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VIA EMAIL

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Re: USCIB Comment Letter on the OECD Discussion Draft on Follow Up Work on BEPS Action 6: Preventing Treaty Abuse

Dear Ms. de Ruiters,

USCIB¹ is pleased to have this opportunity to provide comments on OECD's discussion draft on follow up work on BEPS Action 6.

General Comments

USCIB stands by its comments of April 4, 2014, on the OECD's Discussion Draft on BEPS Action 6. The Action 6 2014 Deliverable did not address many of the concerns we raised. In particular, the 2014 Deliverable and the follow-up discussion draft (hereinafter "the guidance") retain the singular focus on combating treaty abuse. The guidance does not have due regard for the impact on the vast majority of potential beneficiaries of income tax treaties that do not engage in abusive practices and that, due to the broad reach and vagueness of the proposals, would in many cases, lose access to tax treaties and, in any event, will be deprived of the certainty and predictability that is a fundamental goal of tax treaties. We want to be very clear that, in our

¹ USCIB promotes open markets, competitiveness and innovation, sustainable development and corporate responsibility, supported by international engagement and prudent regulation. Its members include top U.S.-based global companies and professional services firms from every sector of our economy, with operations in every region of the world. With a unique global network encompassing leading international business organizations, USCIB provides business views to policy makers and regulatory authorities worldwide, and works to facilitate international trade and investment.

view, the recommendations in the guidance would fundamentally change the role of tax treaties by effectively depriving *bona fide* enterprises and business transactions of the protection accorded by tax treaties from excessive and double taxation, at serious cost to the global economy.² Action 6 should start with the premise that the vast majority of beneficiaries of tax treaties are *bona fide* and then recommend solutions to treaty abuse that are focused, objective and administrable.

Paragraph 6 of the 2014 Deliverable states: “When examining the model treaty provisions included in this report, it is also important to note that these are model provisions that need to be adapted to the specificities of individual States and the circumstances of the negotiation of bilateral conventions.” USCIB strongly agrees with this statement. Presumably, the OECD intends to implement the guidance through the negotiation and adoption of a multilateral instrument. While a laudable goal, this is inconsistent with the OECD’s own recognition of the need to adapt approaches to account for different circumstances. This conflict may prove difficult to resolve. That is, the drive to create a MLI may lead to trying to resolve on a multilateral basis issues that can only effectively be resolved on a bilateral basis. USCIB believes that much of the complexity of the guidance and the unresolved issues in the discussion draft reflect this tension. USCIB believes this is especially the case with respect to the LOB provisions as discussed below.

Having considered the LOB provision that appears in the guidance, USCIB recommends that the OECD take a step back and consider the best way to move forward with incorporating the LOB concept into the proposed minimum standard under Action 6. We believe this could best be done at this stage by approaching the task at a more conceptual level, without attempting to develop specific text for a model LOB provision.

There are several good reasons for shelving the attempt to develop a model LOB provision at this stage. The reality is that only a small handful of the countries engaged in the discussions have expressed the view that an LOB provision would be their primary policy choice for addressing treaty abuse, and we understand the large majority of countries believe the PPT is a better approach. It is not customary, and it does not make sense, for the OECD to try to develop a model provision that only a small minority of countries prefer. It is not obvious to us that even those few countries that prefer LOB provisions will be prepared to follow a model provision worked out by the OECD in the current BEPS process. The September Report itself notes that the model provisions set out there “are model provisions that need to be adapted to the specificities of individual States and the circumstances of the negotiation of bilateral conventions”. One of the main advocates of LOB provisions, the United States, is currently in the process of rethinking its own LOB policies in connection with its development of a new U.S.

² The OECD should be attempting to measure the impact of these changes on global trade and investment.

Model Treaty, just the latest in a very long series of evolutionary changes to the preferred U.S. LOB rules.

The LOB provision presents a large number of complicated policy issues, as is evident from the discussion draft itself. The majority of countries engaged in the discussions have limited background in negotiating LOB provisions and relatively little stake in how those issues might be resolved. That, along with the serious time pressure imposed by the BEPS process, means that issues are unlikely to get the careful analysis they deserve. It would make more sense for those issues to be the subject of direct negotiations between the countries that prefer LOB provisions and their treaty partners. That would also leave more time for the delegates to the BEPS project to resolve the many other outstanding treaty-related issues that feature in that project.

