BUSINESSEUROPE

OECD Centre on Tax
Policy and Administration
Tax Treaties
Transfer Pricing and Financial Transactions Division
2, rue André Pascal
75775 Paris
France

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BUSINESSEUROPE Comments on OECD Discussion Draft "BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances" 14 March 2014 – 9 April 2014

BUSINESSEUROPE is pleased to provide comments prepared by the members of its Tax Policy Group, chaired by Krister Andersson, on the OECD Discussion Draft entitled "BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, 14 March 2014 – 9 April 2014" (hereinafter referred to as the Draft).

General Comments

BUSINESSEUROPE supports OECD's work to clarify the purpose of tax treaties. The initial and prime objective with tax treaties is to facilitate cross-border trade through the allocation of taxing rights between countries and to provide for mechanisms to eliminate double-taxation. By doing so, tax treaties provide certainty and eliminate major obstacles to cross border trade.

The introduction to the commentary recognizes the harm of international juridical double taxation:

> *"Its harmful effects on the exchange of goods and services and movements of capital, technology and persons are so well known that it is scarcely necessary to stress the importance of removing the obstacles that double taxation presents to the development of economic relations between countries".*

In this context however, we believe that the importance of certainty and the harm of double taxation need to be stressed. The proposal at hand aims at preventing the granting of treaty benefits in inappropriate circumstances. Misuse of treaty provisions undermines the integrity of a tax convention and should of course be addressed.

However, preventing tax avoidance and evasion in general, or treaty abuse in particular, should not be a main objective or purpose for entering into a tax treaty. When negotiating a treaty, countries should naturally aim at designing the treaty in a

way that does not open up for unintended non-taxation. However, the need to prevent tax avoidance and evasion does not by itself trigger countries to negotiate a tax treaty. Although the prevention of tax evasion and avoidance may be important purposes of a tax treaty, they do not constitute a prime objective, equal to the prevention of double taxation.

Consequently, BUSINESSEUROPE is concerned about the proposal to insert *tax avoidance* in the title and also the proposed wording in the preamble *without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance.*

Before initiating tax treaty negotiations, it is important that countries carefully analyse and study relevant provisions etc. in the other country, in order to identify potential areas that could open up for treaty abuse. BUSINESSEUROPE fully supports the policy consideration proposed in Section C of the Draft. We believe that, if these policy considerations were to be adopted by countries, there would be fewer loopholes to exploit and thus less need for Anti-Abuse rules. This approach would minimize the impact on genuine business activities.

Although the Draft essentially aims at preventing abuse of treaty provisions we believe that further clarification is needed with respect to what is to be considered abuse of treaty benefits.

It is of utmost importance to make a clear distinction between intended and un-intended non-taxation. In the Action Plan on Base Erosion and Profit Shifting, it is stated that “no or low taxation is not per se a cause of concern, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it.” The distinction between intended and unintended non-taxation provides meaning to differences between tax efficiency and aggressive tax planning from a business point of view, and normal tax policy and harmful tax practices from a government point of view. Businesses should be allowed to respond to legislative tax initiatives without being accused of aggressive tax planning and Governments need to agree on acceptable forms of tax competition.

The Draft proposes various Anti-Abuse provisions to be inserted into the OECD Model Convention; namely a Limitation-on-Benefits provision (LOB), a Main Purpose Test (MPT) and a number of Specific Anti-Abuse provisions.

While both the LOB provision and the MPT aim at addressing treaty shopping in particular, they take different approaches. Whereas the LOB provision is extremely complex, it is at least to a greater extent than the MPT, based on objective criteria, thus leaving less room for arbitrary assessment. The MPT on the other hand is very unclear and subjective and open for arbitrary assessment.

In general, we believe that perceived inappropriate behaviour is best addressed with specific and targeted Anti-Abuse provisions. This way, abusive practices can be prevented with a minimum impact on bona fide business. It is of utmost importance that

Anti-Abuse rules are designed so that they have a minimum impact on genuine business operations. We believe that both the proposed LOB provision and the MPT fail in this respect since they are too general in nature and not limited to abusive situations. In particular, Anti-Abuse provisions should recognize that holding, financing, licensing and investment activities are normal and legitimate business activities that should not suffer blanket exclusions from Treaty protection.

BUSINESSEUROPE strongly opposes the proposal to insert a LOB provision and a MPT into the OECD Model Convention.

