BIAC THE VOICE OF BUSINESS AT THE OECD

William Morris
Chair, BIAC Tax Committee
13/15, Chaussée de la Muette, 75016 Paris
France

Achim Pross
Organisation for Economic Cooperation and Development
2 rue André-Pascal
75775, Paris, Cedex 16
France

Submitted by email: aggressivetaxplanning@oecd.org

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Ref: DISCUSSION DRAFT: BEPS ACTION 2 – "BRANCH MISMATCH STRUCTURES"

Dear Achim,

Thank you for the opportunity to comment on the Discussion Draft: BEPS Action 2 – Branch Mismatch Structures issued on 22 August 2016 ("the Discussion Draft"). We recognise and thank the OECD for the time and effort put into this draft.

BIAC has always acknowledged that some hybrid transactions can lead to exactly the base erosion and, in some cases, double non-taxation, that the G20 leaders identified as requiring action. Branch mismatch arrangements do not always result from differences in the tax treatment of an instrument or entity and so are not straightforwardly "hybrid" but in some circumstances can lead to similar outcomes as the result of differences in allocating income and expenses between a branch and head office jurisdiction. BIAC believes, however, it is important that it is recognised that the vast majority of branches, and transactions undertaken by branches, are not "planned" to gain a tax benefit, and that in the vast majority of cases those instances which the Discussion Draft may be describing as branch mismatches are simply a feature of how the tax rules in different jurisdictions interact.

In addition, we note that a significantly increased number of "new" permanent establishments are anticipated as the BEPS Action 7 proposals are implemented. Accordingly (i) the administrative burden of complying with these rules, and (ii) exactly how profits and losses will be allocated between head offices and permanent establishments (and any mismatch implications of this) will be extremely complex, and is, currently, somewhat unclear.

The Discussion Draft addresses comprehensively the types of branch structures that could lead to mismatches. However, the recommendations to remedy these mismatches are not as thoroughly developed. Our key concern with this draft is that it is not easy to see how the recommendations could be effectively applied without creating a real risk of double taxation (for example where one of the counterparties operates in a country with a worldwide -- as opposed to territorial -- tax system), and placing a significant burden on business to determine where the rules will apply. The interaction of these proposals with international and other domestic rules will also be very complex. BIAC hopes that WP11 will acknowledge these concerns, and we stand ready to help the WP refine these rules so that they are proportional and workable.

Again, we thank you for the opportunity to comment on the Discussion Draft.

Sincerely,

Will Morris

Will Morris, Chair
BIAC Tax Committee

13/15 Chaussée de la Muette, 75016 Paris, France
Tel. +33 (0)1 42 30 09 60 | Fax +33 (0)1 42 88 78 38
email: biac@biac.org | www.biac.org

Introductory Comments

1. BIAC advocates strongly for pro-growth tax systems which facilitate cross-border trade and investment, enhancing economic growth and efficiencies in the international market place. Cross-border trade and investment must be supported by pragmatic and workable international and domestic rules which clarify which jurisdiction has the right to tax income and ensure therefore that income is not subject to double taxation.

2. The OECD/G20 BEPS project aims to ensure that gaps and mismatches in tax rules cannot lead to the artificial shifting of profits to low or no-tax locations. BIAC fully understands that there is a concern that certain mismatches between countries can lead to instances of double non-taxation and that additional rules may be required to support the hybrid recommendations included in the Final Action 2 Report released in October 2015.

3. The Discussion Draft is comprehensive in identifying the branch structures that would lead to mismatches. However, the recommendations to remedy such mismatches are not as comprehensive and BIAC has serious concerns about the difficulty of applying them in practice and the corresponding risk of double taxation. The guidance in the Final Action 2 Report comprised 15 chapters and two annexes and addressed in detail the complex issues that will arise in the implementation of the anti-hybrid rules in domestic law and treaties. It is not clear whether the OECD intends to provide a similar level of detail to deal with the even more complex issues and interactions that arise from extending the principles of the Action 2 report to branch mismatch structures.

4. While BIAC does not defend hybrid mismatches, or the branch mismatches identified as a cause of BEPS in this draft, as a general policy matter, we remain concerned about both the Final Action 2 Report and the Discussion Draft. Although the bulk of this response will be focused on the Discussion Draft many of our general points apply also to the recommendations under the Final Action 2 Report.