We think it is also clear that the amount of commentary and controversy generated by the draft LOB provision published by the OECD, a provision that was acknowledged to have been largely based on the complex provisions appearing in recent U.S. treaty practice, highlights the fact that the draft is not well-suited to form part of a “minimum standard” of treaty anti-abuse provisions to be endorsed by the OECD.

Therefore, rather than expending more effort to try to develop LOB model text which is unlikely to serve as a real model for widespread use in treaty negotiations, we recommend that the OECD endorse the concept of an LOB provision in principle. Such an endorsement could include a broad description of the basic building blocks typical to an LOB provision (i.e., a requirement that a resident of a Contracting State satisfy one or more specified tests to be entitled to treaty benefits; a series of objective safe harbor provisions designed to provide qualification to individuals, governments, tax exempt entities and pension funds, publicly traded companies and their subsidiaries, entities meeting an “ownership / base erosion” test, entities meeting a “derivative benefits” test, and income derived by entities in connection with or incidental to the active conduct of business in the residence State; and a provision authorizing a Contracting State’s competent authority to grant treaty benefits on a discretionary basis by applying a standard comparable to that applied under the PPT). The OECD might or might not refer to certain examples of LOB provisions appearing in countries’ treaty practice as satisfying the LOB leg of the minimum standard, without endorsing the specific drafting of those provisions. We believe this approach would be best suited to achieving the objectives of Action 6 and would protect the OECD from being drawn into further time-consuming and contentious debate about the design of a provision which is unlikely to operate as a broadly accepted model.

USCIB believes this approach is preferable to rushing through a model LOB provision that has not been carefully considered. We therefore think it should be unnecessary to answer many of

the questions posed by the discussion draft. We do, however, comment on those questions below.

As a final general comment, USCIB strongly disagrees with the statement in the discussion draft on BEPS Action 4 concerning the interaction of rules on interest deductibility and BEPS Action 6. Paragraph 225 of the Action 4 discussion draft states: “following the introduction of best practice rules to combat base erosion and profit shifting using interest expense, some groups may look to other available planning opportunities, which could place greater pressure on anti-abuse clauses in treaties and domestic law.” The stated goal of Action 4 is to encourage groups to adopt funding structures which more closely align the interest expense of individual entities with that of the overall group.³ If Action 4 has the intended effect, then treaty abuse becomes less likely and the appropriate relief from double taxation becomes even more important. Thus, an inappropriately narrow LOB provision becomes even more harmful to global trade and investment.

Specific Comments

1. Collective investment vehicles: application of the LOB and treaty entitlement

USCIB strongly supports the BIAC comments advocating for treaty rules based on the 2010 report.

2. Non-CIV funds: application of LOB and treaty entitlement

USCIB strongly supports the BIAC comments on non-CIV funds.

3. Commentary on the discretionary relief provision of the LOB rule

The ability of taxpayers to have access to an efficient and practical discretionary grant process becomes increasingly important if the objective tests in the proposed LOB article are overly restrictive, with the result that a double tax agreement intended to provide treaty benefits for tax residents of the treaty partners only provides benefits for a limited class of tax residents absent a practical and expeditious process for the discretionary grant of treaty benefits. In the United States, the discretionary grant has been described as the "safety net" in recognition that the objective tests in the LOB article may unintentionally deprive bona fide residents of the treaty country access to the treaty and the protections it affords against double taxation and excessive taxation. Thus, we were disappointed that, in contrast to the constructive tone of most of the discussion draft, the discussion of the discretionary relief provision conveys a disturbingly restrictive approach, similar to many aspects of the proposed LOB article more broadly. Our concerns over the restrictive nature of the discussion draft include the following:

³ Discussion draft, BEPS Action 4: Interest Deductions and Other Financial Payments, paragraph 10, page 10.