It does not seem to be a proportionate response to insert two very different provisions that aim at addressing the same issue. It is neither reasonable, nor desirable that taxpayers should have to struggle through a very complex LOB provision, only to be confronted with a very subjective MPT, providing little predictability regarding the outcome. Such a scenario would definitely have a negative impact on businesses and discourage investments and employment.

It should be made clear in the Draft that at most one of these two provisions for preventing treaty shopping shall be inserted in the OECD Model Convention.

Specific comments on the LOB provision

It is mentioned in the Draft that a number of countries already include LOB provisions in their tax treaties. The proposed LOB provision is based on the LOB provision found in treaties concluded by the United States. The fact that a number of countries choose to include a LOB provision in their treaties does not by itself justify a LOB provision to be inserted in the OECD Model Convention. Countries have different needs and priorities when negotiating tax treaties. Although a country may accept a certain LOB provision in relation to another country, this does not necessarily mean that it would be willing to have such an LOB in all of its treaties.

As previously stated, BUSINESSEUROPE opposes the LOB provision as currently drafted. The proposed LOB provision is, to say the least, very complex. Furthermore, it denies treaty benefits by default. Only where explicitly stated would a resident enjoy the benefits under the treaty in question. Such language seems to suggest that taxpayers, as a general rule, evade tax and engage in aggressive tax planning. This is clearly not true. Most businesses allocate substantial resources in order to comply with existing tax rules and struggle to overcome obstacles to cross border trade and investment. The OECD Model Tax Convention must reflect the fact that most businesses are engaged in bona fide operations and not tax evasion and circumvention of tax provisions.

We question whether it is proportionate to exclude all holding companies from treaty benefits. The structure of a holding company may vary significantly and there may be a number of reasons as to why a holding company is being used. The LOB provision

should take into account substance and purpose of the holding company, existence of substantive activities such as premises, employees in the holding state etc. Political stability and geographical location are further factors that may warrant a regional holding company, rather than any intent to engage in abusive behaviour.

It would of course not be possible to cover all genuine business situations in a LOB provision. Neither would it be possible to cover all inappropriate circumstances in Specific Anti-Abuse provisions. The answer however is not to deem all situations abusive unless otherwise stated. Instead of allowing treaty benefit only where explicitly stated, the LOB provision should at least be reversed so that treaty benefit is granted by default, and that benefits are only denied in case of treaty abuse. Listed entities and entities controlled by listed entities as well as entities that conduct active trade or business should still be deemed low risk and always be granted treaty benefits. The situations covered by the Derivative Benefits provision in the Draft should also be considered low risk and granted treaty benefits. Because there is no incentive to treaty shopping, the Derivative Benefits provision should be inserted in the OECD Model Convention itself and not as part of the Commentary if a LOB provision is adopted.

Such language would certainly be more reasonable, provide more clarity, maintain the integrity and purpose of the convention, be more fair and at the same time target cases of treaty shopping. It would also limit the scope of the LOB provision to cases of treaty shopping, which is the aim of Action 6 of the BEPS Action Plan.

Another issue that we think needs a thorough analysis is the question whether the proposed LOB could be in violation of EU law. In particular, our concern is with the prohibition of non-resident intermediaries in the ownership test, the local stock exchange requirement in the publicly traded test and the absence of a derivative benefit provision. All these aspects require analysis in light of EU law. Should the conclusion be that such provisions are in violation of EU law, a significant number of OECD members would not be able to adopt the LOB provision as it stands.

Specific comments on the Main Purpose Test

In addition to the LOB provision, the discussion draft also contains a MPT. Whilst both provisions aim at addressing the same issue, they do have significantly different approaches to doing so. As stated above, the proposed LOB provision is technically complex, but leaves less room for subjective and arbitrary assessments. The MPT on the other hand takes the opposite approach. It does not provide much guidance with respect to when the treaty benefits will be granted. Instead, it opens a door for tax administrations to disqualify taxpayers from treaty benefits where that tax administration finds it appropriate. The problem with the MPT is not that it is very complex. Rather, our concern lies with the fact that it is very subjective and leaves significant room for arbitrary assessments.

As mentioned above, BUSINESSEUROPE strongly opposes the proposed MPT. The language is much too vague and subjective. It is difficult for a company to foresee whether the provision is applicable in a particular situation.

It is stated in the Draft that the MPT would merely incorporate principles already recognized in the Commentary on Article 1 of the OECD Model Convention. Here, the Draft seems to be referring to paragraph 9.5 of the commentary on Article 1 which states the following:

> *"A guiding principle is that the benefits of a double taxation convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions."*

The commentary on Article 1 contains a number of solutions to address improper use of the convention. The MPT is one of many potential solutions. The fact that it is included in the commentary is not in itself a justification to include it in the OECD Model Convention. Such a test may be suitable between some treaty countries, but not necessarily between all.

