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OECD REVISED DISCUSSION DRAFT: BEPS ACTION 6, PREVENTING TREATY ABUSE

Dear Marlies,

Please find below BIAC's comments on the OECD Revised Discussion Draft on BEPS Action 6: Preventing Treaty Abuse, issued on 22 May 2015 (the "RDD").

BIAC continues to support the BEPS project to target clear instances of abuse, including in relation to tax treaties, and welcomes the OECD's work to improve international tax principles and to better align the taxation of profits with substance. However, to ensure that the project is successful, adequate time must be dedicated to developing rules – and refining their complexity – so that they can be objectively and consistently implemented, and consequently stand the test of time.

In relation to this last point, while we are supportive of any necessary changes to prevent Treaty abuse, we do feel it would be advantageous to governments as well as taxpayers to acknowledge that additional time is still needed before the project is "closed". There are three reasons for this:

- Some important concerns stated in earlier BIAC comments, have yet to be fully addressed.
- There are new proposals appearing in the RDD for the first time, too late in this final phase for proper comment and consideration by business.
- Most importantly, several of the proposals currently allow for unilateral disallowance of treaty benefits by a single treaty partner. This seems inappropriate in a process that is meant to drive towards international consensus and practice, rather than unilateral action.

We hope that you find our comments useful. And, as always, we would also be happy to help in any way that we can to refine these proposals in order to renew the confidence of governments in the modern Tax Treaty system. Tax Treaties have played a critical role in facilitating cross-border trade and investment – and spurring growth and jobs – over more than 50 years, and anything that diminishes their effectiveness is a detriment to us all.

Sincerely,

Will Morris

Will Morris, Chair
BIAC Tax Committee

BIAC THE VOICE OF BUSINESS AT THE OECD

BIAC Consensus High-Level Observations on the Revised Discussion Draft 22 May 2015 - 17 June 2015

Procedural

1. BIAC continues to support a common OECD framework to address Treaty Abuse issues. Treaties are principally designed to remove the barrier of double taxation to promote cross-border trade and investment. They are bilateral arrangements entered into by States to determine the agreed allocation of taxing rights. The unilateral denial of Treaty benefits based on subjective criteria should not only cause concern to taxpayers, but for governments too, as taxing rights may be unexpectedly usurped. The value of Treaties is significantly reduced if their application becomes less certain.

2. We recommend again, as a point of policy, that the OECD focus on aligning Treaty Abuse discussions with other BEPS actions, such as the work on Hybrid Mismatches. Many of the concerns identified in the RDD may fall away when other BEPS recommendations are adopted - allowing the Treaty Abuse work to focus on situations where Treaty benefits are claimed in inappropriate circumstances, rather than trying to use Treaties as a tool to tackle perceived avoidance, which should be addressed through domestic legislation.

3. The RDD addresses various concerns raised by Commentators. The RDD contains issues that broadly fall into three categories:

    a. No conclusion reached, to be discussed further at the June meeting of Working Party 1 ("WP1");

    b. Conclusion proposed on way forward, but without addressing business issues raised; and

    c. New points, proposed for the first time.

    In relation to category a), we would like to draw your attention to the previous detailed responses provided on 9 April 2014 and 9 January 2015, which we trust will be of assistance in preparing for the June meeting of WP1.

    Regarding category b), we are concerned that the issues previously raised by BIAC have largely not been addressed. We appreciate that the OECD will have considered these issues, but the reasoning for not addressing those issues is largely unclear. There is also no clear indication as to how the OECD proposes to ensure that, as the proposals are implemented in practice, the Treaty benefits are still available, and genuine business concerns are fully addressed. Rather than repeat all of our concerns in detail, we have set out below the key issues, which we would urge the OECD to reconsider in the context of tackling avoidance through aligned domestic legislation, rather than using Tax Treaties as a tool for revenue raising. Using Treaties as a tool to generate additional tax, risks damaging international investment, and undermining the valuable work of the OECD over the recent years promoting cross-border trade and investment.

    With respect to category c), we are alarmed that two significant proposals were included in the RDD, especially, since comments should be kept short and no public consultation will be held. We have commented further below on these two issues.