5. The vast majority of branches are not planned into for tax purposes, and the vast majority of cases those instances which the Discussion Draft may be describing as branch mismatches are simply a feature of how different jurisdictions' tax rules interact. Whether branches actually create mismatches is itself something which is not straightforward to identify. Even in related party situations, the tax treatment of payments in another jurisdiction is often unclear, and accounting functions are not always coordinated in such a way that it is easy to determine. In unrelated party settings these problems multiply. We would request that these recommendations be drafted to be more realistic about this difficulty, and provide solutions that are workable for taxpayers.

6. It is not clear exactly which countries will choose to implement any or all of the recommendations, when they plan to do so, or how the interaction with the local legislative processes will result in differences between countries in terms of application or timing. The draft appears to envisage implementation through complex changes to domestic laws, but the interaction of these changes with treaties and worldwide tax systems is not explored. If this is not more thoroughly addressed by the OECD there will be an increase in tax uncertainty for business and a risk of double taxation and subsequent disputes between countries.

The Business and Industry Advisory Committee to the OECD
Comité consultatif économique et industriel auprès de l'OCDE
13/15 Chaussée de la Muette, 75016 Paris, France
Tel. +33 (0)1 42 30 09 60 | Fax +33 (0)1 42 88 78 38
email: biac@biac.org | www.biac.org

7. Aligning the tax impact of cross-border transactions involves inherent complexity. Although complexity should not be a barrier to action, the recommendations should not come at the price of undue uncertainty and the compliance obligation placed on business should be kept to the necessary minimum. Even if implemented in a coordinated manner, the complexity of the proposed rules will create substantial compliance difficulties both for taxpayers and tax administrations, and will complicate the allocation of taxing rights between jurisdictions, increasing the risk of double taxation.

8. Sectors such as financial services, and oil and gas will be particularly impacted by these rules as they typically conduct various parts of their operations through branches (for non-tax, commercial and regulatory reasons) than other sectors. Financial services businesses are already facing uncertainty and increased difficulty in applying international tax rules, as a result of the Action 2 recommendations on hybrids, the current lack of final Action 4 recommendations in respect of the sector, as well as the interaction of tax rules with other regulatory requirements they face.

Detailed comments

Interaction with worldwide foreign tax credit system

9. The Action 2 Final Report on Hybrids did not consider in sufficient detail how the recommendations would interact with worldwide/foreign tax credit systems.

10. The treaty section of the Action 2 Final Report also raises issues concerning the interaction of the hybrid rules with worldwide/foreign tax credit systems. Paragraph 446 in Chapter 15 of the Action 2 Final Report provides that: "double non-taxation situations may arise in the application of the credit method by reasons of treaty or domestic law provisions that either supplement, or depart from, the basic approach of Article 23 B (Credit Method) of the OECD Model Tax Convention (OECD, 2014). One example would be domestic law provisions that allow the foreign tax credit applicable to one item of to be used against the State of residence's tax <u>payable on another item of income</u>."

11. A number of countries do not follow the OECD Model Treaty approach in Article 23B, notably the US. That approach is at best a "per country" approach and possibly could be read as an item-by-item approach, which is incompatible for countries that operate a worldwide foreign tax credit system.

12. A foreign tax credit system will generally result in less overall untaxed income. Countries with foreign tax credit systems need to balance the potential for cross-crediting with the administrative burden imposed by very restrictive foreign tax credit rules. Similarly, if countries have a sovereign right to choose an exemption/ territorial system, then they may also appropriately choose a worldwide credit even though that might permit some cross-crediting of taxes from a high-tax jurisdiction against income earned in a low-tax jurisdiction.

13. There are a range of reasonable choices from which sovereign countries may choose a method to eliminate double taxation and they should not need to choose the narrowest option. We do not consider that it is appropriate for the branch mismatch rules to imply that a foreign tax

13/15 Chaussée de la Muette, 75016 Paris, France
Tel. +33 (0)1 42 30 09 60 | Fax +33 (0)1 42 88 78 38
email: biac@biac.org | www.biac.org

credit system must operate on country by country basis, (rather than, for example, allowing pooling of countries' profits/losses and taxes paid).

14. Under certain worldwide taxation systems (notably, that of the United States), worldwide income is taxed and relief for double tax provided through the granting of a foreign tax credit. It is not clear how these rules could apply and would work in this case. The United States Council for International Business' (USCIB) response to this discussion draft provides detail in respect of this problem and, further, offers solutions. BIAC supports the solutions proposed by USCIB.