- The statement that the fact that a tested subsidiary company would obtain a treaty rate reduction no greater than could have been obtained by the parent company under its resident country's treaty with the source country is not sufficient to establish the lack of a treaty shopping motive. We submit that it is quite clear that if there has been no greater treaty benefit obtained by an investment through the subsidiary company than would have been obtainable by the parent company, the subsidiary could not have been formed or availed for a principal purpose of obtaining the treaty benefit. There may be other tax benefits obtained by use of the subsidiary company as the investment vehicle but any such non-treaty benefits that are believed to violate BEPS principles should be dealt with directly, such as through CFC rules, hybrid rules, harmful tax practices and the like but not by denying treaty benefits indirectly obtained that could have been obtained directly.
- The discussion draft gives insufficient attention to the serious problems of lengthy procedures that can leave a taxpayer deserving of access to the treaty with an extended period of uncertainty and deprivation of treaty benefits during the pendency of the procedure. Simply suggesting the Commentary should "encourage" competent authorities to process requests expeditiously undervalues this serious concern. Taxpayers should bear the responsibility of establishing that they are not treaty shopping. Tax authorities should have the responsibility of confirming treaty access expeditiously.
- In contrast to the discussion draft's recommendation that determinations by a tax authority that a transaction violates the principal purpose test should be subject to the treaty's mutual agreement procedure, the discussion draft suggests that if a tax authority has "properly exercised" its discretion, that decision should be final and not subject to the treaty's mutual agreement procedure. It is unclear who is the arbiter of whether the tax authority has "properly exercised" its authority, which underscores the wisdom and fairness of making the process subject to review with the treaty partner. We believe that when a tax authority is considering denying a resident of a treaty partner access to the treaty, there should be a full and fair airing of that decision with the treaty partner. Subjecting a treaty resident to the potential of double taxation or excessive taxation should be viewed as sufficiently harsh to mandate procedures to protect against inappropriate unilateral action by the source state's tax authority.

We encourage the Working Group to be sensitive to the above concerns and suggest the following basic principles that should apply in developing the proper discretionary grant procedures and policies:

- The standards to be applied by the requested tax authority must be clear and public, not leaving the standards subject to the whim of any tax authority.
- If the requesting taxpayer is claiming a treaty benefit that it, or its affiliated group, could have obtained without use of the treaty, the standard should be considered met.
- There should be strict time limits set on the amount of time the tax authority has to provide a conclusion with model guidelines set forth in the Commentary subject to bilateral variations or embellishments agreed upon between the treaty partners.
- If the requested tax authority intends to deny the request, procedures should be included that require the tax authority to present its tentative decision to the treaty partner's tax authority with a full explanation of the reason for the proposed denial of treaty benefits. If the tax authority of the treaty partner does not agree to the proposed denial of treaty benefits, the matter should be resolved through the mutual agreement procedure.

We offer the following examples of cases where the discretionary grant should be given:

- Treasury center: A multinational enterprise places its global or regional treasury function in a separate company. In choosing the country of residence of the treasury center, the enterprise considers a variety of factors, including creditor rights laws, banking laws, stability of the government, an established infrastructure of professional support, labor laws and various regulatory laws. Also considered is the local tax burden and the network of double tax agreements that avoid excessive taxation of interest and investment income.
- Local financing: Company D would meet the relevant base erosion test except for the fact that it obtains bank financing from a local bank that does not qualify for the exceptions to the base erosion test because the local bank is a subsidiary of a public bank holding company and the exception from the base erosion test only applies to payments to local publicly traded companies.
- Joint venture: Company E, resident of treaty partner X under the X/Y treaty and Company F, a resident of treaty partner Y, form a joint venture in the form of a corporation resident in Country Y. The joint venture is a 50-50 undertaking but to avoid deadlock on corporate decisions, Company E, is given an additional vote. Because the ownership/base erosion test only treats residents of Country Y as "good" owners, the joint venture company fails the ownership part of the ownership/base erosion test.

