Public Discussion Draft

FOLLOW UP WORK ON
BEPS ACTION 6:
PREVENTING TREATY
ABUSE

21 November 2014 – 9 January 2015
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21 November 2014

FOLLOW-UP WORK ON THE REPORT ON ACTION 6 (PREVENT TREATY ABUSE)

Paragraph 5 of the Report on the work on Action 6 (“Prevent the granting of treaty benefits in inappropriate circumstances”) of the BEPS Action Plan (the “Report”) indicates that follow-up work will be done on certain aspects of the Report:

... it is recognised that further work will be needed with respect to the precise contents of the model provisions and related Commentary included in Section A of this report, in particular the LOB rule. Further work is also needed with respect to the implementation of the minimum standard and with respect to the policy considerations relevant to treaty entitlement of collective investment vehicles (CIVs) and non-CIV funds. The model provisions and related Commentary included in Section A of this report should therefore be considered as drafts that are subject to improvement before their final version is released in September 2015...

This discussion draft deals with the follow-up work related to the contents of the model provisions and related Commentary included in Section A of the Report, in particular the LOB rule, as well as with issues related to the treaty entitlement of collective investment vehicles (CIVs) and non-CIV funds (the result of the discussions on how countries intend to implement the minimum standard described in the Report will be included in the revised version of the report that will be released in 2015).

The discussion draft identifies the various issues on which there will be follow-up work and includes, in shaded boxes, specific questions on which comments are invited.

As part of the transparent and inclusive consultation process mandated by the Action Plan, the Committee on Fiscal Affairs (CFA) invites interested parties to send comments on this discussion draft, which includes a number of questions and proposals concerning aspects of the Report on Action 6 on which further work is being carried on.

The views and proposals included in this discussion draft do not represent the consensus views of the CFA or its subsidiary bodies but are intended to provide stakeholders with substantive proposals for analysis and comment.

Comments should be sent by 9 January 2015 at the latest (no extension will be granted) and should be sent by email to taxtreaties@oecd.org in Word format (in order to facilitate their distribution to government officials). They should be addressed to Marlies de Ruiter, Head, Tax Treaties, Transfer Pricing and Financial Transactions Division, OECD/CTPA.

Please note that all comments received regarding this consultation draft will be made publicly
available. Comments submitted in the name of a collective “grouping” or “coalition”, or by any person submitting comments on behalf of another person or group of persons, should identify all enterprises or individuals who are members of that collective grouping or coalition, or the person(s) on whose behalf the commentator(s) are acting.

**Public consultation meeting**

Persons and organisations who will send comments on this consultation document are invited to indicate whether they wish to speak in support of their comments at a public consultation meeting on Action 6 that is scheduled to be held in Paris at the OECD Conference Centre on 22 January 2015. Persons selected as speakers will be informed by email by 16 January at the latest.

This consultation meeting will be open to the public and the press.

Due to space limitations, priority will be given to persons and organisations who register first (we reserve the right to limit the number of participants from the same organisations).

Persons wishing to attend this public consultation meeting should fill out their request for registration on line as soon as possible and by 9 January 2015 at the latest. Confirmation of participation, including venue access details, will be sent by email to participants by 16 January at the latest.

This meeting will also be broadcast live on the internet and can be accessed on line. No advance registration will be required for this internet access.
ISSUES TO BE ADDRESSED AS PART OF THE FOLLOW-UP WORK ON ACTION 6

A. Issues related to the LOB provision

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

Issue

1. Paragraph 5 of the Report indicates that further work is needed “with respect to the policy considerations relevant to treaty entitlement of collective investment vehicles (CIVs) and non-CIV funds.”

2. Subparagraph 2(f) of the LOB rule (paragraph 16 of the Report) provides for the inclusion, in the list of “qualified persons”, of a provision dealing with collective investment vehicles (CIVs). A footnote indicates that the subparagraph should be drafted, or omitted, based on how CIVs are treated in the Convention and are used and treated in each Contracting State; that footnote also refers to paragraphs 6.4 to 6.38 of the Commentary on Article 1. The Commentary on the LOB rule includes a discussion of how CIVs could be dealt with as well as a number of alternative provisions that correspond to the various approaches included in the 2010 OECD Report “The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles”.