Ordinary income

15. The draft provides that a rule should apply in the case where a payment is deducted but not included in the "ordinary income" of the payee or in another jurisdiction.
16. However, an exact definition of the term ordinary income is not provided[1]. It is not clear whether capital gains income should be classified as "ordinary income". Paragraph 15 of the Discussion Draft notes that attributing ordinary income does not exclude it from benefiting from a tax exemption, but whether this would be the case would presumably depend on the relevant domestic legislation in respect of the mismatch rules and the nature of the tax exemption.
17. Further, given in most countries taxable profits are calculated from accounting profits, it is unclear how those tax deductions and income inclusions relating to accounting accruals (e.g. fair value movements) ought to be treated and whether they could create mismatch situations.
18. The timing of when amounts are subject to tax is not covered in the paper. The OECD should be clear that if an amount is to be subject to tax, even if it is not during the same period it would be brought into account in another jurisdiction which would subject it to tax under the branch mismatch rules, it should be treated as included in ordinary income and the hybrid mismatch rules should not apply. If governments are concerned about arrangements which intentionally defer an income inclusion for a significant time after the deduction is given, they should target this with a specific anti-avoidance rule which includes a motive test to ensure that there is no impractical general requirement to identify when all payments are recognised.
19. The treatment of foreign exchange differences and timing differences should also be clarified in the Discussion Draft. The Action 2 Final Report is clear that such differences should not be treated as hybrid mismatches and a corresponding clarification should be made in respect of forex under branch mismatch situations.

[1] We note that paragraph 32 of the Final Action 2 Report defines ordinary income and therefore it could be reasonably assumed that the same definition should be used in this report. The Final Action 2 Report definition requires that a foreign tax credit is only brought into account if it is computed on an item-by-item basis, so an inclusion under a worldwide taxation system (e.g. the US system), could result in items that are subject to tax not being included as "ordinary income" (and accordingly the third country would deny the deduction). This problem applies to both hybrid mismatches and branch mismatches.

13/15 Chaussée de la Muette, 75016 Paris, France
Tel. +33 (0)1 42 30 09 60 | Fax +33 (0)1 42 88 78 38
email: biac@biac.org | www.biac.org

CFC rules

20. It is set out in section 2 (diverted branch payments) that a receipt which is fully attributed to the ultimate parent of the group under a controlled foreign company (CFC) regime and has been subject to tax at the full rate should be treated as having been included in ordinary income for the purposes of the branch mismatch rule.
21. A CFC charge could nevertheless cause double taxation in any of the branch mismatch situations identified, particularly imported branch mismatch structures. The final draft should ensure that in <u>all cases</u> income that has been subject to tax under CFC rules is treated as included in ordinary income, or that CFC rules provide credit for taxes that arise as a result of such provisions. For example, a "diverted branch payment" may not be picked up in the head office or branch country, but could still be picked up by the CFC rules in the jurisdiction of an ultimate holding company of the group when it looks at the income of the entire legal entity.
22. As noted above, there is a need for a defense against double taxation via an exclusion for income taxed under CFC rules. However, we do have some concerns about the difficulty of determining and proving whether income has been subject to a CFC charge.
23. The entity applying the CFC rules may be far away in the chain of ownership from the entity applying the branch mismatch rules in the corporate structure of a MNE. The finance and legal team advising an entity that may be subject to branch mismatch rules may also be different to the team applying CFC legislation, and so it will not always be clear whether income has been subject to a CFC charge or not.
24. Further, it is difficult to see how a CFC inclusion can be effectively audited. A parent company is unlikely to be willing to share its tax return and details of its CFC calculation with multiple tax authorities, and therefore the burden of proof will be difficult to obtain. Tax administrations will struggle to verify whether the income has been subject to taxation and in order to be able to effectively audit this, they would require knowledge of other countries' CFC legislation and how it has been applied (particularly where there are areas of uncertainty in the CFC law, perhaps where there is ongoing litigation in relation to the CFC rules). In order to avoid this, we suggest a certification process by the CFC, subject to further verification that could be demanded by the other jurisdiction.
25. We would recommend that the OECD acknowledge in the final branch mismatch report that: (i) establishing a CFC inclusion can be challenging due to the need for information from the shareholder entity that has undergone the inclusion, (ii) a company should be able to rely upon a certification from its shareholder for purposes of claiming an exception resulting from a CFC inclusion by that shareholder; and (iii) any further documentation requirements upon audit should be limited to the minimum amount necessary to confirm the accuracy of the shareholder's representation (e.g., production of an appropriate excerpt from the shareholder's tax return).

