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Comments on the OECD Public Discussion Draft entitled "BEPS Action 2: Neutralise the Effects of Hybrid Mismatch Arrangements" 19 March 2014 – 2 May 2014

Through its members, BUSINESSEUROPE represents 20 million European small, medium and large companies. BUSINESSEUROPE's members are 41 leading industrial and employers' federations from 35 European countries, working together since 1958 to achieve growth and competitiveness in Europe.

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 2: Neutralise the Effects of Hybrid Mismatch Arrangements" 19 March 2014 – 2 May 2014" (hereinafter referred to as the Draft).

BUSINESSEUROPE supports the OECD's work to address mismatches with respect to hybrid instruments and hybrid entities. Unintended non-taxation should be addressed in order to ensure a level playing field and a coherent tax system. The aim should be to address such mismatches with a minimum impact on markets in general, the economy and genuine business activities. From a business perspective and as an overriding principle, group structures and financial flows should not primarily be steered by tax rules, whilst recognising that tax can and should play a part in how organisations operate and structure themselves.

It is important to underline that hybrid mismatches is a symptom of classification and characterisation differences in different jurisdictions' tax laws. While we support the work on eliminating such mismatches, it should be acknowledged that financial instruments and entities that may cause hybrid mismatches are, per se, not the problem. Such instruments and entities may in fact be very important for businesses in undertaking their activities. Thus, we maintain that it is the mismatch effect and not the instruments or entities themselves that should be addressed.

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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 legitimate and intended tax initiatives without being accused of aggressive tax planning and governments need to agree on acceptable forms of tax competition.

If one country openly refrains from taxation (intended non-taxation), another country should not automatically be allowed to undo this effect by taxing the income. This is an issue of the allocation of taxing rights, which is particularly concerning in the third country setting (i.e., under the proposed imported mismatch rules). If that were to happen, the efficiency of the first country’s tax policy objectives would be undermined and tax revenues would de facto unjustifiably be exported to another country. It is important to address each situation, and distinguish this situation from one in which unintended non-taxation arises due to double deductions or lack of inclusion despite legal intent.

Consequently, any recommendation to address hybrid mismatches should be limited to target only unintended non-taxation. It should be recognised that the fact that a payment is not subject to tax in either jurisdiction in case of a cross border transaction does not by itself mean that it is a matter of BEPS.

The Draft seems to indicate that the risk of tax arbitrage as a result of hybrid mismatches is greater in transactions between related entities than between unrelated entities. Considering the fact that a significant portion of cross border transactions is between related entities it is important that the provisions are designed in such a way that genuine businesses do not need to assess whether there is a risk for hybrid mismatch in each and every cross border arrangement. If that were to be the case, it would increase the threshold for cross-border arrangements and it will definitely have a very negative impact on trade and investments. Such a scenario should not be the purpose of the BEPS project, but BUSINESSEUROPE is concerned that based on the Draft it could arise as an unintended consequence.

The main issue with respect to hybrid mismatch is tax arbitrage as a result of arrangements that involve two or more jurisdictions and where either duplicate deductions are granted with respect to the same payment, or where a deduction is granted without the inclusion of the same payment in the ordinary income of a party of the arrangement. It is, however, not recognized in the Draft that the mirror of this problem is the risk for double taxation. As a result of different classifications and characterizations, an arrangement may result in two jurisdictions denying deductions or requiring inclusion of the same payment in the ordinary income of more than one entity. Often, such cases of double taxation may be neutralized by tax treaties. This is

however not always the case. Furthermore, in light of the BEPS project, businesses are concerned that the risk for double taxation may increase significantly. At the same time, access to treaty benefits is likely to be limited as a result of the current work on Action 6 addressing so called treaty abuse.

Because of the potential for double taxation as a result of the proposed hybrid rules, we recommend that the enactment of the rules be clearly linked to the adoption of strong and expeditious dispute-resolution processes, including Mutual Agreement Procedures and binding arbitration for cross-border disputes.

Furthermore, BUSINESSEUROPE is very concerned about the complexity of the recommendations in the Draft. Under the recommendations for domestic laws, the taxpayer's deduction or inclusion is linked to whether that deduction or inclusion is granted or required in another jurisdiction. We are concerned that such an approach would impose a significant compliance burden on taxpayers, particularly if information is to be obtained from non-related entities and/or entities not under control. Taxpayers would be required to learn not only how the arrangement is to be treated in the tax law of their own jurisdiction, they would also have to understand the tax laws of the jurisdiction of their counterparties (and in some cases even more than one other jurisdiction). The tax treatment in each jurisdiction may by itself be unclear and difficult to predict. This approach is very complex and is in contrast with the design principles in para 27 in the Draft (in particular (h) "be workable for taxpayers and keep compliance burden at a minimum"). Consequently, we believe that the recommendations should be designed in such a way that the complexity is kept to a minimum.

The Draft recommends a two-step approach which may differ per category of hybrid mismatch. The recommended primary rule is supplemented by a secondary rule in case a primary rule is not adopted. In addition, further recommendations in relations to certain transactions are made. We worry that the two-step approach may, as result of two or more jurisdictions denying deduction or requiring inclusion of the same payment in the taxpayer's ordinary income, increase the risk of double taxation and add to the complexity.

We also note that the recommendations in general are not limited to abusive circumstances. This is in our opinion another reason for designing the rules in a manner that would keep the impact on genuine business activities to a minimum.

In this respect we also believe that the recommendations on hybrid mismatches should be coordinated with the other Action Points on CFC, interest deductibility and harmful tax practices. That way, interaction between the overall recommendations is ensured, while at the same time the impact across jurisdictions is balanced.

With respect to the proposal to amend Article 1 of the OECD Model Convention, BUSINESSEUROPE understands that there may be some cause for concern with respect to hybrid entities. We do however believe that this is best addressed through recommendations for more uniform domestic tax rules rather than amendments to the

OECD Model Convention. The initial and prime objective with tax treaties is and should continue to be to facilitate cross-border trade and investment through the allocation of taxing rights between countries and to provide for mechanisms to eliminate double-taxation. Consequently, tax treaties should not be overwhelmed with anti-abuse provisions that may undermine that purpose.

BUSINESSEUROPE would be willing to engage in a constructive dialogue with the OECD on the treatment of hybrids.

On behalf of the BUSINESSEUROPE Tax Policy Group

Yours sincerely,

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