UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

April 29, 2015

VIA EMAIL
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Re: USCIB Comment Letter on the OECD Discussion Draft on BEPS Action 12: Mandatory Disclosure Rules

Dear Mr. Saint-Amans,

USCIB appreciates the opportunity to provide comments on the OECD Discussion Draft on Action 12 on Mandatory Disclosure Rules. Because of the extremely short comment period and the need to comment on other drafts, USCIB has focused on a few high-level issues. The lack of comments on other sections of the discussion draft should not be considered an endorsement of the proposals contained therein.

Coordination with Master File, Local File and Country-by-Country Reporting

USCIB believes that information that is required to be provided as part of transfer pricing documentation should not generally be required to be provided separately through mandatory disclosure regimes. This issue is especially relevant with respect to reporting obligations that would be created under Section IV of the Discussion Draft with respect to so-called "international tax schemes" and imposed on entities that are not parties to arrangements (see also below).

Thresholds for Disclosure

Use of a main benefit test as a threshold for disclosure – The use of a main benefit test to determine whether disclosure is required, particularly if the test is "one of the main benefits" rather than the main benefit, may result in a test that violates the first design principle: "mandatory disclosure rules should be clear and easy to understand." As that design principle points out[1] the main purpose test will result in the following consequences: taxpayers will be uncertain whether disclosure is required, transactions that governments would want to be made aware of may be omitted, information that governments receive may be poor quality or irrelevant, and taxpayers may be subject to penalties when they genuinely believed disclosure was not required.

Hypothetical application of generic hallmarks – USCIB strongly objects to the use of hypothetical generic hallmarks. Taxpayers should be judged by their actions, not by what they might have done. This is especially true in the case of premium fees. The notion that the promoter could have charged a premium fee when they did not, involves too many levels of second guessing of the actual conduct of the parties.

Hallmarks for loss transaction – USCIB urges caution against the inclusion of acceleration of losses as a standard for determining whether a loss transaction ought to be disclosed. How does one determine whether a loss has been accelerated? For example, would the disposition of an asset qualify as acceleration? This test also seems inconsistent with identifying the transfer of losses as a hallmark – either the loss is realized and recognized by the transferor (and perhaps accelerated?) or the loss carries over to the transferee. Loss trafficking seems a far greater concern. Economic losses that have been realized ought generally to be recognized and allowed (subject to any general limitations on the ability to use losses). The ability to claim these losses might be especially significant in an economic downturn. Although the discussion draft states the disclosure has no impact on whether the loss would be allowed or not, the overall notion is that "schemes" are subject to disclosure and the reported behavior is in fact suspect.

Timeframe linked to implementation – With respect to the timing of reporting by users it is important that reporting be linked to some reporting cycle, such as the filing of the annual tax return or quarterly reporting cycles. Otherwise it is too difficult to manage the reporting obligation. If the promoter has the primary obligation to report and that is tied to when the "scheme" is made available to users, then the jurisdiction will have the information relating to the "scheme" that will allow it to react in a timely manner.

[1] Discussion draft paragraph 20.

Consequences of non-compliance – non-monetary penalties – Penalties always ought to be proportionate to the failure, with caps to prevent excessive financial burdens. The second recommendation on penalties provides that "countries are free to introduce penalty provisions (including non-monetary penalties) that are coherent with their general domestic law provisions."[2] USCIB is concerned that this is a very open-ended blessing of non-monetary penalties. While non-monetary penalties relating to tax obligations, such as extending the statute of limitations, may be appropriate, an open-ended invitation to impose non-monetary penalties is not. This recommendation should either be limited to non-monetary penalties relating to tax obligations or amended to provide standards for determining whether the penalty is appropriate in light of the failure.

International Tax Schemes

<u>Policy Objections</u>

Obligation of a domestic taxpayer to report -- USCIB is very concerned about the suggestions made in the section on International Tax Schemes. In particular, the general thrust seems to be to create a reporting obligation to a country even though that country may not have a tax interest in the so-called "international tax scheme". The Discussion Draft recommends that "domestic taxpayers should be under an obligation to disclose a cross-border arrangement to the reporting jurisdiction even if they are not a direct party to the cross-border outcome."[3]

In USCIB's view, this approach raises issues a number of issues that have not been addressed. First, a country may consider and reject mandatory disclosure.[4] If that is the case, why should a taxpayer located in another jurisdiction be required to provide information indirectly[5] to that country? If a reporting requirement is imposed in such a case by country A, but not country B, with respect to country C, then there may be commercial incentives for a country C taxpayer to deal with country B counterparties to avoid the reporting. Second, what is the legal authority of a country to require reporting of a transaction if the domestic taxpayer is not a direct party to the cross-border outcome? The more appropriate approach would be that the parties to the transaction should have the obligation to report.

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[2] Discussion draft paragraph 200.
[3] Discussion Draft, paragraph 241.
[4] We understand Australia has considered and rejected mandatory disclosure.
[5] Presumably through treaty exchange between the local jurisdiction of the taxpayer and the country that rejected mandatory disclosure in the first instance.

The outcome of Action 12 ought to be that countries consider whether they wish to adopt mandatory reporting and the scope of that reporting. Any country that does not adopt mandatory disclosure rules should not expect to receive information from another jurisdiction on transactions affecting its tax base. That is, excessive obligations should not be imposed on taxpayers that are not direct parties to a reportable transaction to make up for the lack of an appropriately imposed reporting obligation.

The absence of obligation to report so-called "international tax schemes" does not mean that countries would not have other sources of information available to them. First, the OECD maintains a database that is available to countries that would enable them to identify a very large number of so-called "schemes". Second, to the extent that countries have a legal basis for doing so, they are free to spontaneously exchange information that they believe will be of interest to another country. Third, the master file and local file may provide this information in a standardized way.

