UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

April 4, 2014

VIA EMAIL

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Re: USCIB Comment Letter on the OECD Discussion Draft on BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

Dear Mr. Saint-Amans,

The OECD, through its Commentaries on the Model Tax Convention on Income and on Capital, has long recognized the importance of preventing the abuse of tax treaties through both treaty provisions and appropriate domestic law anti-abuse rules. USCIB[1] accepts and endorses these efforts and the role of BEPS Action 6 to revisit treaty abuse standards in today's environment. We have serious concerns, however, that the Discussion Draft on BEPS Action 6 has a singular focus on combating treaty abuse without due regard for the impact it would have 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 Discussion Draft's 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.

For decades, the OECD had led the way in establishing a robust network of bilateral income tax treaties that play a vital role in the promotion of international trade and investment. The Discussion Draft proposals would seriously erode this accomplishment by creating unacceptable levels of uncertainty and seriously narrowing what enterprises will have access to tax treaties to mitigate excessive taxation and double taxation. Domestic tax laws work imperfectly in the international context and often may lead to excessive taxation (such as the case when gross income is subjected to a 30% rate of tax as under U.S. domestic law) or double taxation, creating artificial barriers to international trade and investment. Tax treaties play a vital role in

[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.

removing these obstacles to international trade and investment by providing accepted standards for the avoidance of excessive taxation and double taxation and, most importantly in the context of the Discussion Draft, provide the business and investment community with the degree of clarity and predictability needed to operate effectively and efficiently in international commerce. The introduction to the BEPS Action Plan recognizes this and underscores the importance of establishing "agreed international rules that are clear and predictable, giving certainty to both governments and businesses." The recommendations in the Discussion Draft would seriously undermine these basic principles by adding overly restrictive criteria for access to treaty benefits and, in addition, adding vague and subjective anti-abuse standards.

We want to be very clear that, in our view, the recommendations in the Discussion Draft 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 transaction, at serious cost to the global economy. This is even reflected in the title to the proposed new article "Entitlement to Benefits" rather than "Limitation on Benefits"[2]. Action Plan 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. We believe a more balanced approach is necessary: one that recognizes the fundamental purpose of treaties while recognizing and addressing legitimate issues of abuse of tax treaties. We suggest specific changes below to help achieve this balance.

USCIB also believes that these problems are due at least in part to the speed at which the OECD is attempting to accomplish these changes. We understand the political imperatives under which the OECD believes it is operating; nevertheless complex issues require the time and care to work through the analysis and study the repercussions of any changes. [3] Failure to take the time necessary to do this will result in faulty rules which governments and businesses will spend years, if not decades, undoing. We also believe that the speed at which the OECD is attempting to move is contributing to the complexity of all of the recently released discussion drafts. It seems because there is no time to resolve differences of opinion among the delegates; the discussion drafts must include all the possible options. It is then up to commentators to make the case for removal of bad options. Given the short comment periods, it is impossible for business to give the careful thought necessary to identify and comment on all the issues in each of these proposals. In our view, the OECD should be taking the time to work through ideas and reject bad ideas. A bad idea is not like a fine French wine: it does not improve with age. The current process could seriously undermine the OECD's reputation for careful, analytical work that supports the foundation of sound tax policy.

We strongly urge the Working Group on Action 6 to:

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[2] Because we believe limitation on benefits is the more appropriate concept, we will use that term throughout this comment letter.

[3] In particular, the timing on this action item may be wrong. It would be appropriate to look at treaty abuse after other action items are completed. For example, if Action 4 significantly reduces the scope for base eroding interest payments, then the rules proposed in Action 6 may be excessive and their primary impact might be to impose undue restrictions on legitimate cross-border investment.

1. Reject the overly restrictive standards in the proposed "Entitlement to Benefits" article that is patterned after the current U.S. Limitation on Benefits (LOB) article and adhere more closely (with modifications discussed below) to the version that already appears in the Commentaries;

2. Reject subjective main purpose or general anti-avoidance treaty solutions but, either use specific treaty measures to address concerns about conduit financing, or, direct countries to revisit their domestic law anti-abuse rules to assure that they are (1) effective in today's environment, (2) focused on identified abuses, (3) administrable and (4) do not impede legitimate business and investment activities;

3. Provide that, if the decision is made to retain a main purpose test, enterprises that meet any of the other criteria for eligibility for the benefits of the treaty under the LOB article should be presumed not to fail the main purpose test unless the relevant Competent Authority establishes by clear and convincing evidence that the test should apply, providing clearly that such evidence cannot take into account the status of the owners of the enterprise as nonresidents of the enterprise's state of residence, and that persons denied benefits should have access to MAP with binding arbitration; and

4. In the course of endorsing effective anti-abuse measures, provide a clear mandate for countries to adhere to the fundamental precept already recognized in the Commentaries that, consistent with the goal of promoting bi-lateral trade and investment through establishing rules that provide the greatest degree of certainty and predictability for *bona fide* beneficiaries of tax treaties, rules that create subjectivity and uncertainty, or that rely on cumbersome pre-clearance procedures straining the resources of tax administrators are to be avoided.

