” of the plan.

Furthermore, as cross-border investments are made to diversify the fund’s investment risk and enhance their value, LOB and principle purpose test rules should be applied sparingly, if at all. LOB rules in particular seem inappropriate in this situation.

Finally, we recommend that examples be provided of the types of situations in which the principle purpose test might be applicable.

Focus on non-CIV Investment Funds

Guidance should be provided to ensure that treaty-entitled investors in non-CIV investment funds, making commonplace cross-border investments, receive the relief negotiated by their relevant States. This guidance will provide better certainty, encouraging continued cross-border investment growth, and more effective capital allocation.

3. Commentary on the Discretionary Relief provision of the LOB rule

Issues on which comments are invited

- suggestions are invited as to possible factors or examples that could be included in the Commentary on the discretionary relief provision of paragraph 5 of the LOB rule in order to clarify the circumstances in which that provision is intended to apply

General Comments

We welcome the Discretionary Relief rule as a fall-back provision to reverse denial of treaty benefits where they should be available.

However, this route should not be seen as a solution for every situation, since it creates uncertainty, causes delay, increases costs, and places pressure on resources of tax authorities. Such an outcome will reduce the value of treaties, and detract from their aim to remove the barrier of double taxation, in order to promote cross border trade and investment. Targeting anti-avoidance accurately, is paramount.

An advanced ruling process should be made available, with an appropriate timescale [e.g. 2months] for agreed outcomes, in order to provide business the predictability that is needed in order to ensure double taxation does not arise, in advance of making investment decisions.

We would also welcome guidance and examples of how Joint Ventures (“JV”) should be able to retain intended Treaty benefits, particularly in situations where a JV holding company may be set up in a third State, with little substance, but for purely commercial reasons with no tax motive.

Specific Comments

Paragraphs 62 and 63 of the Commentary highlight that an entity should not have as one of its principal purposes the obtaining of benefits under the Convention; and that there should be clear reasons, other than obtaining treaty benefits for its formation, acquisition and maintenance.

It is proposed in the Discussion Document, that the fact that such an entity may not have the availability of lower withholding rates than would have applied to its parent, does not satisfy these criteria. *Unless there are other treaty benefits of which the entity makes use*, it is difficult to see how obtaining treaty benefits could be a principal purpose for its existence, when those rates are not lower than could have been achieved directly by the parent. We would welcome some clarification as to the avoidance which the OECD has in mind when making this proposal in the Discussion Document.

We would propose that there be a rebuttable assumption of non-abuse, in situations where the treaty with the ultimate parent provides for a rate of WHT which is not higher than one with the direct beneficiary of the income.

4. Alternative LOB provision for EU countries

We agree with the observation that the LOB provisions need to allow compliance with EU law. The recommendations in this paper, if implemented, should not cause for further changes in order to address EU law requirements.

5. Requirement that each intermediate owner be a resident of either Contracting State; and

6. Issues related to the derivative benefit provision

Issues on which comments are invited

- suggestions are invited on possible changes that could be made to the derivative benefit provision (paragraph 4 of the LOB rule), the definition of equivalent beneficiary (paragraph 6 of the LOB rule) or other provisions of the Model Tax Convention in order to assist in the work on the other parts of the Action Plan and ensure that the inclusion of a derivative benefit provision would not raise BEPS concerns whilst providing that cases where intermediate companies are used for valid commercial reasons are not excluded from treaty benefits

Overall

The purpose of treaties is to remove double taxation in order to promote cross border trade and investment. The success of treaties in encouraging economic activity has been widely realised. This aim must remain fundamental to any treaty network.

We agree that Tax Treaties should not be abused, not should they be used to create double non-taxation. However, in order to retain the economic benefits realised by Treaties over the decades, we strongly recommend that Tax Treaties should not be used as a tool to tackle other avoidance. Such issues should be addressed by local domestic tax legislation, and where appropriate, it should be made clear in Tax Treaties which articles of domestic legislation override the Treaty, in order to ensure the Treaty is not used to circumvent specific domestic anti-avoidance laws.

Treaty networks should continue to eliminate or reduce double taxation as widely as possible, with the exception of circumstances where the Treaties themselves are being abused.

Specific Comments

As already noted, the fundamental purposes of double tax treaties are to facilitate cross border trade and eliminate double taxation. The new proposed OECD Model Treaty includes a limitation on benefits (“LOB”) provision that would deny treaty benefits where there is purported “treaty shopping”. However, the proposed Model Treaty will deny treaty benefits where there is no treaty abuse, including situations where intermediary companies are being tested in addition to the ultimate beneficial owners, e.g., publicly traded companies. In our view, the elimination of intermediary company testing would:

- Be consistent with the fundamental purpose of treaties to encourage cross border trade and eliminate double taxation;
- Alleviate situations where the testing of intermediary companies would deny treaty benefits even where there is no treaty shopping motive;
- Allow more flexibility to account for inherited structures from M&A transactions; and
- Reduce a significant compliance burden.

For this reason, we believe that it is important to reiterate what has previously been said: the Model Treaty should focus on the Contracting State of the ultimate beneficial owners (“UBO”), and not test intermediary companies. There are a number of areas where this is relevant. We highlight below some examples, to demonstrate commercial situations where the Model Convention would fail to meet the objectives of facilitating cross border trade and removing double taxation in the future.