- Organic expansion: Company A was established one hundred years ago as a family business (we know of examples that go back 200 or 300 years) created in the family's country of residence. Over the years the business has grown from a local business to a global enterprise. While management remains in the home country, the local business has diminished in size relative to the global business, causing the company to fail the trade or business test.
- Ownership expansion: Company B was established by three family members, all resident in the country of residence of all three family members, Country B. Company B has formed a regional holding company in Country C that holds investments in Country D. The treaties between Country B and Country D and between Country C and Country D provide identical benefits. Over the generations, the family has grown to the point that ownership is now shared by 12 descendants of the three original founders, most retaining residence in Country B. As a result of the family expansion, the derivative benefits test is failed since it requires tracing ownership to 7 or fewer equivalent beneficiaries.
- Going private: A multinational enterprise, based in Country C, is acquired by a private equity fund. The taxpayer establishes by clear and convincing evidence that the acquisition was driven by solid non-tax business reasons.

USCIB believes all of these cases should be granted discretionary relief and examples indicating that should be included.

4. Alternative LOB provisions for EU countries

The discussion draft states that “there is therefore a need to draft alternative provisions that would accommodate the concerns of EU member states.” (Para. 22, page 8.) This may be necessary because the absence of a derivative benefits test is an instance in which the proposal would violate the EU freedom of establishment rules. From the point of view of U.S. observers, if the goal is to provide derivative benefits to the EU residents that are equivalent beneficiaries, then that issue should be resolved by drafting an appropriate derivative benefits/equivalent beneficiaries rule as described below (issue 6) and not providing a special rule for EU residents. EU residents should not be any more or less entitled to derivative benefits than residents of any other country.

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

USCIB opposes the proposed requirement that would eliminate access to treaty benefits based on the existence of an intermediate owner. The proposed requirement would serve no policy goal and would place a severe restriction on the access to treaty benefits.

The discussion draft (at paragraphs 23 and 24) notes that some States consider the requirement found in subdivision 2 *c(ii)* and 2 *e(i)* requiring that each intermediate owner of a tested company be a resident of either Contracting State may be unduly restrictive and states that further work is required in order to determine whether and how the requirement could be relaxed without creating opportunities for treaty-shopping. The same issue exists in the draft provision on derivative benefits. We fully endorse a further review of these intermediate owner restrictions and urge that they be eliminated in all three provisions.

In regard to the view that these intermediate owner restrictions are unduly restrictive, we note that they potentially would eliminate access to treaty benefits for many if not most multinational enterprises. These enterprises typically involved 100s, if not 1000s of affiliated companies and where a tested entity is situated within the multinational group's organizational structure may be the result of a variety of factors. Some common examples are:

- A multinational enterprise has acquired another corporate group with an existing organizational structure. For example, Company X, resident in Country A acquires Company Y, resident in Country B. Company Y has a subsidiary in Country A, owned either directly or somewhere down the chain of ownership of the Company Y group.
- A multinational enterprise has organized its corporate ownership structure along regional lines. For example, Company X, resident in Country A, has created a regional holding company in Country B to oversee and own affiliated entities in the EMEA region and one of those affiliates is resident in Country A.
- The comparable fact pattern may exist where Company X has organized its structure based on lines of business. For example, Company X, resident in Country A, has created a company in Country B to oversee and own all affiliates that are in a single line of business, amongst the various lines of business in the enterprise. One of those subsidiaries is a resident of Country A.

Each of the above examples are very common and are simplified examples of why a tested company may be several tiers removed from its parent company with intermediate owners resident in a variety of countries. It often would be costly to restructure to avoid the “no bad intermediate owners” rules. For instance, there may be exit taxation resulting from the extraction of the tested company from its current line of ownership. In addition to being costly, it may be legally impossible or impractical because of regulatory restraints or other local law restrictions, or because of covenants in existing bank or public debt documents. Similarly, shares in the tested company may be held by a lender as security for the loan with restrictions

on any change of ownership. In addition to these economic and legal impediments to changing ownership, doing so would disrupt organizational efficiency creating unnecessary and complex reworking of corporate governance.

Underscoring the inadvisability of an intermediate owner rule is the fact that we can perceive of no policy justification for the rule and have seen no explanation justifying its existence, other than an esoteric and unsubstantiated statement that it may lead to treaty shopping. The closest we have seen to any explanation is an example in the discussion of the derivative benefits test in the original discussion draft where an intermediate owner pays a royalty to an affiliate in another country that provides preferential tax treatment for royalty income. But that same royalty could have been paid by the tested entity, with no intermediate owner between the tested entity and the ultimate parent, or it could have been paid by the parent company. The only legitimate concern is the ability of the payee of the royalty to receive favorable tax treatment of the royalty income but that has nothing to do with where the payee is in its corporate chain.

