European Business Initiative on Taxation (EBIT)

Comments on the OECD's Discussion Draft on

FOLLOW UP WORK ON BEPS ACTION 6: PREVENTING TREATY ABUSE

At the time of writing this submission, EBIT Members included: AIRBUS, BP, CATERPILLAR, DEUTSCHE LUFTHANSA, DIAGEO, INFORMA, JTI, LDC, MTU, NUTRECO, REED ELSEVIER, ROLLS-ROYCE, SAMSUNG ELECTRONICS, SCA, SCHRODERS and TUPPERWARE.

EBIT Comments on FOLLOW UP WORK ON BEPS ACTION 6: PREVENTING TREATY ABUSE

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Submitted by email to: taxtreaties@oecd.org

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Dear Marlies,

EBIT welcomes this opportunity to provide comments on the OECD Public Discussion Draft entitled "FOLLOW UP WORK ON BEPS ACTION 6: PREVENTING TREATY ABUSE - 21 November 2014 – 9 January 2015" (hereinafter "the Discussion Draft").

General comments

EBIT strongly supports the principle that treaties should not be used to create non-taxation or for treaty shopping and supports moves to eliminate the use of treaties in situations which were not envisaged when signed and can be considered abusive.

Treaties should, however, be available in all situations where there is a commercial transaction between parties with economic substance in both contracting states, and where neither party is a conduit to a person not entitled to treaty benefits. This is needed to ensure that international trade is not compromised by double taxation, unpredictability and uncertainty.

As stated before, EBIT also hopes that the OECD takes into account that there is a clear distinction between intended and unintended non-taxation. The OECD's newly stated target of preventing non-taxation through treaty abuse negatively impacted on other key and essential targets of tax treaties, i.e. the elimination of double taxation, the creation of a predictable business environment, should not compromise the important work and achievements of the OECD since its inception.

The currently proposed PPT test is too wide and not targeted enough in EBIT's view. EBIT recommends only specific and targeted anti-abuse provisions and the OECD should focus in the first place on substance with respect to the PPT. In this regard, EBIT Members hold the firm view that it is not reasonable, and probably it would breach EU Law / the European Court of Justice (ECJ)'s judgement in the Cadbury Schweppes case, as disproportionate, to conclude automatically and prima facie that obtaining treaty benefits was one of the main purposes in cases of misapplication or disagreement between competent tax authorities.

EBIT has concerns with regard to the proposed unilateral discretion and the inherent risk of anti-avoidance provisions being used selectively and unilaterally by tax authorities to deny treaty benefits based on subjective criteria. This would increase uncertainty and unpredictability and leave legitimate business much more reliant on local tax rulings, which cannot be the OECD's aim.

With regard to the tie-breaker rule for determining the treaty residence of dual-resident companies, EBIT reiterates that we are very concerned that the OECD proposes to substitute a solid concept which works well with a U.S. based competent authorities test which will inevitably result in an increased resource burden on tax authorities, significant delay and uncertainty for international business and many more instances of double taxation.

As stated before, EBIT appreciates that the way tax treaties should apply is changing, yet we do wish to reiterate to the OECD and G20 that there continue to be several issues in relation to the application of tax treaties (i.e. pure non application, application of tax treaties subject to such conditions that application remains uncertain, misinterpretation of clear provisions…) in important emerging economies. From our daily experience, many emerging economies still lack the required sophistication and technical and juridical expertise or the legal framework to be able to apply and interpret the OECD's proposals in a correct and consistent manner. In such a context, it remains our view that maintaining the proposal to introduce a US style LOB, which can be applied much more easily in mature economies than in less mature economies, is coming too soon and going too far. Importantly, the existing gaps in treaty application between OECD members and the above mentioned economies is establishing two different worlds for international business practitioners in terms of complexity, treaty access, treaty interpretation, certainty, the duration of procedures and enforcement. This development is undesirable and in essence undermines the level playing field and competitiveness of OECD and European businesses.

EBIT urges the OECD again to fully take EU Law considerations into account in any of its BEPS proposals otherwise the OECD is proposing international recommendations which 23 out of the 44 BEPS countries will be unable to adopt.

Specific comments

A. Issues related to the LOB provision

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

Whilst EBIT agrees that a discretionary relief provision is required, in our view, such a provision should be an ultimate fall-back instrument to obtain treaty benefits in non-abusive situations, and should not be seen as a provision that will be commonly used. We have great concern that if too much reliance is placed on the discretionary relief provision in practice businesses will be denied relief in non-abusive situations, when the treaty should actually be sparing them from double taxation.

In EBIT's view, the proposed discretionary relief provision approach will open the door, when the other tests in the LOB article are not met, to the risk of anti-avoidance provisions being used selectively and unilaterally by competent tax authorities to deny treaty benefits based on subjective criteria. According to EBIT, such an approach will reduce the value of treaties and encourage unilateral action, which cannot be the OECD's aim. Ensuring the appropriate application of anti-abuse provisions such as the proposed discretionary relief provision is becoming very much dependent on competent tax authorities' levels of technical expertise and "reasonable behaviour", and this notably so - but not exclusively - in less mature economies.