Subsidiaries of publicly traded companies (“Sub test”)

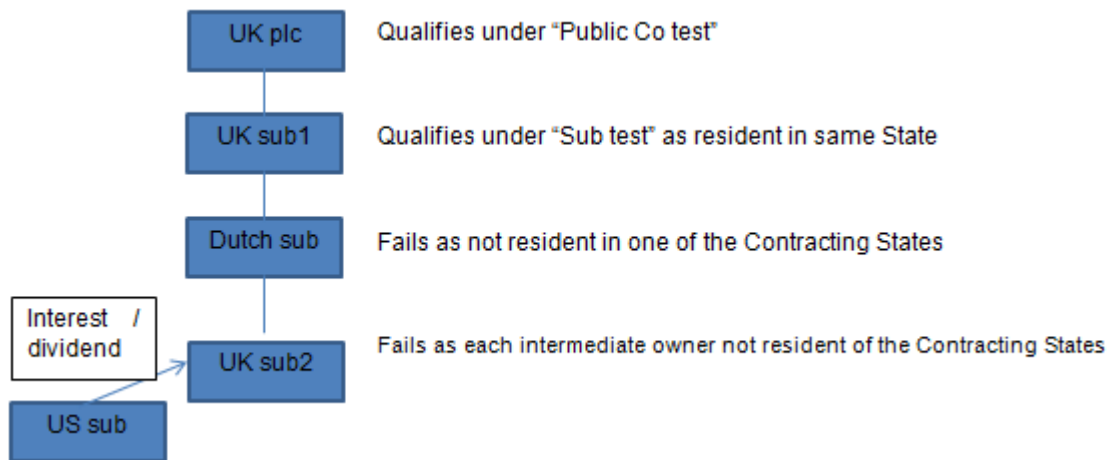
The proposed Model Treaty requires a 50% owned subsidiary to be a resident of a Contracting State and for its publicly traded parent to be a qualified resident of a Contracting State. The Model Treaty also requires that each intermediary subsidiary be a resident of either Contracting State; however, the Commentary to the Model Treaty notes that this requirement may be considered too restrictive by some States. We also agree that testing intermediary companies is too restrictive, and would lead to denial of treaty benefits where there is no treaty shopping. This restriction should be removed.

Such an approach would be consistent with the “minimum” standard approach for the Model Treaty, and would allow more flexibility to account for inherited structures from M&A transactions, etc. It would also reduce the significant compliance burden, and focus on the ultimate beneficial owner (“UBO”), which is the key concern in treaty shopping.

Our recommendation would therefore be to look to the UBO. We would therefore propose to amend para 2 c) ii) to read:

“at least 50 per cent of the aggregate voting power and value of the shares (and at least 50 per cent of any disproportionate class of shares) in the company or entity is owned directly or indirectly by five or fewer companies or entities 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]~~”

Example: This example shows a UK multinational that has taken over a Dutch resident and public listed company (Dutch sub) with various subsidiaries located outside the Netherlands by acquiring its shares via a public offer. **There are commercial reasons for the acquisition of the Dutch group by the UK plc group.** In addition, there are legitimate business reasons (managerial, legal, governance, commercial) for the acquiring company to be UK sub1. In that case, when looking at flows from US sub, the once Dutch public listed company becomes a subsidiary of the UK sub1 and fails the “Sub test” as it is not resident of one of the contracting states--which has a subsequent effect on the income received by UK sub2.

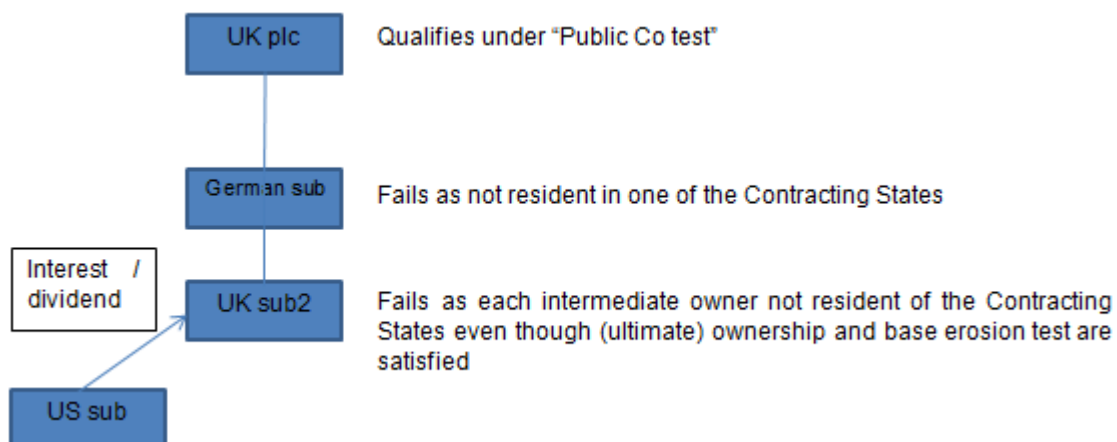


Result: payments from US sub to UK sub2 do not benefit from intended treaty rates.

