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16 June 2015

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Head, Tax Treaties, Transfer Pricing and Financial
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Via Email: taxtreaties@oecd.org

RE: OECD Revised Discussion Draft *BEPS Action 6: Prevent Treaty Abuse*

Dear Ms. de Ruiter:

On 19 July 2013, the OECD published an *Action Plan on Base Erosion and Profit Shifting* (hereinafter the Plan) setting forth 15 actions the OECD will undertake to address a series of issues that contribute to the perception that individual countries' tax bases are being eroded or profits shifted improperly. Pursuant to Action 6 of the Plan "Prevent treaty abuse," the OECD issued a public discussion draft on 21 November 2014 entitled *Follow Up Work on BEPS Action 6: Preventing Treaty Abuse* (hereinafter the November Draft). The November Draft followed on the OECD's first public discussion draft under BEPS Action 6, released on 14 March 2014. A public consultation on the November Draft was held in January 2015. Following on the November Draft and subsequent public consultation, on 22 May 2015, the OECD released a revised discussion draft entitled *BEPS Action 6: Prevent Treaty Abuse* (hereinafter the Revised Discussion Draft or Revised Draft). The OECD requested comments on the Revised Draft no later than 17 June 2015. On behalf of Tax Executives Institute, Inc. (TEI), I am pleased to respond to the OECD's request for comments.

TEI Background

TEI was founded in 1944 to serve the needs of business tax professionals. Today, the organisation has 56 chapters in Europe, North

and South America, and Asia.[1] As the preeminent association of in-house tax professionals worldwide, TEI has a significant interest in promoting tax policy, as well as the fair and efficient administration of the tax laws, at all levels of government. Our nearly 7,000 individual members represent over 3,000 of the largest companies in the world.

TEI Comments

General Comments

TEI commends the OECD for its exhaustive work under BEPS Action 6 as most recently reflected in the Revised Discussion Draft and its continued solicitation of stakeholder input on the rules necessary to address the issues set forth in the Revised Draft. Regrettably, the Revised Discussion Draft is a work in progress and it is disappointing that the OECD seemingly cannot reach a consensus on the proper method for addressing what it views as the abusive use of double tax treaties to effect base erosion and profit shifting. Instead, like other recently issued discussion drafts under the BEPS project (*e.g.*, the drafts on CFC rules and mandatory disclosure), the Revised Discussion Draft presents a menu of options that would permit countries to choose one of several approaches to address treaty abuse. Setting forth alternative approaches will result in a variety of treaty anti-abuse rules across the spectrum of double tax treaties. In addition, the lack of a recommended approach will make it more likely that several countries will not adopt any of the treaty anti-abuse alternatives set forth in the Revised Draft. While this result might be preferable from a business standpoint, it undermines one of the primary goals of the BEPS project to adopt uniform rules across jurisdictions.

Moreover, the Revised Discussion Draft again includes a primary purpose test (PPT), the application of which will be uncertain and subjective. While it is clear that the OECD recognises this, it continues to downplay the negative impact the uncertainty created by the PPT and other potential changes will have on cross border investments and tax disputes. In addition, permitting countries to choose whether to use a limitation on benefits (LOB) provision, a PPT, or both, will make it difficult to conclude a multi-lateral instrument under BEPS Action 15.

The Revised Draft also proposes that when the OECD model tax convention is amended the text of the convention will not include any actual treaty language. Instead, the model will contain only bracketed placeholders providing a brief indication of the types of LOB provisions that contracting states could adopt – with the actual, OECD endorsed alternative versions of such provisions being set out in the official commentary to the model convention. If the countries participating in the BEPS project cannot agree on the wording of the model

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[1] TEI is a corporation organised in the United States under the Not-For-Profit Corporation Law of the State of New York. TEI is exempt from U.S. Federal Income Tax under section 501(c)(6) of the U.S. Internal Revenue Code of 1986 (as amended).

convention, how can tax authorities and taxpayers possibly agree on the interpretation, application, *etc.* of the provisions that are ultimately adopted? This will lead to substantial uncertainty and complexity, and require an increase in resources devoted to tax disputes.

The Use of Treaties to Create Taxation

As the OECD is well aware, there are different approaches to international taxation of business activities with most countries adopting a territorial approach, at least for active business income. Thus, in most cases such countries' tax systems do not need to address holding company structures or intermediary companies because they do not tax the income earned outside the country's jurisdiction in any event. Moreover, most of these structures are put in place for non-tax business reasons, such as the centralisation of functions, to bundle investment, for cash management, or in preparation for a spinoff (among many others). Similarly, intellectual property (IP) holding companies are generally devised for non-tax business reasons, such as ease of licensing IP rights around the world. While certain structures may be used to avoid secondary withholding taxes, this is again only a problem for certain forms of international tax systems. Yet, the Revised Draft attempts to address these narrow problems as part of the OECD's model convention.