13/15 Chaussée de la Muette, 75016 Paris, France
Tel. +33 (0)1 42 30 09 60 | Fax +33 (0)1 42 88 78 38
email: biac@biac.org | www.biac.org

26. There is also a risk of double taxation if income is subjected to certain other types of taxes, such as the UK's extra-territorial Diverted Profits Tax. BIAC would prefer if the recommendation could be drafted broadly enough to guard against double taxation in these circumstances.

Complexity of administration and compliance

27. Chapter 9 of the Final Action 2 Report set out a number of design principles in respect of the Action 2 recommendations, including requirements:

    (i) to be workable for taxpayers and to keep compliance costs to a minimum; and

    (ii) to be easy for tax authorities to administer.

    We are not certain that the proposals currently meet either of these aims.

28. There is some unavoidable complexity inherent in cross-border rules, because determining their applicability requires an understanding of a tax position in two countries (or, under the proposed rules, in some cases, multiple countries).

29. The tax treatment of a payment/receipt in a country, and consequently the results under the proposed branch mismatch rules, will therefore be complicated and in many cases will create uncertainty for taxpayers.

30. Moreover, under the proposed rules, in the case of one type of transaction, Imported Branch Mismatches, a country would deny a deduction for a payment because it considers, on the evidence available to it, that other countries do not apply the proposed rules to an associated branch mismatch transaction. This gives rise to particular complexity and difficult issues regarding the allocation of taxing rights across jurisdictions. For example, an MNE may provide funding through various intercompany sources which may include cash pooling arrangements, where excess liquidity is swept into a common pool under a loan arrangement and then passed to another part of the business. The treatment of corresponding interest deductions will depend on the location of the pooling vehicle (and whether it itself is subject to the imported mismatch rules). In order to ensure compliance, each company making a payment to a pooling entity would have to trace whether the receipt is used to on-pay interest, in case it is passed to a PE where a mismatch is created. A further complexity would arise if the head office jurisdiction's income is subjected to a CFC charge by another entity (which is covered in more detail below).

31. Both taxpayers and tax administrators would need to understand fully the tax treatment in two other countries (or more, if CFC rules must be considered) in respect of each potential mismatch transaction.

32. The corresponding burden on tax officials in administering these proposed rules and on taxpayers in complying with the rules should not be underestimated.

33. The rebuttal was made during the work on hybrid mismatches that taxpayers can avoid this problem by not entering into mismatch arrangements. However, branch structures are very often simply part of the way different jurisdictions interact for tax purposes. Finance and tax teams (like tax authorities) have a significant compliance burden which requires considerable local expertise. Accordingly, where mismatches have not been deliberately structured into,

these local specialists may not be aware of the tax rules in the counterparty jurisdiction for every transaction, and accordingly determining every mismatch of the types identified in this report will be challenging. Tax authorities and tax departments (even in large MNEs), may simply lack the resource to manage the volume of new compliance and audit obligations being generated. As noted above, an Action 2 design principle is to "keep compliance costs to a minimum", and we have set out below a suggestion that may assist in meeting this objective.

34. The BEPS work on Action 7 and lowering of the PE threshold means there are likely to be a greater number of PEs going forward. Although in reality we expect many of these to be "trading" branches, to which these rules may not be particularly relevant[2], it could still lead to an additional administrative requirement for businesses that need to undertake work to confirm that there are no mismatches.

35. We strongly encourage the OECD to provide that substantive trading permanent establishment operations be excluded from counteraction under the branch mismatch rules, in order to ensure that taxpayers do not have to spend significant resources completing assessments of their transactions to ensure that none of them are technically creating a mismatch. In such a case, all that is in practice happening is that the two jurisdictions have slightly differing approaches to the precise attribution of income and expenditure to the PE, but nonetheless arrive at substantially the same overall taxable profit attributable to the PE.

36. The OECD should also encourage jurisdictions to undertake comprehensive consultations before branch mismatch rules are incorporated into domestic law to identify particular issues that may arise (for example, interaction with the different ways that branch exemption regimes work in practice).

Interaction between domestic and international law

37. We are concerned that the Discussion Draft does not include a thorough analysis of the interaction between the domestic law change recommendations and treaties.