Ownership/base erosion test (“OBE test”)

The proposed Model Treaty permits a resident entity of a Contracting State to qualify for treaty benefits under the OBE test where both an ownership test and base erosion test are met. Consistent with the Sub Test, the proposed Model Treaty requires that intermediate owners of an entity seeking treaty benefits must all be a resident of the Contracting State in which the parent company is listed. **For similar reasons as already set forth above--as well as the inclusion of an additional requirement (base erosion test) for companies to meet the OBE test--we believe that the testing of intermediary companies should be eliminated and only the UBO should be tested.**

Example: UK plc acquires German sub in a cross-border acquisition. Acquiring a company with existing foreign subsidiaries introduces an intermediate holding company that is not resident in the UK, which would cause German sub to fail the “OBE test”. (As noted above, UK sub 2 fails the Sub test because of the intermediary company).



Result: payments from US sub to UK sub2 do not benefit from intended treaty rates. Denying treaty benefits to UK sub 2 with regard to interest and dividend payments by US sub is unwarranted and contrary to the fundamental purposes of encouraging trade and eliminating double taxation

Derivative benefits test (“DB” test)

We strongly believe that the proposed Model Treaty should provide for a derivative benefits test (consistent with existing bilateral treaties), as taxpayers should be able to show objectively that there is no treaty shopping abuse where they do not get a better result than if amounts were paid directly to the parent.

We also believe that the benefit provided should be limited to the rates applicable to UBO under its relevant treaty, if such rates are higher than the rate applicable to the recipient of the income under its treaty. As such, this treatment would avoid the “cliff effect” of the current DB test, where benefits are denied completely if the test is failed rather than a comparable benefit that would be obtained if the income were directly received by the UBO.

Given the increasing commercial use of joint ventures, we believe the 95% ownership requirement will deny treaty benefits in many commercial situations. Lowering the ownership requirement to 75% should allow greater flexibility for such situations, without creating a significant risk to treaty abuse situations.

Finally, for the reasons set forth above and the fact that there is a base erosion test in the DB test, we believe that testing intermediary companies is unwarranted and should be eliminated consistent with Sub test and the OBE test.

7. Provisions dealing with “dual-listed company arrangements”

[No further comments]

8. Timing issues related to the various provisions of the LOB rule

Issues on which comments are invited

- comments are invited on the rules concerning the temporal aspects of the various provisions of the LOB rule (paragraph 16 of the Report). One particular issue on which comments are invited as whether it would be possible for an entity to become, or cease to be, publicly-listed without such event triggering a new taxable period and, if yes, whether this should create a problem for the application of the LOB.

Overall

We would recommend that for Treaty purposes, the time at which a company becomes listed should be treated from that time forward as meeting the criteria of article 2 c).

Likewise, if an entity were to cease to be listed, it would not meet the criteria of 2 c) from that point on. For discrete payments (such as dividends) this should be clear. However, there may be instances where a time apportionment on a just and reasonable basis may be required (for the year in which the entity becomes, or ceases to be, listed).

We would therefore recommend amending article 2 c) to read:

“c) a company or other entity, if, at the relevant time for seeking benefits...”

9. Conditions for the application of the provision on publicly-listed entities

Issues on which comments are invited

- Comments are invited as to whether and how subparagraph 2 c) of the LOB rule (the “publicly-listed entity” provision) could be modified to take account of the concerns of small countries that do not have important stock exchanges whilst ensuring that a publicly-listed entity has sufficient nexus with a country to warrant the application of the provision.

Overall

We would strongly encourage countries not to use the publicly-listed test to counter all undesired treaty applications, since a test which is too restrictive can have a significant detrimental impact on normal business operations and capital markets, and impede the purpose of Treaties, to encourage and enhance trade, investment, and economic cooperation.

Countries that want to pursue tax policy objectives beyond the scope of “Preventing the Granting of Treaty Benefits in Inappropriate Circumstances”, should instead adopt domestic targeted anti abuse provision to counter those specific concerns.

- An example may be the concerns in the US around inversions, which should instead be targeted using local legislation in the country of (former) residence, and made clear which local legislation will override Treaties, and in what circumstances.
- We would note that although discretionary relief may be cited as a fall-back, reliance should not be placed on this option, as there is inherent uncertainty, delays, and cost implications. In order for tax authorities to ensure the objectives and economic benefits of the Treaty network are retained, it is important to have certainty upfront as to whether a Treaty will apply.

Specific Comments

Access to capital markets is paramount for companies to fund their business operations and to create economic growth. Moreover some (large) institutional investors require listing at major international stock exchanges (e.g. New York, London) to be allowed to invest in a particular company; or for the shares to be included in certain tracker indices for example.

In our view the issue is two part:

- Is there sufficient nexus with the country of residence of the listed company; and
- what seems to be the underlying concern - is the structure set up artificially to obtain Treaty benefits – in effect Treaty shopping.

We believe the nexus question should already have been considered when looking at residency by virtue of central management and control.

We would also suggest that the question of Treaty shopping could be addressed by listing specific stock exchanges that qualify (or by identifying measurable criteria to apply to stock exchanges), in order to manage the perceived risk, whilst giving certainty to taxpayers, and allowing the vast majority of genuine commercial situations to continue to obtain the intended Treaty benefits.