4. Overall, we have significant concerns about the direction of the various BEPS recommendations, including those made by Action 6. Those concerns relate to:

   a. coherence with other Action Items;

   b. the use of Treaties as a tool to raise revenue, when the perceived underlying avoidance is best addressed through domestic legislation;

   c. the lack of clarity over why business concerns have not been addressed; and

   d. the insertion of significant new proposals at such a late stage; and

   e. clarity as to how it is expected to allow flexibility for different intentions and aims of States, to be incorporated into a Multilateral Instrument.

Clarity, Certainty and Dispute resolution

5. Specifically, in relation to providing the necessary clarity and legal certainty of treatment for taxpayers' investments, Action 6 should make it clear that taxpayers must have the opportunity to seek pre-clearance regarding access to treaty benefits.

6. Furthermore, there should be unobstructed access to a mutual agreement procedure (MAP) and mandatory binding arbitration, to ensure the Treaty is being applied to residents as intended by the relevant States when entering into the Treaty.

7. Finally, although we welcome the additional guidance offered by the RDD, we also request that the proposals (including proposed changes to the Commentary) provide further appropriately detailed examples, as guidance on the application of both the proposed LOB and PPT rules, where currently there remains significant lack of clarity.

8. As the proposals do not yet meet these three conditions, it will be extremely difficult to determine with an appropriate degree of certainty, whether reduced withholding rates may apply under a certain treaty.

Brief High-Level Comments on Specific Proposals

9. ***Funds.*** We welcome the proposals on CIVs. We note the non-CIV funds considerations are ongoing, and would draw your attention to our previous submissions on this topic.

10. ***The current PPT test.*** The Principal Purpose Test ("PPT") test ("one of the principal purposes") remains widely framed. Whilst we welcome the additional examples in the Commentary, and the recommendation to form an advisory panel, there remains a risk of misinterpretation or misapplication by tax authorities. Also, the various technical examples provided on the working of the PPT rule effectively show the difficulty that taxpayers will have in proving the requisite facts to prevent denial of treaty benefits. We continue to encourage a focus on substance. We would recommend that:

    a. if two tax authorities have differing views, there should be a *prima facie* assumption that it is ***not*** reasonable to conclude that obtaining treaty benefits was one of the principal purposes; and

    b. a clear recommendation should be made that disputes under the PPT rule will be rectified by mandatory arbitration. Currently, paragraph 82 of the RDD simply proposes to leave such considerations to work under Action 14.

11. ***Publicly listed companies***. The issues highlighted in paragraph 63 of the RDD, and commented on in previous submissions, remain a concern. Whilst the OECD notes that listed entities are unlikely to be used for tax avoidance, no changes have been made to reflect that. Although the guidance provided in paragraph 67, as to what may be considered to constitute a recognised stock exchange, may be of assistance, it does not address the concerns outlined in paragraph 63. We recommend the simplified Limitation On Benefits ("LOB") rule to be applied to publicly listed entities (as drafted in paragraph 3 of the RDD), and that any (extremely rare instances of) avoidance encountered are addressed through the PPT rule.

    Paragraph 46, which primarily aims to address concerns on the simplified LOB, seems to result in denial of benefits unless the listed entity is resident in the same territory as the entity seeking Treaty benefits. This seems overly restrictive, and we would recommend withdrawing the changes proposed in paragraph 46. We note the OECD's concern that a tax haven could be inserted in the ownership chain, but the changes proposed to paragraph 46 do not address this concern in cases where a publicly listed entity is resident in the same territory as the entity seeking Treaty benefits. In addition, such concerns over a tax haven being inserted should, in any case, be caught more appropriately by the PPT (or the "anti-conduit" version of the PPT). Therefore, paragraph 46 seems unnecessary and creates further restrictions on genuine business situations.

12. ***Intermediary Companies***. The RDD notes that requiring every intermediary entity to be a resident of the contracting state was unduly restrictive. However, no position is taken on the issue, deferring this until the June meeting. We would draw attention to our previous submissions, with detailed worked examples, together with our specific observations in relation to Publicly Listed entities above. We strongly recommend that the requirement to consider all intermediary companies be removed as being unnecessary, time consuming, and overly restrictive.