38. For example, a country may have existing treaty obligations that would limit the effectiveness of domestic law changes calling for limitations on a branch exemption (e.g., Article 23), or limitations on a branch's deduction of notional payments to a head office (Article 7), or denial of a deduction on payment to a separate entity (Article 24).

39. Any such domestic law recommendations should be accompanied by recommendations for making the appropriate treaty changes that would allow the desired solution to be effective. In no event should countries be encouraged to attempt to override their treaty obligations through domestic law changes.

40. Moreover, the recommended solutions under the Discussion Draft should be coordinated with solutions proposed elsewhere (e.g., the proposed exempt PE rule in the Action 6 Final Report) so

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[2] We note that until the OECD's work on allocation of profits and losses to PEs is complete it is not possible to say this with certainty.

13/15 Chaussée de la Muette, 75016 Paris, France
Tel. +33 (0)1 42 30 09 60 | Fax +33 (0)1 42 88 78 38
email: biac@biac.org | www.biac.org

that countries are not led to trigger multiple countermeasures to the same problem. Again, that would dramatically increase the risk of double (or greater) taxation.

41. It should also be noted that the implementation of the Final BEPS Action 7 recommendations, will result in a significant increase in the number of PEs (and where this is implemented through the multilateral instrument ("MLI") these cases are imminent and extensive).

42. In negotiating a bilateral treaty, considerable time is spent by both countries in discussing examples and attempting to reach agreement on the exact definition of and requirements for of a PE to exist in the context of the specific treaty being negotiated. Where treaties are changed through the MLI, it is not expected that the same degree of discussion will take place, and BIAC is therefore concerned that, for each bilateral treaty amendment, there could be differences in interpretation of the applicability of the previous understanding to the new standard[3]. BIAC has set out in concerns in respect of the multilateral instrument in more detail in our letter of 30 June 2016, and in respect of the change to the PE rules in our letters of 9 January 2014, 12 June 2015 and 5 September 2016.

Other

43. Although the rules naturally need some in-built flexibility to allow countries to retain discretion over their own policies, there must also be limits on the scope of the rules, such that they do not unduly impinge on other countries' policies.

44. The proposals are, in effect, anti-avoidance rules, but the avoidance they are concerned with is of a type that depends on the interaction of at least two states' laws. While the mismatch may be an unintended consequence of the interaction of different jurisdictions' tax rules, in other cases it may be the result of an intentional policy decision on the part of one or more of the jurisdictions, such as an investment incentive or specifically targeted deduction. The proposed recommendations run a risk of undermining domestic policies that may be based on fiscal, economic and political considerations[4].

45. In our view the rules should be narrowed in scope to avoid this. For instance, they could be drafted to only apply when the parties enter into structured transactions to achieve a tax avoidance objective. Additionally, the definition of what constitutes "ordinary income" should be defined broadly in the final branch mismatch report, to ensure situations such as the one covered in footnote 4 do not create branch mismatch situations.

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[3] For example, where a head office country does not recognise a PE and therefore does not exempt profits from taxation, yet the branch jurisdiction recognises and taxes the PE, this will frustrate policy aims where the head office seeks to exempt certain types of income.

[4] For example, under a targeted R&D regime, a country may choose to try to stimulate a certain type of economic activity by treating certain profits as "R&D income" or similar subject to tax at a reduced rate. The OECD has separate rules under BEPS Action 5 to ensure that such preferential regimes do not lead to harmful base erosion. Therefore, as long as the regime is compliant with the OECD standard, it seems counterintuitive that if the rules in question are applied to branch profits, they could be undermined through another territory's branch mismatch rules. We note that we would not expect patent box or similar income to be excluded from ordinary income just because it is subject to tax at a reduced rate, but this remains unclear without clarity in the definition of ordinary income.

13/15 Chaussée de la Muette, 75016 Paris, France
Tel. +33 (0)1 42 30 09 60 | Fax +33 (0)1 42 88 78 38
email: biac@biac.org | www.biac.org

46. The position in respect of claiming withholding tax credits should also be confirmed. We presume that the credit would be claimed in the jurisdiction where the income is ultimately subject to tax (i.e. inclusion income). If withholding tax is levied on a payment, jurisdictions should not be able to also deny a deduction for corporate income tax purposes.

47. The Discussion Draft is also silent on partnerships. Although they may be less likely to be structured into, it would be useful to have some guidance on this as in these cases it will be more difficult to ascertain the other party's tax treatment of a transaction.