In that way companies that are resident in smaller economies can be listed on a stock exchange outside their country of residence, whilst tax authorities still have sufficient control over which stock exchanges qualify.

We note that being listed on major stock exchanges subjects a company to stringent and extensive financial regulations which in itself warrant sufficiently that a company will not likely opt for secondary listing for the sole purpose of obtaining treaty benefits.

This practice is recognised in existing Treaties (including for example, US/Netherlands; US/Switzerland), and also in paragraph 16 of the Commentary to the proposed Model Treaty. Therefore, consistent with such existing treaties and the stated objective to be a minimum standard, we would recommend that the proposed Model Treaty provide a broader test, such that trading of shares should not be restricted to exchange(s) in the country of residence of the listed entity.

In addition, we believe that the **primarily traded** test (“principal class of shares... primarily traded”) is too restrictive for larger MNEs listed on more than one exchange. In such circumstance, it may not be possible to meet this test since there may not be one single exchange on which shares are primarily traded. We recommend broadening this test to aggregate all trading of principal class of shares on all recognised stock exchanges at which a company’s shares are listed.

This practice is applied for instance in the US-UK Treaty and is commonly believed to serve well, for example in defining “regularly traded”. The Explanation to the Treaty mentions: “A class of shares will be “regularly traded” in a taxable period, (...) if the aggregate number of shares of that class traded on one or more recognised exchanges during the twelve months ending on the day before the beginning of that taxable period is at least six percent of the average number of shares outstanding in that class during that twelve-month period.”

As such, we recommend to amend the wording of Article X para 2 c) i) A) to read:

“its principal class of shares is primarily traded on one or more recognised stock exchanges located in the Contracting State of which the company or entity is a resident; or ”

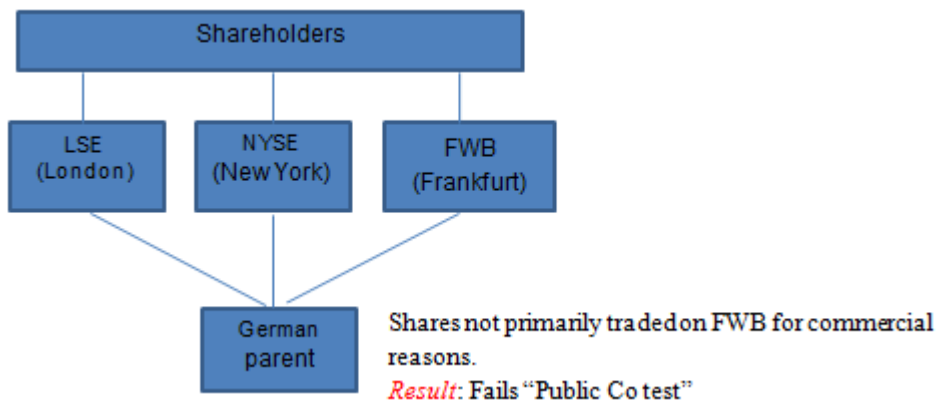
We would recommend that a standard list of “recognised stock exchanges” (para 6 a) i)) be included (or qualifying criteria), and consistently applied when signing up to the proposed Model Treaty.

Finally, as a consequence, the wording of the Commentary (for example, in paragraph 16) should be amended to reflect that this is a recommended minimum standard, which has been applied in practice, and to clarify that all trading on recognised stock exchanges can be considered in **aggregate**.

By way of example:

The following example shows a German based multinational listed on multiple stock exchanges to have optimal access to global capital markets. The shares are primarily traded on the LSE and NYSE for commercial reasons. This is especially applicable for multinationals located in smaller economies, or with significant capital listed on various stock exchanges.

The principle class of shares in the example below is therefore not primarily traded on the German stock exchange, which would result in failing the “Publicly-listed test”. It may, in fact, not be primarily traded on any individual exchange.



10. Clarification of the "active business" provision

Issues on which comments are invited

- Comments are invited as to possible clarifications that could be made concerning the interpretation and application of the "active business" provision found in paragraph 3 of the LOB rule (paragraph 16 of the Report).

Overall

Currently a Headquarters company would be excluded from qualifying. We believe that the OECD should also recognise that regional headquarters companies are common in today's business environment involving regional operations, where there can be benefits of understanding local market requirements in order to adjust and modify products and services offered. Notably, in the context of global M&A transactions, an acquired company may not qualify under the active conduct of a business test, and without a HQ test, this could become problematic for MNEs operating in genuine commercial circumstances. We would therefore recommend that, aligned with existing treaties, the proposed Model Treaty be amended to incorporate a HQ test.

The second comment seems to be based on the assumption that there is some type of conflict between the exclusion of financing activities in paragraph (a) and the affiliated activity provision in paragraph (c) in the event that both activities are present within the same affiliated group. We understand that the way it is supposed to work is that one looks at the entire affiliated group to determine whether there is a substantial active business. However, investment/financing activities conducted by various affiliates of the group are not counted in determining whether there is an active business or whether that business is substantial. If the group as a whole does have a substantial active business then all members of the group qualify regardless of their particular activities. The point is that if the group has a substantial active business, then neither the group nor individual entities are tainted because the group also has investment/financing activities.