3. As part of the follow-up work on the Report on Action 6, it is intended to review these alternative approaches and to examine whether it would be possible to suggest a single preferred approach not only with respect to the application of the LOB to CIVs but also with respect to the more general question of the treaty entitlement of CIVs, taking into account developments since 2010 and, in particular, the results of the work on the Treaty Relief and Compliance Enhancement (TRACE) project.

Issues on which comments are invited

Comments are invited as to whether the recommendations of the 2010 CIV Report continue to be adequate for widely-held CIVs and whether any improvements should be made to the conclusions included in that Report. Comments are invited, for example, on whether it would be advisable to provide for a preferred approach with respect to issues related to the tax treaty entitlement of the income of CIVs and the application of the LOB to CIVs, and if yes, on what that approach should be.

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

Issue

4. As mentioned in paragraph 1 above, paragraph 5 of the Report indicates that further work is needed with respect to the policy considerations relevant to the treaty entitlement of non-CIV funds.

5. Whilst changes were made in the final version of the Report in order to deal with collective investment vehicles, no such changes were made to address comments that were received on the March
2014 discussion draft in relation to Real Estate Investment Trusts (REITs), sovereign wealth funds (SWFs), pension funds and alternative funds (including private equity funds).

6. Although most of these comments focussed on the LOB rule (paragraph 16 of the Report), some commentators also suggested that the Principal Purposes Test (paragraph 17 of the Report) could affect negatively these investment funds (to a large extent, the concerns expressed in this regard reflected a more general objection to the Principal Purposes Test). In some cases (especially for alternative funds), the comments received went beyond concerns related to the work on Action 6 and raised general issues related to the treaty entitlement of investment funds.

7. The following subsections describe some of the issues that were discussed in relation to sovereign wealth funds, pension funds and alternative funds / private equity funds.

i) Sovereign wealth funds

8. These funds are owned and operated by States themselves. The legal status and tax situation of sovereign wealth funds vary but in many countries, foreign sovereign wealth funds are entitled to an exemption from taxes on their portfolio investment income under the sovereign immunity doctrine. Paragraphs 6.35 to 6.39 of the Commentary on Article 1, which were added to the OECD Model Tax Convention in 2010, explain how treaties apply to sovereign wealth funds. These paragraphs discuss the application of the sovereign immunity doctrine to taxation, which is a matter of domestic law, and the application of the definition of “resident” in the light of the different views reflected in paragraphs 8.6 and 8.7 of the Commentary on Article 4.

9. It has been suggested that the LOB rule that is included in the Report on Action 6 may create difficulties for sovereign wealth funds. Where a sovereign wealth fund invests directly in a country, however, the definition of “qualified person” included in the LOB rule would apply to a resident who is “a Contracting State, or a political subdivision or local authority thereof, or a person that is wholly-owned by such State, political subdivision or local authority” (subparagraph 2 b) of the LOB rule), which would cover a sovereign wealth fund that qualifies as a resident of a Contracting State and that is wholly-owned by that State or its subdivisions. Similarly, investments that a sovereign wealth fund resident of one Contracting State makes through a subsidiary established in the same State would typically be covered by the “ownership / base erosion” provision (subparagraph 2 e) of the LOB rule). Problems could arise, however, in the case of investments made through an entity that is a resident of a third State (e.g. a sovereign wealth fund of State R uses a company in State T in order to invest in State S). Also, sovereign wealth funds are often among the institutional investors that invest in alternative funds and private equity funds and these may be established in other countries (see under subsection iii)).

ii) Pension funds

10. The LOB rule included in the Report on Action 6 does not restrict benefits in the case of a resident who “was constituted and is operated exclusively to administer or provide pension or other similar benefits, provided that more than 50 per cent of the beneficial interests in that person are owned by individuals resident in either Contracting State”. The LOB rule also does not restrict benefits in the case of an entity that was constituted and is operated to invest for the benefit of such pension funds, “provided that substantially all the income of that entity is derived from investments made for the benefit of these pension funds.” Similarly, investments that a pension fund that is a resident of one Contracting State makes through

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1. REITs are covered by the 2010 Report on CIVs to the extent that they are widely-held and regulated. When that is not the case, they may face the issues described below in relation to alternative funds / private equity funds (see subsection iii)).