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Comité consultatif économique et industriel auprès de l'OCDE
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Questions for public consultation

Section 2: Branch payee structures that give rise to D/NI outcomes

1. Are there any practical issues that could arise in denying the benefit of the branch exemption for a payment that is disregarded, exempt or excluded from taxation under the laws of the branch jurisdiction?

48. Yes. The rule attempts to neutralise mismatches in the allocation of income between the head office location and branch under the respective laws of these two jurisdictions. However, this should be determined with reference to the relevant tax treaty in place (if there is one) and subject only to domestic rules in areas the treaty does not cover.
49. For example, in the UK where branch mismatch rules are already being legislated, there were some unintentional, and harmful, consequences in the first draft, which was not widely consulted on. For example, where a UK branch election is made there was a risk that deductions which have corresponding taxable income may have been denied. A head office jurisdiction in the UK, under the draft rules, would tax either: (i) the worldwide profits of the entity, arising from external transactions; or (ii) only the head office jurisdiction profits, having exempted the branch (note that the exemption is irrevocable).
50. The branch mismatch rules in the UK, which were drafted in line with the Discussion Draft (albeit before its release), apply in all cases except where there is sufficient dual inclusion income. There is not any dual inclusion income where a UK branch exemption applies (for overseas permanent establishments of UK companies), nor where there is an overseas branch profits exemption (for UK permanent establishments of overseas companies). Where a UK company does not operate a branch exemption, there may, nonetheless, be a shortfall in dual inclusion income due to commercial circumstances in certain accounting periods.
51. In BIAC's view, it is not appropriate to create a tax charge under the mismatch legislation to counteract the proper deduction of the expense of a substantive, actively trading permanent establishment operation simply because it has low revenues.
52. The proposed approach thus seems to create undesirable adjustments where a branch computes its profits under the separate enterprise approach, which involves obtaining a range of tax deductions for amounts which are treated as payments to the head office jurisdiction, and those deductions cannot be directly traced to a share of a third party expense incurred by the enterprise. We believe that a range of such deductions are likely to arise in substantive commercial branch operations, and which are not abusive. Hence we believe the rule needs to better focus on any arrangements which are put in place with a tax related principal purpose, as set out above.
53. The way in which the proposed rules will interact with other domestic regimes has not been analysed comprehensively in the short period of time available to review the Discussion Draft, but we would expect other examples to arise.

2. Are there any practical differences between reverse hybrids, on the one hand, and disregarded branch and diverted branch payment structures, on the other, that would justify a different approach to that set out in Chapters 4 and 5 of the Action 2 Report?

13/15 Chaussée de la Muette, 75016 Paris, France
Tel. +33 (0)1 42 30 09 60 | Fax +33 (0)1 42 88 78 38
email: biac@biac.org | www.biac.org

54. BIAC's view is that it is likely to be more challenging to determine whether the disregarded branch or diverted branch payment rules are triggered, given the relatively more ambiguous and fact-intensive standards for determining whether a presence rises to the level of a PE or branch and whether income is attributable to a branch, as compared with the question of whether an entity is a reverse hybrid.

3. Should the branch payee mismatch rule apply only to payments made under a structured arrangement or between members of the same control group?

55. BIAC recommends that these rules should be limited to apply only to payments made under a structured arrangement between members of the same control group (or within the same legal entity).
56. It is often not straightforward to ascertain the tax treatment of the other side of a transaction within a controlled group. This difficulty will be greatly increased in respect of transactions with unrelated parties.
57. We have explained above the rationale for focusing any counteraction on any arrangements which are put in place with a tax related principal purpose.

4. Are there any practical differences between hybrid entities and deemed branches and diverted branch payments that would justify modifying the scope of the rule or the guidance on the application of the structured arrangement rule to these types of branch mismatches?

58. One important difference is that the OECD has already published detailed standards for determining the existence of a notional separate entity in the form of a PE (i.e., Article 5) and for determining whether income is attributable to a PE versus the head office (i.e., the "Authorised OECD Approach" or "AOA"), whereas there is no comparable international standard or consensus around countries' rules for characterizing entities or for considering income as attributable to one entity versus another.
59. That means that this Discussion Draft's prescribed countermeasures to supposed branch mismatches, which are designed to ascribe taxing rights to a particular jurisdiction, may conflict with the results that could be achieved through consistent application of the existing standards already prescribed by the OECD.
60. If income is attributed under the AOA by the branch country, but by a non-AOA approach in the head office country (or vice versa), this could result in a hybrid branch mismatch. We believe that the simplest and most appropriate remedy is for all countries to commit to consistent adoption of the OECD's guidelines on attributing profits to permanent establishments under the AOA, rather than implementing domestic rules that add an additional layer of complexity in an effort to undo the mismatch where it results in double non-taxation (but not where it results in double taxation).

