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By e mail to: taxtreaties@oecd.org

## PricewaterhouseCoopers Comment Letter on the OECD Revised Discussion Draft on BEPS Action 6: Preventing Treaty Abuse

Dear Ms. de Ruiter,

We welcome the opportunity to provide comments on behalf of the PwC network of firms on the Revised Discussion Draft on BEPS Action 6 (RDD). Per your request to keep comments as short as possible, we have limited our comments to issues we consider of key importance. We refer to our previous comments letters of 9 April 2014 and 9 January 2015, which commented more extensively on the Action 6 proposals, many of which remain relevant.

The PwC network of firms is one of the largest providers of global professional services. As such, we believe we bring a perspective that reflects our extensive experience in working with the global business and investment communities and bring an understanding of the practical realities that the impact the Action 6 proposals may have on the conduct of international trade and investment. The OECD faces a formidable task in the development of new rules and standards that are responsive to the concerns raised by BEPS in a short time frame. The Working Group is to be commended for their efforts under these circumstances. Our comments are intended to aid in assuring that the end product achieves the basic goals of BEPS in a manner that is workable, balanced and consistent with the underpinnings of international tax treaty policy. Our aim is to help make sure that the end product is consistent with the fundamental purposes of tax treaties to promote bilateral trade and investment and that the rules needed to combat BEPS are formulated in a manner that provides access to tax treaties to their intended beneficiaries by the promulgation of rules that are adequately targeted and balanced to that end.

### A simplified LOB article

We welcome the introduction in the RDD of the concept of a simplified limitation of benefits (LOB) article. The detailed provisions of the originally proposed Entitlement to Benefits article (ETB) were modelled on the most recent version of the US LOB. A number of those details were controversial and widely criticized, largely because they would deprive taxpayers that are not treaty shopping of access to tax treaties and would impose new and vague concepts. The US LOB on which the ETB was based contains provisions that are oriented to US domestic policy concerns and the US Treasury is in the process of developing a new US Model Income Tax Convention, including revisions to the LOB. It

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would be unfortunate if the OECD were to embody these evolving and controversial provisions in a new OECD Model or in a multilateral convention. Some of the more critical aspects are outlined below.

Unfortunately, the RDD ties the use of the simplified LOB to treaties which combine it with a principal purpose test (PPT) test, which means it would only be available to the limited number of treaties where both treaty partners agree to this combined test. The LOB and the PPT are directed to distinct treaty shopping issues – eligibility of treaty residents for treaty benefits in the case of the LOB and combatting abusive use of treaties by eligible treaty residents in the case of the PPT. These independent standards should not be welded together. Some countries will prefer to deal with anti-abuse through a PPT and others may consider a more targeted anti-abuse rule the best avenue. That choice should not dictate whether a simplified LOB is used. We urge that the OECD opt for the simplified version, leaving it to bilateral negotiation to tailor a treaty LOB to the needs to the treaty partners.

**CIVs and Non-CIVs**

We welcome the RDD confirmation that the LOB should apply to CIVs and non-CIVs as set out in the September 2014 Report on Action 6. This recognizes the importance of collective investment vehicles in an efficient operation of the global capital markets. If a LOB does not explicitly set forth how CIVs and non-CIVs are to be accorded treaty benefits - either by opting to include in the treaty one of the six alternatives for specific text spelt out in paragraphs 6.17 and onwards of the Commentary on the Model Article 1, or by following one of these alternatives when settling the wording of an LOB rule in the form in the September 2014 Report – then, many of these forms of collective investment will fail to qualify for treaty benefits and investors in these vehicles will end up paying a tax penalty for investing through the collective vehicle as contrasted with direct investment. Accordingly, there should be a much greater emphasis of the need for treaty partners to follow the recommendations of the 2010 CIV Report in any form of LOB rule, “simplified” or otherwise

The final report should provide clearer guidance as to where the boundary between CIVs and non-CIVs lies, with broadness of scope being encouraged. For example, the use of an approach as detailed as the UK’s “genuine diversity of ownership” test, as a way of meeting the “widely held” condition, noted at paragraph 13 of the RDD, should be considered further. Similarly, examples of what constitutes “investor-protection regulation” would be useful. For example, confirmation that a fund vehicle whose manager is subject to the full scope of the AIFM Directive within the EU is to be regarded as subject to “investor-protection regulation” would be both useful and reasonable.