Of course, the "in connection or incidental to" test must also be satisfied. This interpretation has been the consistent US interpretation of the US LOB provision as is made clear in the various US Technical Explanations.

Specific Comments

Headquarters companies

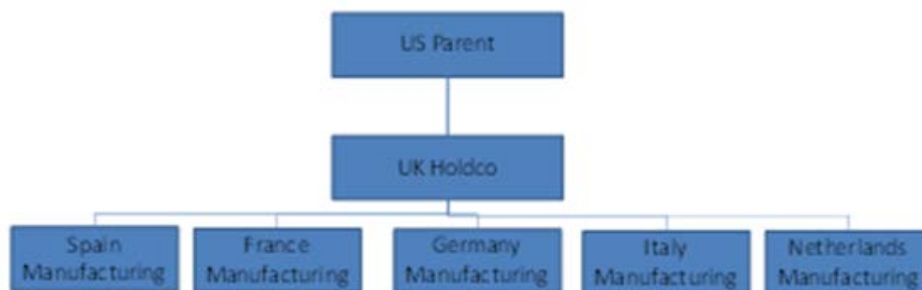
In addition to the overall observation above, in relation to a holding company, we would recommend removing the Commentary in para 48 which specifically excludes HQ companies from satisfying the active conduct of a business test, if its business is managing of investments. It is not

clear how this operates in conjunction with the attribution of business activities to a holding company where appropriate affiliation tests are met. It is also not aligned with some existing treaties which require the principles of an active conduct of business to apply before HQ status can be achieved.

Headquarters companies are commonplace, and removal of this test can cause issues.

By way of example:

US public parent buys UK plc, a listed entity which ran various operations in Europe. UK plc becomes UK Holdco.



Result: without a “HQ test”, UK Hold co is not able to apply treaty benefits to payments made to US parent (unless US parent meets other criteria, such as Public Co test), despite there being no treaty shopping intended either in the original acquisition, or the ongoing structure being maintained for purely commercial reasons, due to there being no other active business in the UK. Similarly, payments made from the manufacturing subsidiaries to UK Hold co would not benefit from treaty rates.

Other Holding Companies

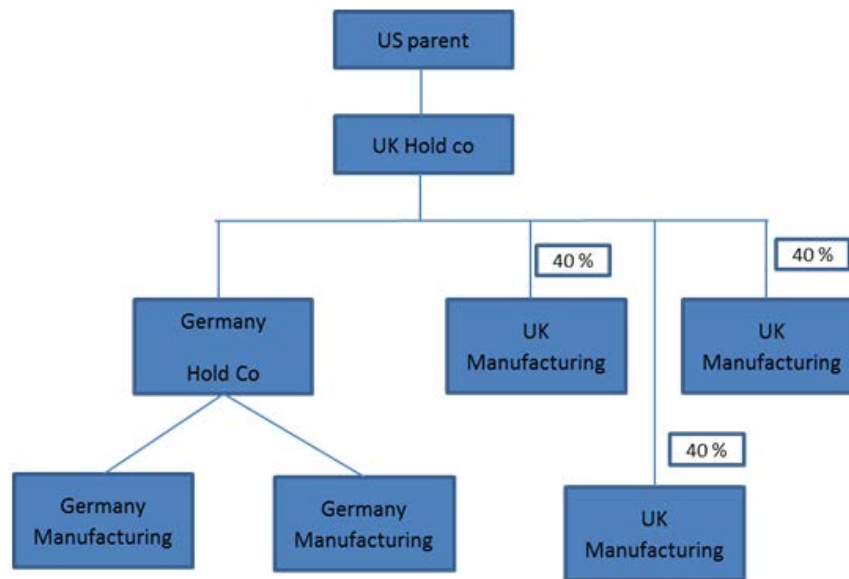
We also have concerns where the recipient is a holding company, and will therefore fail the LOB test in its own right. In that case the recipient may still qualify under the connected entities provision (para 3 c), which states that activities conducted by entities connected (as defined) to the recipient shall be deemed to be conducted by the recipient itself.

The provisions in para 3 a) and para 3 c) together require that only connected activities in the state of the recipient can qualify. The next test in the main rule is whether the income received by the recipient is in connection with or incidental to the business conducted by the recipient. An item of income is derived in connection with a business if the business activity in one State forms a part of or is complementary to the business activity in the other State. The final part of the test (para 3 b)), is that where the business activity carried on by the recipient is substantial in relation to the business activity carried on by the distributing company, the active business test will be considered to be met. This will be determined based on all facts and circumstances. The substantiality test is only applicable with regard to income from transactions with a branch or a related party. One compares the size of the activities in the first state to size of the activities in the other state not to the size of the income item. One also takes the size of the market and general economy of each country in determining substantiality.

By way of example, for an MNE, the following situation could arise:

A UK Holdco, with no active conduct of business. The below depicted structure can very well be the result of multiple genuine business transactions occurring in the course of years in which the

company decided to buy and sell investments in various countries. In this case the “connected to test” does not work as the investments in the subsidiaries in the UK are less than 50%. UK Hold Co used to have 100% in the UK subsidiaries but for commercial reasons of risk management and capital allocation, decided to cooperate with a partner who acquired 60% of the UK subsidiaries. Lowering the ownership from 100% to 40% would have detrimental effect under the proposed Model Convention.