5. Do the above paragraphs provide a clear explanation of the intended interaction between the branch payee mismatch rule and the ordinary rules for allocating income to a branch (including

13/15 Chaussée de la Muette, 75016 Paris, France
Tel. +33 (0)1 42 30 09 60 | Fax +33 (0)1 42 88 78 38
email: biac@biac.org | www.biac.org

any rules consistent with those set out in Section 2.3 limiting the scope of the branch exemption)?

61. No. The paragraphs are confusing. For example, they call branch payee mismatch rule "the primary (and, in effect, only)" rule for neutralising disregarded branches and diverted branch payments, while at the same time appearing to recommend a limitation on the branch exemption as the primary means of solving those mismatches.
62. As we hope is clear from our foregoing comments, we do not believe that a counteraction under a rule for branch mismatches is appropriate where there are slight differences in the precise attribution of income and expenditure to the permanent establishment but both jurisdictions nonetheless arrive at substantially the same overall taxable profit for the permanent establishment. We also believe that recommendations which essentially require an assessment of two jurisdictions' views as to the nature and extent of every item of branch expenditure and income will be impractical and unworkable if applied to substantive commercial branch operations.

6. Should a payment to a branch be treated as included in income for the purposes of the disregarded branch or diverted branch payment rules if the payment is taken into account under the CFC rules in the parent jurisdiction?

63. If a payment is taken into account under the CFC rules in a parent jurisdiction it should treated as included in ordinary income. If it were not treated as ordinary income, there may be double taxation, which the OECD and BIAC agree is harmful to cross-border trade and not in line with the aims of the BEPS project. See our comments above in paragraphs 20 – 26.

7. Do the paragraphs above provide a clear explanation of when a disregarded branch and diverted branch payment will be treated as having given rise to a mismatch in tax outcomes?

64. No. As indicated above, the Discussion Draft does not clearly indicate what is meant by inclusion as "ordinary income". It does not go into the detail of the Final Action 2 Report regarding distinctions between mismatches due to timing and base differences versus mismatches due to differences in the geographic attribution of the income as between the branch and the head office.

8. What is the appropriate legal test for determining whether a payment made under a branch payee structure has given rise to a branch mismatch?

65. The branch mismatch rules should be triggered only in cases where there is a mismatch in treatment between related parties or under a tax structured arrangements.
66. Even in related party cases, we would propose that they are limited to cases where there is a tax avoidance motive to a transaction, in order to (i) avoid payment by payment analyses, (ii) prevent the unwarranted displacement of the normal process of the attribution of profits to

permanent establishments; and (iii) prevent the general over-riding of branch exemption regimes.

9. What other guidance (if any) is required to explain the intended scope of the branch payee mismatch rule.

67. The scope of these rules should be restricted in a pragmatic way per our detailed comments above.

Section 3: Deemed branch payments

10. Are there any practical differences between disregarded hybrid payments, on the one hand, and deemed branch payments on the other that would justify a different approach to that set out in Chapter 3 of the Action 2 Report?

68. No comments

11. Are there any practical issues that could arise in applying the branch mismatch rules to a deemed payment between the branch and head office?

69. Yes, see the practical issues as set out in our general comments.
70. It will be very difficult to identify deemed payments if the basis of calculation of income is not otherwise on the same basis (despite the definition provided that it should not include any deemed payment that is calculated with reference to a third party expense of the taxpayer). For example, in the case where the US is the residence country and taxes all of the income of the branch, this should be sufficient, despite the fact there is not a specific law or regulation including the deductible payment. Denying the deduction in this case will mean that the income is recorded in two jurisdictions and subject to double taxation.

12. Do you agree that a payment that is treated (for tax purposes) as made between the branch and head office but which, in practice, results in an allocation of third party expenses should be outside the scope of the deemed branch payment rule?

71. BIAC agrees that these payments should be outside the scope of these rules, but considers that this does not go far enough to prevent undesirable consequences, as set out above.

13. Do you agree that payments that represent or are calculated by reference to a third party expense should fall within the scope of the DD branch payment rules discussed in Section 4 below?