<u>Technical objections</u>

Imposing a reporting obligation on domestic taxpayers that are not direct parties to the cross-border outcome will also violate a number of the design principles that are supposedly important to designing sound mandatory disclosure regimes. First, the materiality standard is not clear and easy to understand. Second, there seems to be no balancing of compliance costs with the benefits obtained by the tax administration. The discussion draft acknowledges that domestic taxpayers may have incomplete knowledge of the transaction, but reporting is nevertheless required. There does not seem to any "out" from reporting if the actual parties to the transaction are subject to reporting requirements. There could, therefore, be reporting of the same transaction multiple times by domestic taxpayers located in different jurisdictions who are not themselves a direct party to the cross-border outcome. This could especially be the case in the context of acquisitions, refinancings or restructurings, which may involve dozens of companies. If all of the parties to a restructuring are required to report the same transaction, the reporting could involve many companies reporting inconsistent information at different times on the same structure. This could substantially increase costs with little benefit to tax administrations.

Materiality standard – Paragraph 243 provides as follows:

> An arrangement that incorporates a cross-border outcome should be treated as a reportable scheme if it *involves a domestic taxpayer.* A domestic taxpayer should be treated as involved in a cross-border arrangement where the arrangement includes a

transaction with a domestic taxpayer that has **material economic consequences for that taxpayer or material tax consequences for one of the parties to the transaction**. (Bolding added.)

This standard is flawed in two respects. First, critical terms are not defined. Second, it is not clear how, even if it were defined, the domestic taxpayer would be in a position to apply the second half of the test, since the information on the tax consequences to the other parties to the transaction may not be in the possession of the domestic taxpayer.

Example 1[6] "applies" the materiality standard in determining whether reporting is required. It is assumed that a loan from A Co to B Co will have material economic consequences for A Co. There are no facts justifying this assumption. It is certainly possible, and may even be likely, that a single loan to a related party does not have material economic consequences to the lender. For example, if A Co has substantial assets and the loan represents a small portion of those assets and B Co is a good credit risk, it would seem that the loan may not have material economic consequences for A Co. A Co's entire investment in B Co could be immaterial from A Co's point of view depending on the relative sizes of A Co and B Co and A Co's risk diversification profile. Are these considerations intended to be taken into account in determining materiality?

Example 2[7] involves a loan between B Co. and C Co. that by itself does not raise any issues. It is only because there is a hybrid financial instrument between A Co. and B Co. that the transaction becomes reportable. Although the example recognizes that C Co.'s reporting obligation may be limited because it may not hold complete information about the "scheme", it is possible that C Co. has no information and that it would therefore be entirely unaware of an obligation to report any information to the tax authorities or to request additional information and certify that such a request has been made. This might especially be the case if B Co. is a group financing entity that sweeps excess cash in and loans it out to other members of the group as needed. It might be impossible to track the flow of funds as described in this example. In any case, any entity that could demonstrate that it was unaware of any "scheme" should be exempt from any potential penalties.

Example 3[8] illustrates both flaws with the materiality test. Paragraph 272 provides that A Co must report as it is a direct party to a cross-border outcome and the transaction has material tax consequences for B Co. Again there are no facts justifying this assumption. A client list may

[6] Discussion draft paragraphs 257 through 261.
[7] Discussion draft paragraphs 262 through 269.
[8] Discussion draft paragraphs 270 through 274.

or may not have substantial value, but if the issue is the materiality of the tax benefit then should the outcome not depend on the relative value of that benefit to the tax liability of B Co? If A Co does not have information concerning B Co's overall tax situation how will A Co apply this test?

Further, although the Discussion Draft does not deal with reporting between countries, reporting this information to the country that is not affected by the cross-border arrangement will undermine some of the principle benefits of the mandatory reporting regime: quick identification of issues and the ability to respond quickly. Any information provided to a jurisdiction that is not a party to the transaction would likely have to go through a treaty exchange process, meaning the affected jurisdiction would not obtain the information until that process was complete and this might not be before the information becomes available through other channels such as the tax return including transfer pricing documentation. Thus, the proposed reporting with respect to so-called "international tax schemes" would create an unreasonable and uncertain reporting burden on international taxpayers with limited benefit to the affected jurisdiction (which may have considered and rejected a mandatory disclosure regime).

Given the limited utility of mandatory reporting that would be implemented through treaty exchange, USCIB recommends that tax authorities publish international tax schemes they consider aggressive or make a list of such tax schemes available to other tax authorities. Making any list public has the advantage of warning taxpayers away from aggressive planning techniques. The JITSC list (which is not public) may assist governments in identifying tax planning ideas that are of concern. Accessing this data base may be a better way for a government to get early information that would be useful to them than requiring taxpayers that are not party to the transaction to report the transaction while relying on exchange of information through the tax treaty network to provide the information to the affected jurisdiction.

Paragraph 230 raises the issue of reporting with respect to cross-border tax planning "schemes" that are incorporated into acquisitions, refinancings or restructurings. The OECD's guidance with respect to the master file and local file will require reporting on these transactions both globally and locally if the transaction affects the local country business. Additional reporting – especially before the usefulness of the master file, local file and country-by-country reports has been evaluated – will likely be duplicative and will potentially significantly increase taxpayers' costs. Significantly increased costs are especially likely in this area because of the modular design of the rules. Modular design will result in differences across jurisdictions as countries pick and choose those parts of the modules that serve their purposes and thus reporting will be unique to each country that adopts a mandatory disclosure regime. This runs counter to the design principles under Action 13, under which the OECD was attempting to achieve consistent reporting that would result in cost savings for multinationals.

Sincerely,

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