Under existing bilateral treaties, all payments benefit from applicable Treaties, as intended. However, applying para 3 c), activities conducted by entities connected (as defined) to the recipient shall be deemed to be conducted by the recipient itself.

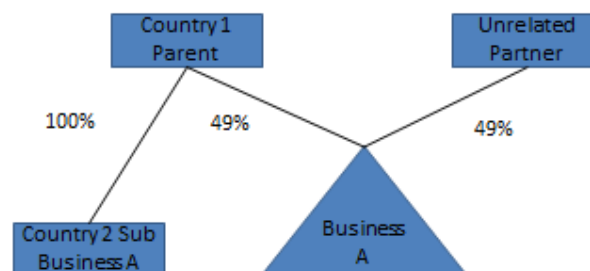
- Note that Joint Ventures (which exist for purely commercial reasons) may not be brought into account if the holding structure does not meet the ownership threshold (i.e. 50%);
- Partnerships are not currently brought into account
- UK activities of connected entities are allocated to UK Holdco, which (before selling 60% to a partner), may have allowed it to qualify under para 3 a), depending on further facts and circumstances.

If UK Holdco receives income from its German subsidiary, then based on para 3 a), the income producing activity in Germany must be connected with or incidental to the business conducted by UK Holdco. The German subsidiary does not conduct a business as it is also a Holdco. However, the business activities of its German connected entities may allow it to qualify under Para 3 c).

Subsequently, based on para 3 b), business activity carried on by the recipient must be substantial in relation to the business activity carried on by the distributing company. This will be determined based on all facts and circumstances, as noted above. However, many legitimate business activities are carried out by partnerships. Para 3 c) is overly restrictive in that it excludes all activities carried out in partnerships. Thus, we would propose that as in some existing bilateral treaties, the wording of Para 3 c) be amended as set forth below to include the activities of partnerships of which the resident is a partner.

- “c) For purposes of applying this paragraph, activities conducted by a partnership in which that person is a partner and 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 per cent of the beneficial interest in the other (or, in the case of a company, at least 50 per cent 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 per cent of the beneficial interest (or, in the case of a company, at least 50 per cent 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.”

By way of example:



- Country 1 Parent has been engaged in Business A for a number of years. Some years back Country 1 Parent contribute all of its business into a partnership with an Unrelated Partner.
- Country 1 Parent wishes to expand Business A into Country 2, but Unrelated Partner does not wish to expand into Country 2.
- Country 1 Parent incorporates Country 2 Sub to carry out Business A in Country B on its own.
- Even though Country 1 Parent has a longstanding and active business in Country 1m it does qualify under the active conduct of business test because the business was contributed to the partnership in a prior unrelated transaction

Finally, “substantial” is not defined in the proposed Model Treaty, although the examples are illustrative. We would recommend that the proposed Model Treaty contain a “safe harbour” based on objective metrics such as the one contained the NL-US treaty, where three ratios are examined: value of the assets, gross income, and payroll expense.

B. Issues related to the PPT rule

11. Application of the PPT rule where benefits are obtained under different treaties; and

12. Inclusion in the Commentary of the suggestion that countries consider establishing some form of administrative process ensuring that the PPT is only applied after approval at a senior level; and

13. Whether the application of the PPT rule should be excluded from the issues with respect to which the arbitration provision of paragraph 5 of Article 25 is applicable; and

14. Aligning the parts of the Commentary on the PPT rule and of the Commentary on the LOB discretionary relief provision that deal with the principal purposes test

Issues on which comments are invited

- Comments are invited as to possible inconsistencies between the Commentary on how the phrase “did not have as one of its principal purposes the obtaining of benefits under this Convention” should be applied in the context of the discretionary relief provision of the LOB rule (paragraph 16 of the Report) and how the phrase “obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit” should be interpreted in the context of the PPT rule (paragraph 17 of the Report).

Overall

Application of the discretionary relief rule of the LOB, and the PPT rule should both be under mandatory arbitration.

In any case, if the Contracting States are unable to agree, then there should be an underlying assumption that it is therefore **not** reasonable to conclude that obtaining a benefit was a principal purpose, and therefore the PPT rule should not apply (and discretionary relief should be available).

Denial of treaty benefits should require alignment, and not allow unilateral action by one authority.

Tax will usually be one of many considerations to take into account when deciding on the economic viability of an investment. It would be instructive to include examples of how tax authorities will therefore interpret whether tax is one of the principle purposes, and in what circumstances.

Finally, treaty benefits should remain available unless tax authorities establish that the PPT rule applies, rather than there being an assumption of avoidance, and passing the burden of proof to the taxpayer.

Specific Comments

The examples in the Report are quite specific and as such have limited application in giving clarity to typical holding company structures and M&A activity.

Often, a MNE will have holding companies in various jurisdictions. Typically acquisitions will be made by existing regional or divisional holding companies, or specific acquisition vehicles will be established for individual acquisitions (for example to ring-fence financing relating to the acquisition; to ring fence legal risks related to investments; or to facilitate a post-acquisition integration of the acquired business).