Encouragement for implementation of the TRACE project is welcomed. However this should not be seen as allowing Contracting States to be deflected from progress in following the recommendations of the 2010 CIV Report. Agreement on clarifying the tax treaty entitlement of CIVs is essential before TRACE implementation can be effective, and not vice-versa.

The investor base of many investment vehicles is frequently concentrated in large, often tax-exempt organisations and governmental institutions which, if investing directly, would benefit from a further reduced rate of tax (or an exemption often accorded to pension funds and governmental funds). We recommend that CIVs and non-CIVs qualify for treaty benefits if they satisfy a derivatives benefit test similar to that set forth more generally in the simplified LOB. In light of the unique nature of collective investment vehicles, we urge that the required percentage owners of qualified or derivative owners should be the same 50 percent threshold as used in the ownership/base erosion test. This

would ease what would otherwise be a difficult and sometime impractical administrative burden for CIVs and non-CIVs to not only trace the residency of their ultimate investors but also to determine whether they meet the criteria for treaty eligibility. For those for whom the derivative benefits approach is not feasible, we recommend the inclusion of a "look-through" approach as included in the sixth option of the 2010 Report irrespective of whether the CIV is opaque for local tax law purposes, thereby allowing ultimate investors to claim the same treaty benefits that would be available had they invested directly. Tests focused on the eligibility of the investors should allay concerns about treaty shopping. We note that collective investment vehicles will in any event be subject to whatever anti-abuse rule is agreed by the treaty partners although, as noted in our discussion of the PPT, we would urge an example that creates a presumption that the PPT will not apply to collective investment vehicles due to their clear non-tax reasons for existing.

**Targeted LOB Proposals**

We have commented extensively on many of the detailed aspects of the ETB proposal and refer you to those detailed comments. In the interest of adhering to the request to keep comments brief, we highlight here select key proposals, the resolution of which we view as critically important to the development of a fair and practical approach to LOB, whether found in the text of the LOB or in Commentary.

1. **Discretionary grant of treaty benefits**. It has long been recognized that the objective tests for eligibility for treaty benefits will deny access to the treaty to treaty residents that are not treaty shopping. The discretionary grant provision is a recognition of this reality and is intended to assure those who can establish to the satisfaction of the relevant tax authority that the acquisition, establishment or maintenance of the resident or the conduct of its operations did not have a principal purpose of obtaining the benefits of the treaty. This provision is intended as a safety net for treaty residents. However, the RDD would impose new standards rather than add clarity to the existing standards, including an additional requirement that the claimant have a clear non-tax business reason for establishing residency in the treaty jurisdiction. There are many fact patterns where the ability of a claimant to meet this standard is questionable but the decision to locate in the treaty jurisdiction was not motivated by access to treaty benefits (such as a private equity fund's acquisition of a publicly traded company). Adding this new hurdle is unnecessary and inappropriate, particularly where the tax authority already has broad discretion in determining whether to grant benefits. Similarly, the RDD could be read to support a determination by a tax authority that a claimant's considerations for choice of residency included the fact that the jurisdiction had a wide network of tax treaties triggers a principal purpose conclusion, even if the claimant had no interest in the relevant treaty at the time of establishing residency in the country. Further, the discretionary grant process is seriously compromised if there is not a disciplined procedure for assuring prompt resolution of a request for a discretionary grant; simply stating, as suggested in the RDD, that the request should be handled expeditiously is not meaningful. Finally, there should be an opportunity for the tax authority of the country of residence to have a substantive voice in the resolution of a request if a source country is proposing to deny the request.
2. **Intermediate Owners**. The proposal to deny treaty benefits to a subsidiary company where there is an intermediate owner that is not a resident (or, in the case of the derivative benefits test, an equivalent beneficiary) has no defensible policy justification and would severely limit

access to treaty benefits for such subsidiary companies because, either as a result of acquisitions or regional structuring choices, having an intermediate owner in a third jurisdiction is common in the corporate world. A simple example is where a publicly traded company resident in Country A acquires the parent of a corporate group and the parent is in Country B such that the acquired group has a subsidiary in Country A. The RDD offers as a policy reason the fact that base eroding payments can be made by the subsidiary to the intermediate owner. However, base eroding payments can be made by the subsidiary to any member of the corporate group, unrelated to where the recipient is in the chain of ownership. Further, the subsidiary, under most tests, will already have to meet a base erosion test.