13. ***Active Business Test.*** The RDD acknowledges previous comments regarding headquarters companies and holding companies. However, the RDD fails to address the issue either positively or negatively. The RDD also does not address situations of mixed active and investment income. We encourage clarification on both of these issues in a way that ensures treaty benefits will be granted to bona fide business activities. In particular, we are concerned over the possible inconsistency between the LOB and the PPT. Examples G and H provided in the Commentary to the PPT seem effectively to state that treaty benefits should be granted to companies that perform regional headquarters operations in one way or another. If this understanding is correct, it is counterintuitive for the LOB not to grant treaty benefits to a regional headquarters.

    Finally, the RDD adds two new proposals to the deemed activities section. The first is the special tax regime (which is addressed in more detail below), and the second is that a connected party needs to be in the "same or similar" line of business. This requirement is ambiguous and unclear how it ties to the "in connection or incidental to" test that establishes the necessary relationships between the related businesses. The current Active Business test is longstanding and well understood. We would draw your attention to our previous detailed submissions on this topic.

14. ***Derivative Benefits***. The RDD acknowledges the key comments presented to the OECD but again fails to address them. These issues remain of great concern to business, and we encourage the OECD to give them due consideration. We are happy to discuss the

comments already provided if that would be of assistance, in advance of the June WP1 meeting.

Of equally great concern, is the addition of two new concepts at such a late stage in the process:

a. The “special tax regime”; and

b. Changes to Treaty partner’s domestic law.

The “special tax regime” would apply if a person attracts special tax treatment (either through rate or tax base), with the proposed result that they should receive no derivative benefits. It is considered that States should assess such risks and special regimes before entering into a bilateral Treaty. We believe that issues relating to “special tax regimes” are best addressed through the OECD’s work on Harmful Tax Practices. We note too, that in relation to interest payments for example, in addition to potential disallowances as a result of Action 4, the proposals under Action 6 may create further restrictions, and this is once again effectively endorsing the use of Tax Treaties as a tool for revenue raising. Again, avoidance is best addressed through coordinated domestic legislation, and Treaties should remain focused on enhancing international trade by removing double taxation. We strongly recommend that this late addition be removed, and any concerns over such tax regimes be addressed more appropriately outside Action 6.

The second new addition would result in a unilateral and automatic denial of treaty benefits if there is a subsequent change in domestic legislation, exempting “substantially all” foreign source income. It is inappropriate to have automatic and unilateral denial of treaty benefits, which creates uncertainty for all taxpayers. It is not only undesirable, but in some States, such a trigger to remove intended Treaty benefits may require ratification. The preferred solution would be to renegotiate the Treaty where there is a concern over changes in domestic law of the Treaty partner.

15. ***LOB Discretionary Relief.*** The RDD notes in paragraph 28 some of the comments provided by business, but does not explain why disregarding those comments is consistent with the aim of Action 6. Clarification as to why those comments have not been addressed would be constructive, and would provide a better understanding on the future interpretation of the proposals. We draw your attention finally to our related comments in previous submissions.

The RDD proposes in paragraph 32 that as long as a competent authority has properly exercised the discretion granted by the discretionary relief provision of the LOB rule, that provision has been complied with and it cannot, therefore, be argued that taxation is not in accordance with the provisions of the Convention. This seems to be intended to deny a taxpayer the possibility to invoke MAP regarding this decision. This seems unfair as MAP typically will involve both contracting states, whereas the residence country competent authority may not have been involved in a denied request under the discretionary relief provision. We therefore request that the related changes in the Commentary on paragraph 5 of the LOB rule (i.e. paragraph 65) as proposed in paragraph 32 of the Draft, be reconsidered.

16. ***Tie-breaker rule***. We note that the RDD highlights the key concerns that competent authorities should be obliged to determine the State of residency within a fixed timeframe and that failure to do so should result in MAP arbitration. The RDD reduces “required” to “encourages”; a “fixed timeframe” to “as quickly as possible”; and, by omission, appears to decline from according the protection of MAP arbitration. These are genuine – and growing

– business concerns over commercial structures, and we encourage the OECD to reconsider the above points, together with our previous submissions. Again, we advocate the continued use of the effective place of management tie-breaker.

17. We note again 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 fully coordinated with, and addressed in, Action 14.