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The 2015 OECD International Tax Conference

June 10-11, 2015
Four Seasons Hotel
Washington D.C.



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VII. Treaty Abuse

The 2015 OECD International Tax Conference

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Panelists

- Brian Ernewein, General Director, Tax Policy, Department of Finance, Canada
- Quyen Huynh, Associate International Tax Counsel, U.S. Treasury
- Henry Louie, Deputy to the International Tax Counsel (Treaty Affairs), U.S. Treasury
- Angelo Bertolas, Vice President, Tax Services, TD Bank
- Kim Blanchard, Partner, Weil, Gotshal & Manges LLP
- Jesse Eggert, Senior Advisor, BEPS Project, OECD

Overview

- Background
- Revised Discussion Draft
- Proposed Simplified LOB
- Proposed New Provisions (Special Tax Regimes and Subsequent Changes to Tax Laws)
- Treaty Entitlement of CIVs and non-CIV Funds

Background

- Action 6: Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances...
- September 2014: Report issued which:
 - Recommended a three-pronged approach to address treaty shopping including (1) changes to title/preamble to make clear that treaties are not intended to create opportunities for non-taxation through evasion/avoidance; and addition of (2) LOB and (3) PPT
 - Adopted a minimum standard which would include the title/preamble changes plus either (1) combination of LOB/PPT; (2) PPT; or (3) LOB + anti-conduit rule
 - Addressed specific issues related to interaction between treaties and specific domestic anti-abuse rules
 - Describes tax policy issues to be considered before deciding to enter into a tax treaty

Background

- The September 2014 Report also identified three areas of follow-up work:
 - The implementation of the minimum standard
 - Precise contents of model provisions and related Commentary, particularly with respect to the LOB
 - Policy considerations relevant to the treaty entitlement of collective investment vehicles (CIVs) and non-CIV funds
- A discussion draft was released on 21 November 2014 inviting comments with respect to 20 issues identified as part of this follow-up work.
- 750 pages of public consultation received, and public consultation held 22 January

Revised Discussion Draft

- Released 22 May 2015
- Comments due by 17 June 2015
- Those comments will be taken into account by Working Party 1 in its 22-26 June meeting so that a final version of the Report on Action 6 can be produced

Proposed Simplified LOB

- Several comments suggested that rather than develop a detailed model LOB, the work should focus on guidance on underlying principles and general elements to be included in an LOB
- Alternative “simplified” LOB was discussed by WP1 and included in the revised discussion draft

Proposed Simplified LOB

The proposed rule simplifies or relaxes a number of tests under the LOB:

- Simplifies public trading test by eliminating primary trading/management control tests
- Eliminates base erosion components of ownership-based tests
- Reduces ownership threshold and simplifies derivative benefits test

Proposed Simplified LOB

- Intended to be coupled with a PPT, and not to be used as a standalone provision
- Intended to provide a simpler way to address the most obvious treaty-shopping case, while leaving other cases to be addressed by the PPT rule if necessary
- Important to ensure that “passing” the simplified LOB does not suggest that the PPT test could not apply
- Could be incorporated into the Model Tax Convention by describing main features of LOB in the text of the Model and presenting alternative formulations in Commentary

Proposed New Provisions

- November 2014 draft indicated that concern remained about the possibility that the derivative benefits provision in paragraph 4 of the LOB rule could raise BEPS concerns
- The draft indicated that the provision would be reviewed in light of progress in other areas of BEPS, particularly Actions 5 (Harmful Tax Practices) and 8 (Transfer Pricing of Intangibles)
- Would also consider whether changes could be made that would broaden the scope of the provision without creating treaty shopping opportunities
- Comments expressed concern that intermediate ownership requirements, limit on quantity of owners, and 95% threshold were too restrictive

Proposed New Provisions

- Two potential new provisions were discussed as potential ways to address some of the objections to the inclusion of a derivative benefits clause
- These proposals were intended to deal with special tax regimes and make tax treaties responsive to future changes in domestic tax laws
- These new proposals were included in the revised discussion draft for comment, with a final decision to be made in light of those comments

Proposed New Provisions: Special Tax Regimes

Special Tax regime provision:

- Adds new provisions to Articles 11 (Interest), 12 (Royalties) and 21 (Other Income) denying treaty benefits to payments made to residents subject to a special tax regime with respect to that income
- Special tax regime (as defined in a new paragraph of Article 3) generally refers to a rule or practice providing a preferential effective tax rate, subject to a number of exceptions, including for certain regimes satisfying a substantial activity requirement, rules designed to relieve double taxation, rules intended to facilitate investment in widely-held regulated entities, etc.

Proposed New Provisions: Subsequent Changes in Tax Laws

Provision on subsequent changes in tax laws:

- Allows a Contracting State to turn off benefits for interest, royalties, and other income paid to individuals or companies (as appropriate) where after signing the Convention, either State provides an exemption to resident individuals or companies with respect to substantially all foreign-source income
- Requires the Contracting States to consult with a view to concluding amendments to restore the balance of benefits provided

Treaty Entitlement of CIVs

- The 2014 Report on Action 6 provided for inclusion of rules consistent with the 2010 CIV report to address treatment of CIVs
- November 2014 discussion draft invited comments on whether the recommendations of the 2010 CIV Report continued to be adequate and whether any improvements should be made, including whether a single preferred approach should be adopted
- Comments uniformly supported the 2010 CIV Report's recommendations, but noted the need for countries to follow those recommendations and to implement TRACE
- Revised discussion draft concludes no need for further changes to Report on Action 6, but that implementation of TRACE was important for the practical application of these conclusions

Treaty Entitlement of non-CIV funds

- Although the Report on Action 6 included provisions to address CIVs, no such changes were made to deal with REITs, sovereign wealth funds, pension funds, or alternative funds (including private equity funds)
- The November 2014 discussion draft invited comments on these issues, recognizing that certain issues go beyond treaty abuse and relate more broadly to treaty entitlement of funds

Treaty Entitlement of non-CIV funds

Comments suggested a number of changes including:

- extension of treatment of CIVs to non-CIV funds
- expressly addressing treaty entitlements of REITs
- addressing practical ways for pension funds to establish qualification for LOB and residence of pension funds

Treaty Entitlement of non-CIV funds

Revised discussion draft:

- Notes that WP1 was considering adding a specific reference to the conclusions of the 2008 REIT Report dealing with the treaty entitlement of REITs
- Notes that WP1 agreed that a pension fund should be considered a resident of its State of constitution regardless of whether it benefits from limited or complete tax exemption in that State
- Notes the need to ensure that non-CIV funds are granted benefits where appropriate, but notes that suggestions received did not adequately take account of treaty-shopping concerns

Treaty Entitlement of non-CIV funds

With respect to non-CIV funds, the revised discussion draft notes that:

- New treaty provision on transparent entities under Action 2 (Hybrid Mismatch Arrangements) will be beneficial for non-CIV funds treated as fiscally transparent in one or both States
- Possible inclusion of a derivative benefits provision in the LOB rule could also help regarding treaty entitlement of non-CIV funds in which there are non-resident investors

Treaty Entitlement of non-CIV funds

- WP1 agreed to continue to explore solutions related to non-CIV funds to address two general concerns:
 - Non-CIV funds being used to provide treaty benefits to investors that are not themselves entitled to benefits
 - Ability of investors to defer recognition of income on which benefits have been granted
- Options being considered include adding a specific provision on non-CIVs to the LOB rule and adding one or more examples to the Commentary on PPT
- Work on these options may continue after September 2015, but should be completed before December 2016 deadline for negotiation of the multilateral instrument implementing the conclusions of the work on Action 6