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a subsidiary established in the same State would typically be covered by the “ownership / base erosion” provision (subparagraph 2 e) of the LOB rule).

11. As in the case of sovereign wealth funds, however, problems may arise where a third State entity is used, e.g. a pension fund of State R sets up an entity in State T in order to invest in State S; in that case, the LOB rule of the T-S treaty could deny benefits to the entity even if all participants in the fund are residents of State R (in such a case, however, the treaty entitlement and benefits of the pension fund under the R-S treaty may be different from those available under the T-S treaty, which could raise treaty-shopping concerns). In addition, pension funds, like sovereign wealth funds, are often among the institutional investors that invest in alternative funds and private equity funds and these may be established in third countries (see under subsection iii)).

12. Another specific issue for pension funds that arises in relation to the LOB rule relates to the requirement that more than 50% of the beneficial interests in a pension fund be owned by individual residents in either Contracting State. This requirement may create difficulties for some EU pension funds (this issue is one of the issues that will be examined as part of the follow-up work on alternative LOB provisions for EU countries; see section 4 below).

13. It has been suggested that, as part of the work on the treaty entitlement of non-CIV funds, the OECD should look at how the treaty definition of “resident” applies to pension funds in the light of the different views reflected in paragraphs 8.6 and 8.7 of the Commentary on Article 4.

14. It has also been suggested that many of the above issues related to pension funds could be addressed by countries including in their treaties the alternative provision that is found in paragraph 69 of the Commentary on Article 18 of the OECD Model Tax Convention, which deals with the source taxation of income of foreign pension funds. As the preamble of that paragraph recognises, however, such a provision should be used where it will be mutually beneficial and there may therefore be valid policy reasons for not including that provision in a bilateral treaty.

iii) Alternative funds / private equity funds

15. For the purposes of the 2010 Report, “collective investment vehicles” are defined as “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”. Alternative funds / private equity funds generally do not meet these conditions because they typically have a limited number of institutional investors, may not hold a diverse portfolio and are not subject to the same investor-protection regulation.

16. The problems that the LOB rule creates for CIVs may also be encountered by private equity funds / alternative funds (i.e. since their investor base is not restricted to a single country, they would be denied benefits under the LOB rule and would probably not get the active business exception; any provisions dealing expressly with CIVs would not apply to them). Also, these funds face many of the treaty issues that were addressed in the 2010 OECD Report on CIVs (e.g. whether they qualify as residents).

17. It is intended to examine how these issues related to the treaty entitlement of sovereign wealth funds, pension funds and alternative funds / private equity funds could be addressed in a way that would not create treaty-shopping opportunities.

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<th>Issues on which comments are invited</th>
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<td>Comments are invited as to whether the preceding paragraphs accurately describe the treaty entitlement issues of sovereign wealth funds, pension funds and alternative funds / private equity</td>
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funds. Comments are also invited as to how to address these issues without creating opportunities for treaty shopping.

As regards more specifically the situation of pension funds, comments are invited on:

- 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, which deals with the source taxation of income of foreign pension funds, in order to ensure that two States that follow similar approaches with respect to the taxation of retirement savings consider more thoroughly the appropriateness of including in their bilateral treaty a provision exempting such investment income from source taxation in order to achieve greater neutrality with respect to the taxation of capital.
- 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 applicable to pension funds could be modified in order to address cases where it may produce inappropriate results (e.g. in the case of the individual retirement fund of a pensioner who moves abroad) without creating opportunities for treaty-shopping.
- How the description of pension funds found in subparagraph 2d) of the LOB rule (“person that ... was constituted and is operated exclusively to administer or provide pension or other similar benefits”) could be clarified.