EBIT urges the OECD to mention in its proposals that a tax authority should always consult with its treaty partner first before denying a request for treaty benefits by a resident of the treaty partner.

Discretionary relief provisions have been available under some treaties, [particularly those involving the US] for some time. However, Members of EBIT have reported that obtaining such relief has been a long and costly process. One EBIT Member has had an application for discretionary relief with a tax authority for two and a half years, in a case where the facts are quite straightforward. In that time, one supplementary information request has been received and dealt with, but there is no indication of whether or not the relief will be granted. Such uncertainty is bad for business, and has delayed what should have been a non-tax sensitive, straightforward, inter-company reorganisation.

EBIT also urges the OECD to include a hard time limit of 6 months in its proposals for finalisation of applications for discretionary relief by competent authorities.

4. Alternative LOB provision for EU countries

EBIT generally welcomes the fact that Paragraph 13 of the Report acknowledges that the LOB rule (paragraph 16 of the Report) needs to be adapted to reflect EU Law requirements. We agree that there may be a need to draft alternative provisions that would accommodate the EU Law concerns of EU member states.

We consider that it is arguable that EU Law, and in particular the ECJ's judgement in the 2002 *Open Skies* cases, would indeed support the view that a derivative benefits provision should be included. In *Open Skies* the ECJ considered that the "nationality clauses" in eight EU Member States bilateral international air transport agreements with the US were in breach of EU law i.e. contrary to the EU's fundamental freedoms. In particular, the requirement in most of those bilateral agreements for more than 50% of the shares in their national airline to be held by nationals of that airline's home country breached the freedom of establishment of the EC Treaty (now TFEU).

Similarly, in our view EU Law, in particular the ECJ's judgment in the *Papillon* case requires EU/EEA countries to be able to trace bilateral treaty entitlement via any EU/EEA country entity, and not just via the relevant EU/EEA country and its treaty partner entities (see also point 5 below).

EBIT also notes that the original LOB provision did not include such requirement or limitation and that it was most probably changed to allay U.S. domestic policy concerns about inverted companies. EBIT strongly believes that such domestic policy concerns should be addressed under domestic law, however, and not through treaties.

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

EBIT considers that this proposed requirement is unduly restrictive and we consider that it should be omitted from the Discussion Draft, as further work by the OECD is needed to determine how treaty shopping concerns can be allayed in a different, more even-handed way with less collateral damage. Requiring that intermediate owners of the tested company must be residents of one of the contracting States will typically apply and pose an issue to MNCs which have many affiliates in several countries, and would not allow them to benefit from treaties anymore. EBIT wishes to stress that the choice of an MNC as to where a tested entity is situated within its organisational structure can be the result of many different factors, and is often the result of acquisitions. We believe that the proposed requirement is also not in line with EU Law (see also point 4 above).

6. Issues related to the derivative benefit provision

To EBIT's Members and many MNCs for that matter, the derivative benefits provision is an aspect of LOB of critical importance as it ensures access to treaty benefits to a company if 95% or more of its shares are owned by companies that would be entitled to equivalent benefits under the bilateral treaty between the source state and the country of residence of the owners (and other criteria are met). EBIT is concerned that the proposed OECD Model Tax Convention will deny treaty benefits even where there is no treaty abuse, including situations where intermediary companies are also being tested, i.e. in addition to the ultimate beneficial owners. EBIT considers that intermediary company testing should not be included in the

Model Tax Convention and that the Contracting State of the ultimate beneficial owners should be the focal point.

EBIT understands that there is currently no consensus among the BEPS-44 on whether to include a derivative benefits provision which would also cover the use of intermediate entities and which has the potential to create treaty shopping risks in the OECD proposals. EBIT's Members urge the OECD to clarify what treaty shopping risks it sees concretely.

7. Provisions dealing with "dual-listed company arrangements"

EBIT welcomes the OECD's recognition of the unique circumstances of dual-listed company arrangements and encourage further study by the Working Group of this issue, as there are likely collateral issues, such as the appropriate application of the subsidiary of a publicly traded corporation that merit careful consideration and how to apply the substantial presence test.

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

EBIT Members do not share the OECD's view that the conditions in 2 *c)* of the proposed U.S. style LOB rule under A and B (the substantial presence test) are relevant to treaty shopping concerns and should be omitted. The proposed conditions are taken over from the current US treaty LOB article but are there because of a domestic policy concern over so-called corporate inversions. Domestic policy concerns should be addressed under domestic law, however.

10. Clarification of the "active business" provision

EBIT prefers the new Discussion Draft recommendation over the initially proposed anti-avoidance approach.