In making an acquisition, a MNE typically has a degree of choice as to the location of the acquiring entity and this choice is often influenced to some extent by the tax treaty implications. As such, many holding structures will be exposed to the risk that tax authorities will argue that one of the principal purposes of the arrangement is to benefit from the relevant double tax treaty.

BIAC believes that for a commercial acquisition the main purpose of the transaction will by definition be to acquire the entity, and not to obtain treaty benefits, notwithstanding the fact that access to treaties will be taken into account in determining the appropriate acquisition structure. This is similar to Example C (at paragraph 17 of the Report) where a producer of electronic devices based in State R decides to establish a manufacturing plant in State S and where the tax convention between State R and State S is effectively the deciding factor.

However, Example D (at paragraph 17 of the Report) includes a number of caveats which make the position unclear. It specifies that residents of State S are minority investors and that investors' decisions to invest in RCo are not driven by any particular investment made by RCo. Whilst again this example is quite specific, it could be used to support a position that casts doubt on the application of double tax treaties given the decision to use a particular acquisition entity will typically be driven in part by reference to access to an appropriate double tax treaty.

It is not clear how the above two examples reconcile and this could lead to a risk of misinterpretation or misapplication by tax authorities.

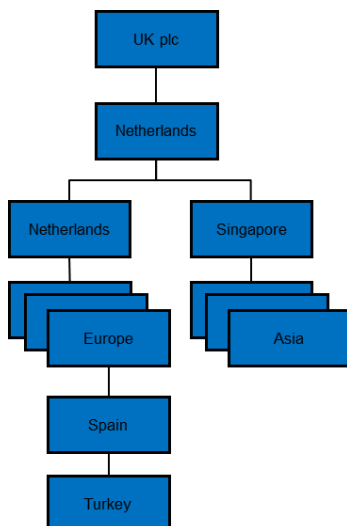
By way of example

A UK public parented group has worldwide operations. It is mainly structured with regional holding companies the majority of which are held by a Netherlands holding company.

The group acquires a subsidiary in Turkey (where the group does not have an existing presence) from a third party.

The non-treaty rate of dividend withholding tax for Turkey is 15%. Turkey has a double tax convention with both the UK and the Netherlands under which the treaty rate of dividend withholding tax is 10%.

However, the double tax convention between Spain and Turkey provides for dividend withholding tax of 5%. The group has an existing trading subsidiary in Spain and uses this subsidiary to make the acquisition of the Turkish subsidiary.



We would recommend providing better clarity around this type of scenario. For example:

- assuming that the choice of using the existing Spanish trading subsidiary to make the acquisition was driven by access to the favourable treaty rate for dividend withholding tax, confirmation whether the PPT would be considered to apply to deny treaty benefits for dividends paid from Turkey to Spain;
- confirmation whether the PPT would be considered to apply to deny treaty benefits if instead a new Spanish company had been established to make the acquisition
- confirmation whether the PPT would be considered to apply to deny treaty benefits if instead a new Spanish company was established to make the acquisition and the group did not have any existing operations in Spain.

Whilst additional examples and guidance to provide more clarity would be welcome, with a purpose based test there will inevitably be disagreements as to whether treaty benefits should apply and accordingly denial of treaty benefits for certain situations. In such cases, we believe that treaty relief should not be denied per se, rather that the treaty benefit provided should be limited to the rate applicable to UBO under its relevant treaty which would avoid a cliff effect (similar to the observations in point 6 above).

15. Whether some form of discretionary relief should be provided under the PPT rule

Issues on which comments are invited

- Commentators are invited to suggest examples where some form of discretionary relief would be justified following the application of the PPT rule

Overall

The treatment of an item as income or capital should follow domestic legislation (in a similar way to the comments in paragraph 43 of the Report).

Where there are concerns that a treaty may be abused in order to override such provisions, we refer to our comments on question 20 below, so that domestic law should be allowed to override treaties in specified circumstances.

Once the treatment of the item in question is established, the treaty should be applied to that item. The fact that the domestic anti-avoidance rule may have overridden the treaty in order to characterise the income/capital as intended, should not prevent the treaty from being applied to that income/capital as normal. This then ensures that anti-avoidance concerns are addressed, and the treaty only serves to reduce/eliminate double taxation as intended when entering into the treaty.

We believe this should then address the question underlying the issue raised in question 15.

However, there should be protection against creation of double taxation (for example, if the recipient recharacterises the income, but the source State does not, and therefore different rates of WHT may result than anticipated by the recipient State, the recipient should not be restricted in crediting the source State WHT).

16. Drafting the alternative “conduit-PPT rule”

Issues on which comments are invited

- Comments are invited on the various features of the “anti-conduit rule” in paragraph 15 of the Commentary on the PPT rule (paragraph 17 of the Report).
- Commentators are also invited on possible examples that could be included in the Commentary in order to illustrate the application of this “anti-conduit rule”.

Overall

Since the proposed wording for the conduit arrangement includes a principal purpose test, this option is similar in concept to, although more targeted than, the PPT rule.