3. Commentary on the discretionary relief provision of the LOB rule

Issue

18. Paragraph 5 of the LOB rule (paragraph 16 of the Report) is a provision that grants to the competent authority of a Contracting State the discretion to grant treaty benefits in some situations where a resident of a Contracting State would otherwise be denied treaty benefits under the LOB rule (the “discretionary relief” provision).

19. Paragraph 63 of the Commentary on the LOB rule explains that the person who makes a request for discretionary relief must establish to the satisfaction of the competent authority “that there were clear reasons, unrelated to the obtaining of treaty benefits, for its formation, acquisition, or maintenance...”. That paragraph should clarify that, in the case of a resident subsidiary company with a parent in a third State, whilst the fact that the relevant withholding rate provided in the Convention is not lower than the corresponding withholding rate in the tax treaty between the State of source and the third state would be a relevant factor, that fact would not, in itself, be sufficient to establish that the conditions for granting the discretionary relief are met. In addition, other relevant factors and examples could be added to the Commentary in order to clarify circumstances where the discretionary relief provision is intended to apply.

20. It has also been suggested that the Commentary on the discretionary relief provision should encourage the competent authority that receives a request for relief under that provision to process that request expeditiously.

21. Finally, it has been suggested that, in order to remove any doubt, the Commentary should clarify that if a competent authority has properly exercised the discretion granted by the discretionary relief
provision of paragraph 5, that provision has been complied with and it cannot, therefore, be argued that taxation is not in accordance with the provisions of the Convention.

**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.

4. **Alternative LOB provisions for EU countries**

**Issue**

22. Paragraph 13 of the Report acknowledges that the LOB rule (paragraph 16 of the Report) needs to be adapted to reflect certain EU law requirements. There is therefore a need to draft alternative provisions that would accommodate the concerns of EU member states.

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

**Issue**

23. Subdivision 2 e)(ii) of the LOB rule (paragraph 16 of the Report) includes a rule dealing with indirect ownership requiring that each intermediate owner be a resident of either Contracting State. A similar condition found at the end of subdivision 2 e)(i) requires that each intermediate owner be a resident of the same Contracting State as the company seeking qualified person status. In both cases, the condition has been put between brackets and the Commentary indicates that some States consider that the requirement is unduly restrictive and prefer to omit it.

24. Further work is required in order to determine whether and how the requirement could be relaxed without creating opportunities for treaty-shopping; that work will be carried on in relation with the work on issues related to the derivative benefit provision and the definition of equivalent beneficiary which are described in section 6 below.

6. **Issues related to the derivative benefit provision**

**Issue**

25. As indicated in paragraph 5 of the Report:

... one assumption in the drafting of the limitation-on-benefits rule found in Section A.1 below is that Action 5 (Counter harmful tax practices more effectively, taking into account transparency and substance) and Action 8 (Intangibles) will address BEPS concerns that may arise from a derivative benefits provision; that provision, or alternative means of addressing those BEPS concerns, may therefore need to be reviewed based on the outcome of the work on these Action items.

26. There are still unresolved issues that need to be addressed before a decision can be reached on the way that a derivative benefit provision will be reflected in the final version of the LOB rule and the Commentary thereon. The provision in paragraph 4 of the LOB rule will therefore be reviewed in the light of progress on other parts of the Action Plan and, in particular, on Actions 5 and 8. In doing so, it is intended to examine whether other possible changes to the Model Tax Convention could ensure that the
inclusion of a derivative benefit provisions would not raise BEPS concerns and contribute to the work on other parts of the Action Plan. It is also intended to examine whether changes could be made that would broaden the scope of the derivative benefit provision without creating opportunities for treaty shopping. One such change deals with the requirement, in subparagraph 4 a) of the LOB rule, that in the case of indirect ownership, each intermediate owner be an equivalent beneficiary.