We note that the only impact of having an intermediate owner is that the tested company can pay dividends to the intermediate owner out of treaty-benefited income. However, that dividend payment is not deductible. The treaty benefited income of the tested income has not been reduced by the dividend payment and, accordingly remains in the tax base of the tested company. While the dividend may not be subject to tax by the residence country of the intermediate owner, depending on how its tax system deals with parent/subsidiary dividends, it is likely that the parent company's country of residence has a similar system for not subjecting dividends to tax. Hence, in most cases, the tax results would be the same whether the tested company paid the dividend to the intermediate company or if the tested company paid the dividend directly to the parent company. We further note that if the intermediate company was not in the chain of ownership but a sister company to the tested company, the dividend could be paid to the parent company and then the funds could be contributed down by the parent company to the sister company. In other words, no tax advantage, or treaty abuse, has occurred by reason of the intermediate owner being in the ownership chain. The only practical effect would be to eliminate access to treaty benefits for a large portion of the multinational population.

Any concern with dividend income being held by an intermediate company where the parent company's country of residence does tax dividends should be addressed directly, such as in the context of CFC rules, rather than making the major tests for the treaty qualification of subsidiary companies inaccessible to many, if not most, multinational enterprises.

For the above reasons, we urge that the restraint on intermediate ownership be eliminated from all three tests where it now appears.

6. Issues related to derivative benefits

The discussion draft solicits comments on the definition of equivalent beneficiary and the need for each intermediate owner to be an equivalent beneficiary. Our comments on issue 5 apply equally here. We also reiterate the portion of our comments on issue 3 (concerning discretionary relief) that relates to rate reductions. If a tested company would obtain a treaty rate reduction no greater than could have been obtained by the parent company under its resident country's treaty with the source country, then it is clear that a treaty rate reduction is not the principal purpose of the structure.

The OECD has repeatedly stated in the context of the BEPS project that BEPS is not about tax rate competition, yet the first discussion draft cited a preferential tax rate as the reason for omitting a derivative benefits test. We note that all three companies in the example would be entitled to the same source country tax reduction under the relevant treaties, so the establishment of the tested company in State S does not provide any treaty benefit that would not otherwise be available. We further note that the Parent in State T could also pay a royalty to the affiliate in State R and that apparently does not raise BEPS concerns. If the preferential tax regime for royalties in State R is considered a BEPS concern, then the proper avenue for addressing it is in the harmful tax practices Action Item. If the preferential rate is not considered to constitute a harmful tax practice, then the appropriate response is for State S to take this into account in its treaty with State R. If the preferential regime is not harmful and State S has considered it in the context of the treaty with State R, then there is no reason to consider that preferential regime in determining whether derivative benefits are appropriate.

One of the reasons that a derivative benefits test is important is that it provides a level of certainty that is not available with other tests. For example, the active trade or business test may be difficult to apply and lead to uncertain results (see discussion below). Listed below are some instances when USCIB believes it is appropriate to apply a derivative benefits test. Many of these overlap with the cases discussed above and the rationales supporting the application of a derivatives benefits provision are the same as those supporting either discretionary relief or deleting the intermediate owner requirement or are intended to address problems with the active trade or business test.

Derivative benefits should be available in the case of: joint ventures, treasury and regional holding companies, organic expansion, and acquisitions. To the extent that the active trade or business test requires that the business be substantial in relation to the business conducted in

the source country, this standard may be impossible to meet for, for example, a small local distributor.

7. Provisions dealing with “dual-listed company arrangements”

USCIB has no comments on this issue.