3. **Active Business Test**. The active business test treats a company as having adequate nexus to its country of residence if it is engaged in active business in the residence country but limits access to treaty benefits to income connected to that business. In almost all US tax treaties with LOBs, the business activities in the residence country of an affiliate can be attributed to the resident company claiming the treaty benefits. RDD notes that the US delegate has proposed that the attribution rule not apply if the claimant itself is not conducting business in the residence jurisdiction. Under this proposal, an operating company receiving a dividend from an affiliate in the source country could claim treaty benefits as long as the dividend met the requirement that the income be connected with the active business in the residency country (e.g., the payor is in the same business) but that same dividend would not qualify if received by a holding company resident in the treaty jurisdiction. The attribution rule simply is a recognition that, once the business nexus to the jurisdiction is established, the taxpayer should not be deprived of the treaty benefit if the taxpayer chooses a local organization involving multiple entities. The proposal from the US delegate would force companies to distort their operations to have the operating company hold the shares rather than the holding company. For a test that only applies to the business connected income this makes no policy sense and should be rejected.

**New proposals on special tax regimes and partial treaty termination**

For the first time, and at the very end of the BEPS process, the RDD introduces two new proposals that would reflect fundamental changes in treaty policy. A major shortcoming of the BEPS process is the truncated time period allowed to address complex, untested principles. Neither time nor the request for brevity allows us to critique the rules proposed in the RDD for these novel concepts that can have a major impact on entitlement to treaty benefits and the viability of a tax treaty. Determining how these rules would work, the definitional standards to be applied, the appropriateness of the "remedy" and the local constitutionality of the partial termination proposal are among the more obvious issues that should be vetted in a careful, deliberative process. The BEPS process has been an iterative process where new rules are aired, stakeholders respond, revisions are proposed and further input is provided by stakeholders before the end product is produced. We urge that the final report on Action 6 should not attempt to formulate rules that could be faulty and could be embedded in the Model or the multilateral convention, making hastily developed decisions difficult to reverse. Rather, it would be appropriate to set forth general principles for further consideration and development in a deliberative manner.

**The Principal Purpose Test**

We welcome the inclusion of examples that help provide guidance on the parameters of the principal purpose. Unfortunately, the examples offer limited guidance because they address facts where the outcome is obvious, adding little to the clarity that is so important for the PPT. We urge the Working Group to add further examples based on suggestions made by those who responded previously. We note, in particular, that examples demonstrating that the use of an entity for the purpose of collective investment is a positive factor in determining that such collective investment vehicles ordinarily would not be subject to challenge based on the principal purpose test. Also, in aligning the standards under the discretionary grant procedure in the LOB article with the standards applied to the principal purpose test, we refer to our comments with regard to the standards to be applied for discretionary grants for what we believe are necessary modifications of the standards to achieve an equitable, balanced approach to the discretionary grant (or denial) of treaty benefits.

Finally, we suggest that the last sentence of Paragraph 63.1 be revised to read: "All evidence relevant to the determination of a principal purpose must be provided to the competent authority in order to enable it to determine whether this is the case." Adding a standard of relevance will protect against information requests that may be motivated by reasons other than the relevant determination.

**Other issues**

We welcome the requirement for competent authorities to deal with requests regarding dual residence "expeditiously". We nonetheless consider that, in the interest of certainty and equity, a timeline be added. Our suggestion is "The competent authorities to which a request for determination of residence is made under paragraph 3 should deal with it within 6 months, unless there are exceptional circumstances preventing this, and should communicate their response to the taxpayer as soon as possible".

In regard to the design and drafting of the applicable rule to a permanent establishment in third States, we urge the Working Party to reinstate former paragraph f) excepting royalty income from the rule if the royalties are earned with respect to intangible property produced or developed by the enterprise through the permanent establishment. From an EU law perspective, the Cadbury Schweppes case would suggest that taxing rights in regard to an arm's length profit earned by activities undertaken in the jurisdiction of the permanent establishment should remain with the source country, irrespective of the effective rate of tax.

Yours sincerely

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