**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 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.

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

**Issue**

27. As a result of the public consultation on the March 2014 discussion draft, provisions were added to the definitions in paragraph 6 of the LOB rule (paragraph 16 of the Report) in order to address the situation of “dual-listed company arrangements”. These provisions will be examined in more detail, in particular to ensure that they are drafted in a way that appropriately address the situations for which they were designed and do not create treaty-shopping opportunities.

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

**Issue**

28. Timing issues are dealt with differently under the various provisions of the LOB rule (paragraph 16 of the Report). For instance, the definition of “qualified person” in paragraph 2 of the rule applies “at a time when a benefit would otherwise be accorded by the Convention if, at that time” the conditions of the relevant subparagraph are met. In the case of subparagraph c) (the “publicly-listed entity” provision), the conditions must also be met “throughout the taxable period that includes that time”, which means that a company that would become publicly-listed in the middle of a taxation year would fail that test. Further work is needed to ensure that the rules governing the temporal aspects of the various provisions of the LOB rule are appropriate.

**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 is 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 could create a problem for the application of the LOB.
9. **Conditions for the application of the provision on publicly-listed entities**

**Issue**

29. It has been suggested that the alternative conditions in 2 c)i)A and B) (the “publicly-listed entity” provision) of the LOB rule (paragraph 16 of the Report) could be too restrictive for small countries that do not have important stock exchanges and whose companies are therefore listed on foreign stock exchanges. There is a risk that the alternative conditions would not be satisfied if the shares of such a company were traded on a foreign stock exchange and the subsidiaries of the company were managed from abroad. It is not clear, however, how these provisions could address these concerns whilst ensuring that a publicly-listed entity has a sufficient nexus with a country to warrant the application of the provision.

**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 a sufficient nexus with a country to warrant the application of the provision.

10. **Clarification of the “active business” provision**

**Issue**

30. It has been suggested that various interpretative issues raised by paragraph 3 of the LOB rule (the “active business” provision) should be addressed through changes to the provision and/or its Commentary (e.g. what is the exact scope of the last sentence of paragraph 48 of the Commentary, which refers to headquarters operations, and what is the effect of the deeming rule in subparagraph c) in cases where subsidiaries situated in the same country carry on different activities such as manufacturing and investment activities).

**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).

B. **Issues related to the PPT rule**

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

**Issue**

31. Paragraph 13 of the Commentary on the PPT rule (paragraph 17 of the Report) provides that where an arrangement is entered into for the purpose of obtaining benefits under a number of treaties or under both a treaty and domestic law, this should not lead to the conclusion that obtaining one benefit under one treaty was not a principal purpose for that arrangement. It has been suggested that in order to avoid any doubt, the wording of the PPT rule should be clarified in this respect.
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**

**Issue**

32. In a number of countries, the application of the general anti-abuse rule found in domestic law is subject to approval by a committee composed of senior officials. In some cases, that committee includes academics and/or tax experts from the private sector. The Commentary on the PPT could include the suggestion that countries consider establishing a similar form of administrative process that would ensure that the PPT is only applied after approval at a senior level.

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**

**Issue**

33. Some countries have expressed the view that the application of the PPT rule is not an issue suitable for the arbitration mechanism of paragraph 5 of Article 25. A majority of countries, however, disagreed with that view. It is necessary to determine whether and how the views of the minority should be reflected when the final version of the PPT rule and its Commentary are included in the Model Tax Convention.

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**

**Issue**

34. Both the PPT rule (paragraph 17 of the Report) and the discretionary relief provision of the LOB rule (paragraph 16 of the Report) include a test based on whether one of the principal purposes for arrangements/transactions is the obtaining of benefits under a tax treaty. The Commentaries on these two provisions, however, were developed separately and there is therefore a need to ensure that these Commentaries provide consistent explanations on how the principal purposes test applies for the purposes of the two provisions.