8. Timing issues related to the various provisions of the LOB rule

As noted in paragraph 28 of the discussion draft, timing issues are dealt with differently under various provisions of the LOB rule. For instance, as noted, the definition of "qualified person" in paragraph 2 applies at the time when a benefit would otherwise be accorded. In our view, this general view is sound for individuals and governments. We offer the following comments for other categories:

1. The publicly traded test (and subsidiary of publicly traded entity)

The proposed Commentary on the publicly traded test states that the conditions of subparagraph c) must be satisfied throughout the taxable period of the company or entity. This standard raises several practical concerns:

- First, as noted in the Discussion Draft, this creates a problem in the year the company becomes listed. Similarly, this creates a problem in the year a company de-lists. We submit that, in these "short-year" situations, there should be no reason to deprive a publicly traded entity of treaty benefits in the first or last year of its publicly traded status. Rather, as with the general rule for paragraph 2, the test should be applied at the time the potentially benefitted income is received. As long as a company meets the publicly traded standards (including the "regularly traded" requirement) at the time the payment is received, treaty benefits should be accorded. There are sufficient safeguards in the publicly traded test (including the regularly traded test and the listed stock exchange requirement) to prevent abuse without a requirement that the publicly traded test be met throughout the relevant year. Absent testing at the time of receipt, it would become impractical to administer the withholding regime.
- Second, we suggest that the Commentary: (i) allow the taxpayer to apply the regularly traded test based on the prior tax year, if there is a full prior tax year in order for the taxpayer to be confident that it can represent to withholding agents that it meets the test, relying on current year trading only where there has not been a full tax year of public trading in the preceding year, and (ii) provide an adjustment to the Commentary's numerical test of regularly traded (10% of the average outstanding shares traded during

60 days of trading) for short years -- that is, the first year of trading and the last year of trading. By way of example, U.S. tax regulations applying rules similar to the publicly traded test substitute, in a short year, one-sixth of the number of days of the short year for the 60 days and adjusts the 10% of the average outstanding shares by multiplying 10% by a fraction, the numerator of which is the number of days in the short year and denominator of which is 365.

- Third, the statement in the proposed commentary that the conditions of subparagraph c) must be met throughout the taxable year should be clarified for purposes of applying the subsidiary of a publicly traded company to make clear that the subsidiary test applies at the time the benefit is claimed. In other words, the fact that a company becomes a subsidiary or ceases to be a subsidiary at some point during the taxable period should not impact the eligibility of the subsidiary for treaty benefits as long as the company met the subsidiary test at the time the treaty benefit is claimed.

2. The ownership/base erosion test

This test looks to the percentage of qualifying ownership of the tested entity and whether certain deductible payments to non-qualified persons exceed 50% of the tested company's gross income. A critical timing consideration is that, with respect to items of income that are subject to withholding at the time of payment, the withholding agent must be able to determine the recipient's treaty status at the time of payment. Both elements of the test require testing ownership and base erosion payments over the full taxable year. It is not practical for the tested company to know whether it will meet those tests before the end of the year. To make the tests practical, we submit the tested entity should have the option of using the prior tax year for determining eligibility where such prior year exists. We further note, with respect to application of the base erosion test, the same timing issues exist under the derivative benefits test. Accordingly, companies should have the option of applying the test based on the prior taxable year.

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

These conditions should be deleted. USCIB believes there are two types of treaty shopping. One is the use of a treaty by a third country person who simply sets up an entity in a treaty state. It is very difficult to use a publicly traded entity for this type of treaty shopping (which is the origin of the principle that publicly traded entities should be considered qualified residents in their jurisdiction of residence). The second type of treaty shopping involves conduit financing arrangements; publicly traded entities can be used to achieve conduit financing results and would be subject to any conduit rule. Thus, the status should be irrelevant with respect to conduit financing arrangements.

Further, these provisions are based on U.S. domestic concerns with inversions. As the OECD pointed out in paragraph 6 of the 2014 Deliverable, these provisions are intended to be a model and will need to be adapted to the specificities of individual States. This is a prime example of a rule that should be left to individual States to determine on a bilateral basis whether this rule is needed. If the U.S. believes this is essential, then they can insist on including it in their bilateral agreements, but it should not become part of the model.