Commentary 20 on Article 1 currently describes a possible format for an LOB without the controversial restrictions included in the current US version. EBIT considers that the use of the LOB article in treaties other than those with the U.S. will probably be limited, the OECD should leave the current version in the Commentaries as a starting point with countries free to negotiate departures or refinements on a bilateral basis.

B. Issues related to the PPT rule

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

We welcome aligning the Commentaries on the PPT rule and on the LOB discretionary relief provision that deal with the principal purposes test. Application of the discretionary relief rule of the LOB, and the PPT rule should both be under mandatory arbitration, and be subject to a 6 months' time limitation from the PPT denial of the relevant treaty benefit for finalisation of applications by the competent tax authorities.

EBIT wishes to reiterate that the OECD include in its proposals that a tax authority should always consult with its treaty partner first before denying a request for treaty benefits by a resident of the treaty partner.

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

EBIT's Members consider that in general, the denial of benefits under the PPT rule should always be proportionate to the perceived abuse, and, as stated under point 14 above, that a hard target period for resolution of discretionary relief of 6 months from the PPT denial of the relevant treaty benefit be included.

16. Drafting the alternative "conduit-PPT rule"

EBIT considers that the proposed anti-conduit rule in paragraph 15 should be targeted to cases where it is evident that an intermediary company has been used for a principal purpose of accessing treaty benefits. We believe that the proposed rule will be an intrinsically subjective and arbitrary anti-abuse rule and that there is a high risk that the conduit rule could lead to inappropriate denial of treaty benefits and many legal disputes if it is not carefully defined. The "all or substantially all" threshold coupled with the PPT is in our view reasonable. However, we firmly believe that the "at any time" provision's scope is too broad, as it would lead to an indefinite period of uncertainty for businesses as any future transaction could be taken into account to deny treaty benefits. Useful examples of practical anti-conduit arrangements can be found in the Annex to the US/UK tax treaty exchange of notes, and which we advocate to be included.

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

EBIT considers that the examples in the Report are quite specific and as such limited in providing adequate clarity on the application of the PPT rules on commercial arrangements entered into by MNCs. Two common situations are considered below:

1. M&A activity and holding company

Often, MNCs use a holding company in a territory with a favorable tax treaty with the target territory for acquisition purposes. Whilst tax will usually be one of many considerations that are taken into account in determining the economic viability of an acquisition, it is not clear from the examples whether the PPT rules could apply prevent MNCs from benefitting from the tax treaty in such a situation.

Also unclear in our view is whether the application of the PPT rule would be different if:

a) The MNC uses as the holding company to acquire the target, an existing group company in that territory that already has economic substance, OR
b) The MNC sets up a new holding company but has other group companies in the territory with economic substance, OR
c) The MNC does not have any economic substance in the territory prior to the acquisition but sets up a new company there for the purpose of the acquisition.

2. Intra-group financing and lending entity

When considering ways to debt finance a subsidiary, MNCs often have a choice between two or more lending entities in the group. As cash is fungible, two or more entities may be in a position to utilise group's cash to provide funds to group entities as necessary. In such a scenario, it is not clear from the examples whether selecting a lending entity that provides for a more favourable tax treaty outcome would be caught by the PPT rule.

Whilst additional examples and guidance to provide more clarity would be welcome, with a purpose based test there will inevitably be disagreement as to whether treaty benefits should apply and accordingly denial of treaty benefits for certain situations. In such cases, EBIT believes that treaty relief should not be denied per se, rather the treaty benefit provided should be limited to what would have been available otherwise.

C. Other issues

18. Application of the new treaty tie-breaker rule

Any residence tie-breaker rule must provide a clear and predictable result in advance which is why the members of EBIT urge the OECD to move away from the proposed competent authority test and retain the effective management test in the Model Convention but with a recourse to ascertain a single residency via competent authorities. This should only serve as a fall back option, and with a maximum timeline of 6 months for the competent authorities to reach a final decision guaranteed expressly in the Model Convention.

EBIT wishes to reiterate that we are very concerned that the OECD proposes to substitute a 100 years old concept which works well with a U.S. based competent authorities test which will inevitably result in an increased resource burden on tax authorities, significant delay and uncertainty for international business and many more instances of double taxation.

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

In EBIT's view the bottom line should be clearly that the anti-abuse test for paragraph 42 of the Report should be whether the structure is a genuine business and has real substance. A country's low rate of taxation as such is not a problem in this context, which the OECD has acknowledged itself in its 2013 BEPS Action Plan. EBIT Members consider that where there is no proof of abuse and the beneficial ownership of the income is with a resident of one contracting State, the source State should not be allowed to deny treaty relief.

EBIT trusts that the above comments are helpful and will be taken into account by the OECD in finalising its work in this area. We are happy to discuss with, and remain committed to a constructive dialogue with, the OECD.

Yours sincerely,

The European Business Initiative on Taxation – January 2015

For further information on EBIT, please contact its Secretariat via Bob van der Made, Tel: + 31 6 130 96 296; Email: bob.van.der.made@nl.pwc.com).

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