72. No comments.

13/15 Chaussée de la Muette, 75016 Paris, France
Tel. +33 (0)1 42 30 09 60 | Fax +33 (0)1 42 88 78 38
email: biac@biac.org | www.biac.org

14. Is it practical to distinguish between deemed and DD branch payments based on whether the notional payment is treated as an allocation of a third party expense by the taxpayer?

73. No comments.

15. Do you agree that no mismatch arises (and no adjustment should be required) under the deemed branch payment rule if the rules in the branch or residence jurisdiction operate in such a way as to ensure that the total amount of the taxpayer's income will be brought into account in at least one jurisdiction?

74. Yes.

16. Are there any practical difficulties in determining the amount of dual inclusion income in the context of branch mismatches that do not arise in the context of hybrid mismatch arrangements?

75. Yes. See our detailed comments above.

17. Is further guidance required on the circumstances when the deemed branch payment rule should apply?

76. Yes, please see our general comments above.

18. Do you agree that the primary rule in respect of deemed branch payments should be to deny the deduction in the jurisdiction where the payment is deemed to be made?

77. No comments.

19. What further guidance (if any) is required on implementation solutions for the identification of dual inclusion income in the context of these branch mismatch arrangements?

78. No comments.

20. Do you agree that a secondary or defensive rule is required to address any mismatch in tax outcomes that could otherwise arise where the payer jurisdiction does not apply the primary rule?

79. No comments.

Section 4: DD branch payments

Section 4 (DD branch structures)

21. Do you agree that although these branch mismatch structures may not be thought of as "hybrid" they still fall within Recommendation 6 of the Action 2 Report and would be subject to adjustment under those rules?

80. Our earlier comments are equally applicable in the case of a rule addressing double deductions involving branches. How that rule is framed will be critical if it is not to have undesirable impacts. For all cases where the head office jurisdiction operates a worldwide basis of taxation, there will be a wide range of expenses arising in substantive commercial branch operation for which both the permanent establishment jurisdiction and the head office jurisdiction provide a tax deduction. The Discussion Draft proposes to identify the double deductions which are appropriate from a policy perspective by requiring there to be a deduction from dual inclusion income. However, depending upon how that is approached, a rule addressing double deductions will apply a counteraction where a branch is simply in a net loss position for a year (and hence there is insufficient dual inclusion income in the branch territory).
81. There will also be the problem outlined above of a mismatch arising when all that is in practice happening is that the two jurisdictions have slightly differing technical approaches to the precise attribution of income and expenses to the permanent establishment but nonetheless arrive at substantially the same overall taxable profit for the permanent establishment. For example, the permanent establishment jurisdiction may consider a branch expense to be deducted from an item of income, and the head office jurisdiction simply determines the income in a slightly different way – that might not strictly be dual inclusion income, even though there are no domestic policy concerns as both countries are taxing substantially the same overall taxable profit.
82. To prevent those problems, we believe a better approach is that any counteraction for double deduction cases only applies where the expense is actually set against income of another person, and that income is not dual inclusion income. For example, this might occur where a local entity is within a tax consolidation with the branch and some of that entity's income is actually offset by a branch expense, and the head office also deducts the expense against its head office taxable profits.

22. Are there any practical difficulties in determining the amount of duplicate deductions and dual inclusion income in the context of branch mismatches that do not arise in the context of hybrid mismatch arrangements?

83. Yes. See detailed comments above.

23. Is further guidance required on the circumstances when Recommendation 6 should apply to DD branch payments?

84. No comments.

Section 5: Imported branch mismatches

24. Should the imported branch mismatch rules apply only to payments made under a structured arrangement or between members of the same control group?

85. The imported branch mismatch rules should be restricted to apply only to structured arrangements.
86. Even in the related party case, the complexities involved in MNE intragroup financing etc. will make the application of these rules extremely challenging and will create substantial complexity in administration and compliance, and the rule should only be applicable when the imported mismatch is part of the same wider arrangement – rather than requiring groups to undertake an assessment of whether a series of unrelated items in a multinational group could be argued to result in a branch mismatch being imported into a jurisdiction.
87. We agree that it would not be practicable to apply these rules to transactions involving members that are not in the same control group.

25. Are there any practical differences between branch and imported mismatches that would justify modifying or clarifying the scope of the rule or the guidance on the application of the imported mismatch rule?

88. The nature of the transactions that would be subject to the imported mismatch rules will make them more difficult to trace and hence compliance even more challenging.