10. Clarification of the “active business” provision

One important role for the active business provision of paragraph 3 is to allow treaty benefits for dividends or other payments made by an active operating subsidiary to its active operating parent where they are engaged in the same or complementary lines of business, regardless of whether the parent is a qualified resident. Unfortunately neither the text of paragraph 3 nor the commentary thereunder makes this as clear as it should be. The Follow-Up Discussion Draft, at item 10, invited comments on the exact scope of the last sentence of paragraph 48 of the Commentary, which provides as follows:

Since a headquarters operation is in the business of managing investments, a company that functions solely as a headquarters company will not be considered to be engaged in the active conduct of a business for purposes of paragraph 3.

This sentence was taken from the Technical Explanation of the U.S. Model Treaty. It is merely an illustration of the general rule that, in order to qualify for benefits under paragraph 3, the recipient of the income must be engaged in an active business, and that the term active business, while not defined, specifically excludes the business of making or managing investments for one’s own account (unless that business is carried on by a bank, insurance company or broker). Moreover, because a headquarters company conducts no active business, it would be impossible to apply the general rule of paragraph 3 to it, as the general rule requires that the benefitted item of income be derived in connection with, or incidental to, an active business.

However, the attribution rule of subparagraph (c) may permit a headquarters company to receive treaty-benefitted payments in certain cases where the headquarters company is affiliated with other companies that are engaged in same country active businesses. The attribution rule recognizes that, for business reasons unrelated to treaty shopping, multinational businesses often do not conduct all activities incident to an active business in one entity. It would be helpful for the Commentary to clarify that the last sentence of paragraph 48 of the Commentary does not preclude the attribution of a same country active business from an affiliate to a headquarters company for purposes of treating the headquarters company as if it were engaged in that active business.

The attribution rule would work as follows: the taxpayer must be connected to the person from which the active trade or business is attributed and the income must be derived in connection with or incidental to the active trade or business. USCIB believes that a taxpayer that is resident in the same country in which the active trade or business is conducted may be attributed the active trade or business regardless of whether that entity is a parent, subsidiary, or brother/sister entity. If the recipient of the income is a holding company, then the income must be derived in connection with or incidental to the attributed active trade or business.

11. Application of PPT rule where benefits are obtained under different treaties

Paragraph 13 of the Commentary on the PPT rule (para. 17 of the Report, page 71) is very poorly drafted. The paragraph starts off explaining when a purpose will not be considered a principal purpose. It states:

[W]here an arrangement is inextricably linked to a core commercial activity, and its form has not been driven by considerations of obtaining a benefit, it is unlikely that its principal purpose will be considered to obtain that benefit.

It is difficult to imagine when it would ever be appropriate for a tax authority to challenge the *bona fides* of such an arrangement. Thus, the use of the word “unlikely” is disturbing. This illustrates the core issue with the principal purpose test: its application is uncertain. If the OECD is unwilling to make a conclusive statement that a principal purpose of obtaining a treaty benefit is not present in such a case, when will the taxpayer ever be able to achieve certainty?

Paragraph 13 then returns to explaining when a purpose may be a principal purpose. The focus of this part of the paragraph is confused. The example seems to be dealing with a conduit financing arrangement, in which case one would expect to look at the purpose of the transaction rather than the “arrangement” of the entity. This goes to the view that USCIB expressed above and in its earlier comment letter, that there are two types of treaty shopping and issues relating to the establishment of an entity should not be confused with issues relating to conduit financing arrangements. If a taxpayer is attempting to determine whether a transaction is a conduit financing arrangement, then purposes relating to the establishment of the entity are irrelevant. Similarly, if the treaty benefit does not relate to a conduit financing arrangement, but rather the status of the entity as a qualified resident of a jurisdiction, then that determination generally ought to be based on purposes relating to the establishment of the entity and not the intent with respect to a particular transaction.⁴ A properly functioning LOB article is intended to provide guidance that defines appropriate boundaries on the status of

⁴ The active trade or business test is a bit of a hybrid, since the test is transactional, but in general a properly functioning LOB provision is not an item by item test.

the resident. The PPT is confused because these two different types of treaty shopping are not distinguished. We anticipate that this will lead to problems in the application of the PPT.