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<td>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).</td>
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15. **Whether some form of discretionary relief should be provided under the PPT rule**

**Issue**

35. The application of the PPT rule (paragraph 17 of the Report) results in the denial of the application of treaty provisions, which means that the relevant income then becomes taxable under the
provisions of domestic law. In some cases, however, it would seem more appropriate to provide some form of treaty relief. Assume, for instance, that a taxpayer engages in an avoidance transaction for the purposes of transforming what would normally be cross-border dividends (taxable at source under the provisions of Art. 10(2)) into a capital gain on shares (exempt from source taxation under Art. 13(5) of the Model Tax Convention). In such a case, the application of the PPT rule would result in the denial of the benefits under Art. 13(5) but a tax administration may consider it appropriate to apply the relief provided under Art. 10(2), which could be done in a manner similar to how it would be done under the discretionary relief provision of the LOB 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.

16. **Drafting of the alternative “conduit-PPT rule”**

**Issue**

36. Paragraph 15 of the Commentary on the PPT rule (paragraph 17 of the Report) includes an alternative to the PPT rule that States may use in order to address treaty-shopping strategies commonly referred to as “conduit arrangements” that would not be caught by the LOB rule. Questions have been expressed about some features of that rule (e.g. whether the “all or substantially all” threshold might be too high and whether the reference to a payment made “directly or indirectly” and “at any time” might be too broad). It has also been suggested that examples should be added to illustrate the application of the alternative rule, in particular to explain that the rule is not intended to apply to a company merely because that company’s policy is to distribute most of its profits in the form of dividends (some of the examples found in the Annex to the exchange of notes between the United States and the United Kingdom concerning the application of the “conduit arrangements” rules of the 2001 treaty between these two States could be used for that purpose).

**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”.

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

**Issue**

37. Paragraph 14 of the Commentary on the PPT rule (paragraph 17 of the Report) illustrates how the PPT rule would apply through five examples. The justification for the result in some of these examples could be better articulated; also additional examples could be added to the Commentary in order to provide more certainty for taxpayers and tax administrations.
**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.

C. **Other issues**

18. **Application of the new treaty tie-breaker rule**

*Issue*

38. The new tie-breaker rule proposed in paragraph 39 of the Report provides that in the absence of an agreement between the competent authorities, a legal person that is a resident of each Contracting State under Art. 4(1) “shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States”. It will be necessary to clarify that the fact that the person would not be entitled to relief and exemptions under the Convention will not prevent the person from being considered a resident of each Contracting State for the purposes of the provisions of the Convention that do not provide reliefs and exemptions to that person (e.g. Art. 15(2)b)). It may also be useful to encourage competent authorities to address as quickly as possible requests that will be made under the new rule.

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

*Issue*

39. Subsection A.1(b)(vii) of the Report (at paragraph 42) includes a new anti-abuse rule dealing with permanent establishments located in third States. As currently drafted, the rule could be over- or under-inclusive in some cases. It is intended to review the drafting of the rule to address such cases.

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

**Issue**

40. Subsection A.2 of the Report (at paragraph 49) includes changes to the Commentary on Article 1 intended to clarify that the inclusion in tax treaties of the new general anti-abuse rule included in the Report will not affect the conclusions already reflected in the Commentary on Article 1 concerning the interaction between treaties and domestic anti-abuse rules. These conclusions will remain applicable, in particular with respect to treaties that do not incorporate the new general anti-abuse rule, and it is intended to review the changes included in paragraph 49 in order to make this clearer and to address more generally the issue of potential conflicts between treaties and domestic law.

41. Also, as mentioned in paragraph 5 of the Report, the changes to the Commentary proposed in paragraph 49 of the Report will need to be reviewed in order “to take account of recommendations for the design of new domestic rules that may result from the work on various Action items, in particular Action 2 (Neutralise the effects of hybrid mismatch arrangements), Action 3 (Strengthen CFC rules), Action 4 (Limit base erosion via interest deductions and other financial payments) and Actions 8, 9 and 10 dealing with Transfer Pricing.”

42. Additional changes to the Commentary on Article 1 and to the Commentary on other Articles will also be required in order to reflect the inclusion of the different anti-abuse rules found in the Report (e.g. the example of an LOB article currently found in paragraph 20 of the Commentary on Article 1 will be deleted as a result of the inclusion of the LOB rule in subsection A.1.(a)(i) of the Report).

**Issue on which comments are invited**

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