This approach is present in other areas. For example, the Revised Draft discusses implementing a kind of effective tax rate test to address supply chain planning and the use of principal structures with a permanent establishment or branch in a third jurisdiction. But again this kind of planning is only problematic for certain forms of international taxation and it is unclear why the OECD is including a solution for these issues in its model convention and the accompanying commentary when it will be relevant for very few countries. The Revised Draft also proposes addressing the problem of dual-residency through a tie-breaker mechanism. However, it has never been clear why it is considered abusive for a taxpayer to subject itself to taxation in two separate jurisdictions. If this is truly a problem, then two countries can come to an agreement on how to address it. Overall, cluttering the OECD model convention with minor or insignificant issues is unhelpful and only complicates what should be a uniform approach.

Nevertheless, the recommendations in the Revised Discussion Draft and throughout the OECD publications on BEPS Action 6 seem intent on addressing the perceived abuses of such structures and companies that may be of concern to countries that take a minority approach to international taxation. As a whole, these proposed treaty provisions create taxation where it would not exist in the absence of the treaty, which has not been the traditional purpose of double tax treaties. A treaty has traditionally allocated the right to tax among jurisdictions to ensure income is taxed only once; however the OECD is now proposing to use the treaty as an active or affirmative instrument of taxation, a role traditionally reserved to the treaty partners (*i.e.*, to assert their own taxing rights). Moreover, as noted, the use of a PPT to implement this new treaty approach adds substantial uncertainty to operational business planning whenever it

might include a cross-border tax aspect. TEI therefore recommends that the OECD leave the decision whether to address these structures generally to the domestic law of a jurisdiction. If two countries wish to address these issues jointly, then they can of course adopt a (hopefully objective and well defined) LOB provision in their double tax treaty to address specific issues.

Active Trade or Business Test

With respect to the active trade or business test for qualification for treaty benefits, if OECD wants to introduce this as a way to qualify for treaty benefits, it should include a commonly accepted standard for what constitutes an active trade or business. It seems it has not done so because the 34 OECD countries likely have 34 different definitions of an active business. This is yet another area where it is more appropriate to rely on the domestic law of an individual jurisdiction or through the use of an LOB provision, rather than creating a standalone term in a tax treaty without context or a commonly understood definition.

Transition Period for Implementation

The structures currently used by many multi-national enterprises to conduct their business operations were put in place over a period of several years, in certain cases as long as a decade. These structures were implemented, in part, in reliance on the current treaty rules as generally exemplified by the OECD's model convention as in existence before the start of the BEPS project. Thus, most double tax treaties do not include an LOB provision or PPT. If these provisions are included in the OECD model convention and become the baseline for treaty negotiations among OECD member states and other countries, they have the potential to disrupt the business structures currently used by international business by disqualifying entities within a multi-national group from treaty benefits – sometimes at great and unexpected tax cost. TEI therefore recommends that the OECD suggest a transition period of at least five years for countries that incorporate an LOB or PPT into a particular double tax treaty for the first time to give businesses a sufficient period to adjust their operations to the new rules.

Examples in the Revised Discussion Draft

The Revised Discussion Draft includes additional examples to "clarify" when the PPT applies. Unfortunately, these examples highlight the significant uncertainty inherent in a rule that effectively requires a taxpayer to prove that none of its principal purposes was to obtain a tax benefit – when tax will be a consideration in virtually any transaction. The conclusion in Example F involves assuming that a business is a "real business . . . using real assets and assuming real risks."[2] It is unclear what is meant by "real" business assets and risks outside; real in comparison to what?

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[2] Revised Discussion Draft, p.32

Special Tax Regime Definition

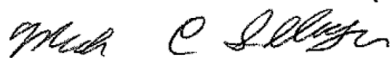
The proposed definition of a "special tax regime" is quite broad.[3] The definition could encompass notional interest deductions, companies located in a special tax zone of a jurisdiction or companies that benefit from special tax incentives such as R&D tax credits, manufacturing incentives, *etc*., unless the regime or tax status at issue meets one of the specific exceptions provided. In addition to the potential exceptions listed in the Revised Draft, TEI recommends that the OECD adopt an exception for circumstances where the effective rate of tax of the "special" regime is above a certain percentage of the "normal" tax rate (such as 60%). That is, it a tax regime should not be subject to a designation as "special" unless the regime has the effect of reducing the effective tax rate below the normal tax rate.

In addition, it is unclear what is meant by the exception to the definition of special regime for "any legislation, regulation or administrative practice . . . that implements the principles of Article 7 (Business Profits) or Article 9 (Associated Enterprises) . . . ."[4] This exception could be interpreted very broadly to exempt most tax regimes or very narrowly to exempt very few. Thus, an additional explanation of what this exception is intended to encompass would be welcome.

Conclusion

TEI appreciates the opportunity to comment on the Revised Discussion Draft regarding concerns over the abuse of double tax treaties. These comments were prepared under the aegis of TEI's European Direct Tax Committee, whose Chair is Nick Hasenoehrl. If you have any questions about the submission, please contact Mr. Hasenoehrl at +41 786 88 3772, nickhasen@sbcglobal.net, or Benjamin R. Shreck of the Institute's legal staff, at +1 202 638 5601, bshreck@tei.org.

Sincerely yours,
TAX EXECUTIVES INSTITUTE, INC.



Mark C. Silbiger
International President

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3 *Id*. at 17.

4 *Id*.