12. Inclusion in the Commentary of the suggestion that countries consider establishing some form of administrative process ensuring that the PPT is only applied after approval at a senior level

USCIB strongly agrees with this suggestion as the ability of lower-level tax authorities to routinely assert the PPT will greatly increase uncertainty.

13. Whether the application of the PPT rule should be excluded from the issues with respect to which the arbitration provision of paragraph 5 of Article 25 is applicable

USCIB strongly agrees that this issue ought to be covered by an agreement to submit to binding arbitration. It is unclear why the views of the minority would need to be expressed in any way other than as a reservation or observation, as has been the traditional practice with respect to the OECD Model. Further, to the extent that countries are unwilling to agree to arbitration generally, their objection to arbitration in this case ought to be clear.

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 purpose test

USCIB believes that where facts warrant a discretionary LOB ruling they should also warrant good treatment under the PPT rule. Thus, all of the examples set out on page 5 above ought to be considered cases in which the PPT does not apply. As discussed above, in the context of the LOB provision, the tax authorities ought to be taking into account “foot faults”. It is not clear that this concept has any relevance for the PPT. Thus, it may be necessary for the OECD to provide more extensive examples to make clear the proper scope of the PPT rule. It would be helpful to provide certainty and harmonized policies for both if the examples under the PPT were broadly aligned with the LOB provisions.

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

USCIB agrees that discretionary relief ought to be available as suggested in the Discussion Draft.

16. Drafting of the alternative “conduit-PPT rule”

As stated in the general comments section of this letter, USCIB believes that the LOB should not be part of the OECD model. Because the anti-conduit-PPT is intended to be applied in conjunction with the LOB test, we also believe (for the reasons set forth above) that the OECD should not draft specific text with respect to the anti-conduit rule. To the extent that the LOB conduit arrangement option is specifically targeted to the U.S. because of its inability to agree

to a principal purpose test and the U.S. already has extensive rules on conduit financing arrangements in place, it ought to be unnecessary to provide additional rules in the OECD model.

We nevertheless make the following high-level comments. The “at any time or in any form” standards contained in the 2014 Report are far too onerous, particularly in light of the application of this rule in conjunction with the LOB provisions. That is, an LOB provision will already contain an ownership/base erosion provision, so the qualified resident is by definition not paying out excessive amounts to non-residents. Thus, if the OECD feels compelled to add something, perhaps it should focus on defining structured transactions. Perhaps it would be good to adapt the standards from the Report on Hybrids (recommendation 10) to define a structured transaction that is a conduit financing arrangement.

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

USCIB suggests that all of the examples identified on page 5 as deserving of discretionary relief should also be entitled to treaty relief under the PPT rule.

18. Application of the new treaty tie-breaker rule

USCIB notes that the proposed rule denying any relief or exemption when the Contracting States cannot agree on a residence reflects current U.S. treaty policy. Thus, this does not represent a change for U.S. companies. We agree with the proposed clarifications set forth in the discussion draft.

20. Proposed Commentary on the interaction between tax treaties and domestic anti-abuse rules

USCIB is very concerned about the UK’s recent so-called “diverted profits tax” proposal. We understand that the UK believes this proposal does not violate its treaty obligations. We are not privy to the UK’s analysis but believe it must be based on the notion that the “diverted profits tax” is a domestic anti-abuse rule that is permissible under the principles expressed in the current Commentary. We disagree strongly with this view.

To the extent that the UK has agreed to PE thresholds, imposing tax on companies that do not satisfy that standard as a penalty for taking legitimate steps to avoid the threshold is not consistent with the specific obligations set forth in the treaty. The point of a threshold is to provide a rule that is clear and uniform, if a company chooses to stay under that threshold that is not abuse of the treaty. If, in the opinion of the UK, there ought to be a maximum amount that can be earned without becoming subject to tax in the UK, then the UK should propose that standard as part of the PE threshold. Absent, such a rule, the so-called “diverted profits tax” is

not an appropriate anti-abuse rule and would violate the UK's treaty obligations. The commentary on domestic anti-abuse rules should make clear that simply moving the bar is not an acceptable anti-abuse provision.

Sincerely,

A handwritten signature in black ink, appearing to read 'William J. Sample', written in a cursive style.

William J. Sample
Chair, Taxation Committee
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