17. List of examples in the Commentary on the PPT rule

Issues on which comments are invited

- Commentators are invited to suggest additional examples that could be included in paragraph 14 of the Commentary on the PPT rule (paragraph 17 of the Report). For example, representatives of investment funds are invited to suggest an additional example that would deal with the non-tax motivated use of a special purpose vehicle in order to pool the investment of various institutional investors from different countries.

Overall

CIV Funds

CIV relief from the PPT rule appropriately is provided by Example D. This example’s relief is limited, however, to a CIV that (1) has, as a majority of its investors, persons resident in the CIV’s country of residence and (2) distributes its income annually to investors (paying tax on any retained amounts).

We believe that additional examples should be provided of CIVs that do not fall foul of the PPT rule.

One example would apply to a CIV that is owned more than 50% by investors resident in any State with which the source State has a tax treaty providing tax relief comparable to that provided to investors resident in the treaty partner. This example would apply the equivalent beneficiary standard to globally-distributed CIVs and is necessary to ensure appropriate treaty relief.

A second example would apply to a CIV that distributes, rather than retains, its income (as the retained income becomes taxable when the investor disposes of the CIV interests). This second example could be applied by any State that provides treaty relief from double taxation (rather than double current taxation).

These additional examples will provide appropriate relief to investors in globally-distributed CIVs. The individual investors in these CIVs typically are of moderate means and invest in CIVs to help meet their retirement savings needs.

Non-CIV Funds

We believe that an example should also be provided of an investment fund created for investors, such as pension funds, that would be treaty-entitled if investing directly. Treaty-entitled investors in a non-CIV investment fund, created for legitimate investing purposes (including professional

management and economies-of-scale benefits) should not be disadvantaged by seeking to benefit from those advantages.

C. Other issues

18. Application of the new treaty tie-breaker rule; and

19. The design and drafting of the rule applicable to permanent establishments located in third States

Issues on which comments are invited

- The anti-abuse rule included in paragraph 42 of the Report is currently restricted to cases where the profits of the PE are exempt in the State of the enterprise to which the PE belongs. Are there other situations where the rules should apply?

- Are the exceptions included in subparagraphs e) and f) of the anti-abuse rule sufficient to address cases where the rule would otherwise affect arrangements that are not tax-motivated?

- Do these exceptions raise potential BEPS concerns?

Overall

Tie Breaker rule

As noted previously, 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.

The above comments should be taken into account in the hybrid mismatch discussions (not considered in this paper), to ensure consistency.

Transparent entities

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. 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 – or put another way, the focus should be on substance. Specifically:

- a. The proposed wording in paragraph 42 is solely focused on an effective tax rate, which remains in stark contrast to the wording of the action plan referred to above, where no or low taxation is not the driving concern;
- b. Genuine commercial activities can include holding, financing and investment activities; and
- 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 commercial structure exists.

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 domestic anti-avoidance rules).

The current wording proposed (paragraph 42 of the Report) 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 be dealt with under one or more of:

- local legislation;
- under Harmful Tax Practices; and
- taken into consideration when weighing up the risks before deciding to enter into a treaty.

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 or PE in a third State, where the income is earned.

20. Proposed Commentary on the interaction between tax treaties and domestic anti-abuse rules

Issues on which comments are invited

- Apart from the changes described above [sic], are there other clarifications/additions that should be made to the Commentary changes in paragraph 49 of the Report?

Overall

We agree with the comment in paragraph 44, 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 45.

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

Furthermore, 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.

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.

Specific comments

In order to retain as much clarity and certainty as possible, we would recommend that Treaties should specify clearly which domestic legislation is intended to override the Treaty. This protects both the taxpayer from later changes in views, and similarly tax authorities from entering into a Treaty which does not then apply to its residents in situations where they had expected it would.

In this vein, the proposed paragraph 9 to the Commentary suggests that the PPT could be used as a route to allow domestic rules to override the Treaty. We would strongly encourage the issue of tax avoidance (to be addressed under local legislation) to be separated from Treaty Abuse (which is a different question).

Domestic anti-avoidance rules should be allowed to override the Treaty, to ensure their proper application, but the circumstances for overriding the treaty must be clear and known upfront. The PPT rule should not be seen as a route to allow tax authorities to removed intended Treaty benefits, in circumstances unforeseen by either the taxpayer or the other Contracting tax authority, due to a change in their domestic interpretations. We therefore have concerns over the wording of paragraph 9 to the Commentary as drafted.

Finally, we note that paragraph 9 to the Commentary suggests that “...*the application of tax treaty provisions in a case that involves an abuse of these provisions may be denied under paragraph 7 of Article [X] (the PPT rule) or, in the case of a treaty that does not include that paragraph, to the guiding principle in paragraph 9.5 of the Commentary on Article 1.*” Whilst we agree with guiding principle, the mechanics of how the tax authorities agree those principles should work, is set out in either the LOB and/or the PPT rules adopted. If the tax authorities have agreed not to include a PPT rule, then it should not be possible to invoke one under the guise of the guiding principles. Doing so would create confusion, reduce the value and certainty of the treaty network, and allow one tax authority to behave in a manner which was not intended or agreed when signing the

treaty. If it had been, it would have been easy to include a PPT clause. We would therefore recommend removing such suggestion from the Commentary.