Furthermore, the proposal in the Draft differs significantly from the language in paragraph 9.5 of the commentary to Article 1. In the Draft, the MPT would be applicable if it is reasonable to conclude that a tax benefit has occurred, if one of the main purposes of the arrangement would be to obtain a tax benefit and the tax benefit is achieved directly or indirectly. Compared to para 9.5 of the commentary to Article 1 the threshold has been lowered considerably.

With respect to the one *of the main purposes* criteria, The Draft indicates that there could be more than one main purpose. In our view, there could only be one main purpose. Since the Draft seems to suggest otherwise, it should be clarified how many main purposes there can be without any of them falling below the threshold of being considered a "main" purpose.

Similarly to the proposed LOB provision, the MPT imposes a significant burden on the taxpayer. The onus on the tax administration is set low ("reasonable to conclude", "one of the main purposes", "directly or indirectly") while the onus on the taxpayer is significant ("establish that the granting of tax benefit would be in accordance with the object and purpose of provisions in the convention").

Such a vague, unclear and wide scoped provision in itself is not acceptable. The provision is extremely unpredictable and would likely have a very negative effect for genuine business activities. In particular, holding, financing and investment activities are all normal and genuine business activities that may fall within the scope.

Should the OECD choose to insert a MPT in the OECD Model Convention, it is of utmost importance that it is designed to be applicable only where a structure has been

wholly artificially set up solely to secure a treaty benefit. Tax administration should establish (instead of make it reasonable to conclude) that the main purpose (instead of one of the main purposes) of an arrangement was to obtain the tax benefit. Furthermore, the provision should only be applicable if it is established that granting the benefit would be contrary to the objective of the provisions of the Convention.

Although such redrafting of the provision would not be enough to solve the fact that the MPT is unclear and unpredictable, it would at least increase the threshold for when an arrangement or transaction is considered abusive. In addition, where any dispute arises over the application of the MPT, we suggest provision is made for a binding arbitration process with time limits to provide a quick resolution and to avoid unnecessary costs.

Additionally, the MPT requires analysis in the light of EU law. Given the fact that the language of the MPT in the Draft is so wide in scope, it could be argued that EU Member States would not be able to adopt such a provision.

Furthermore, if the MPT were to be adopted, the interaction between that provision and GAARs and SAARs in the domestic tax laws would need to be clarified. It is established in the commentary on Article 1 of the OECD Model Convention that the domestic Anti-Abuse rules may be applied to address abuse of tax treaties. Domestic tax law may contain Anti-Abuse rules that do not correspond with the proposed MPT. Allowing domestic Anti-Abuse rules in addition to the proposed LOB, MPT and SAARs would definitely cause more uncertainty.

Conclusions

In conclusion, BUSINESSEUROPE considers that, as currently drafted, both the proposed LOB provision and the MPT would be contrary to the purpose of tax treaties and undermine their effect as a tool to facilitate enhanced cross border trade and investments. Instead, we believe that countries should put significantly more effort and focus on the policy considerations proposed in section C of the Draft.

Should the OECD include an Anti-Abuse provision in the OECD Model Convention, we believe that either a redrafted LOB provision or a redrafted MPT should be inserted. It would simply not be reasonable to include both a LOB and a MPT.

From a business perspective, and as an overriding principle, the objective should be to design a targeted provision that does not affect genuine business activities. A vague and unclear General Anti-Abuse provision would certainly be harmful. It would be extremely difficult for businesses to be certain whether treaty benefits will be granted. Likewise, it would be difficult for governments to fully understand the scope of the tax treaty that is being negotiated. Such uncertainty would undermine the very purpose of tax treaties and result in an increasing number of double taxation cases. The effect would be very negative on investment, jobs and growth. This in turn would risk

undermining sustainable tax revenue collection. The lack of an impact assessment on private sector activities, administrative costs and revenue allocation between countries is deplorable and unacceptable. Each proposal should be analysed carefully and its consequences should be presented to policy makers.

Furthermore, we urge the OECD to further analyse potential violations with EU law in the Draft. Otherwise, a significant number of OECD members would not be able to adopt the provisions as they stand.

BUSINESSEUROPE is happy to continue a constructive dialogue with the OECD on this topic.

On behalf of the BUSINESSEUROPE Tax Policy Group

Yours sincerely,

James Watson
Director
Economics Department