Specific Comments

USCIB believes there are two kinds of "treaty shopping." One is use of a treaty by a third country person who simply sets up an entity in a treaty state (usually one that has very low taxation or that can be base-stripped to achieve low taxation). This is addressed by a limitation on benefits clause. The other type of "treaty shopping" is a conduit financing type case. Conduit financing cases can and should be dealt with by domestic law and concepts of beneficial ownership, which the OECD has addressed elsewhere. Layering a main purpose test on top of limitation on benefits provision is excessive; a limitation on benefits clause is enough.

Comments on the Proposed Limitation on Benefits Provisions

1. In our prior submission to the Working Group we commented that a well drafted, simplified general Limitation on Benefits article that is targeted and not overly restrictive provides tax administrators with protection against claims for unintended benefits by "treaty shoppers" while providing *bona fide* enterprises with certainty regarding the availability of treaty benefits. The proposed article does not meet this standard for three reasons:

- It is unduly restrictive, patterned after recent versions of the U.S. LOB article whose provisions are influenced by U.S. domestic policy considerations.
- It omits a clause commonly relied upon in the U.S. experience, namely the derivative benefits test.
- It includes a main purpose test which totally undermines the principal benefit to taxpayers – their ability to rely on an objective set of standards providing the needed certainty and predictability.

We have attached as an appendix to this comment letter a formulation of the article that meets the standards we have recommended. We would be happy to discuss this in more detail with the Working Group and provide here a few examples that reflect the U.S. experience.

2. There are numerous circumstances where enterprises that are clearly not treaty shopping would be deprived of access to the benefits of the treaty:
    - The restriction found in the subsidiary of a publicly traded company test, the ownership/base erosion test, and the sample (but not accepted) derivative benefits test that precludes their application if there is an intermediate entity that is not resident in one of the Contracting States (or, in the derivative benefits test, an equivalent beneficiary) fails to recognize the reality of how multinational enterprises are organized in a global economy, usually based on a regional or operating units structure, the result of which is that a great many MNE subsidiaries would be precluded from qualification even though each intermediate entity conducted bona fide activities in its own country. This restriction does not, in our view, further any anti-abuse goal, particularly in the context of the ownership/base erosion and derivative benefits tests that include a base erosion criterion for qualification under these tests. USCIB also believes that this restriction violates EU freedom of establishment rules.
    - The inclusion in the publicly traded test of a substantial presence criterion based on either the shares being traded on a local exchange or the vague standard of the primary place of management being in the country of residence would deprive many publicly traded companies of access to the treaty because their shares are listed on regional exchanges that provides the greatest marketability and their management is decentralized. The Discussion Draft fails to recognize that part of being a publicly traded company is not having control over the residence of the persons that purchase the shares.
    - The requirement in the ownership prong of the ownership/base erosion test that at least 50% of the shares of the tested entity be owned by local residents means that a joint venture company exclusively owned by residents of the two Contracting States would fail to qualify if residents of the source Contracting State own a majority of the shares even though, clearly in this example, no third country resident is accessing the treaty. If a resident of the

source State is considered to be inappropriately reducing source State tax, then that should be dealt with under appropriate CFC or PFIC rules.

- The restriction in the base erosion tests that treats ordinary course of business payments(for example, interest or royalties) as base eroding payments when paid to a local corporation that is not publicly traded could cause an enterprise to fail this test even though the enterprise operates on an exclusively local basis.

3. The Discussion Draft discusses the possible inclusion of a derivative benefits standard for eligibility for treaty benefits but raises concerns about “base eroding” payments that give rise to BEPS concerns. It illustrates this by an example in which a State S company (the tested company) is wholly owned by a parent company that is a qualified resident and the State S company makes a royalty payment to a sister company in State R. The State R company qualifies as an equivalent beneficiary. The BEPS concern identified in the example is that State R provides a preferential rate of tax on royalties. We question whether this benefit, which is unrelated to any treaty provision, is a concern that should preclude the inclusion of a derivative benefits in an LOB. The purpose of a derivative benefits clause is to permit treaty benefits where the ultimate owner – here the parent company – would be entitled to the same treaty benefit with respect to an item of income whether it earned the income directly or earned it through an equivalent beneficiary. That is the parent has achieved no further <u>treaty</u> benefit by transferring income-producing property to its State R subsidiary.

   The OECD has repeatedly stated in the context of the BEPS project that BEPS is not about tax rate competition, yet the Discussion Draft cites 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. Consideration should also be given to whether the absence of a derivative benefits test is another instance in which the proposal would violate the EU freedom of establishment rules.

   Derivate benefits clauses serve as an appropriate escape hatch from the strict LOB provisions in cases not involving treaty shopping. For example, assume that a 50/50 joint venture between a resident of State A and a resident of State B is set up in State C; State C could be a neutral choice for any number of reasons having nothing to do with treaty shopping. In this example, the State C entity may earn income from source State D. If there is a tax treaty between State D and each of States A and B that provides equivalent benefits to those provided under a tax treaty between State D and State C, there is no reason to believe that the residents of States A and B are treaty shopping.

4. Paragraph 4 of the proposed LOB article would provide an important safety net for companies that do not qualify under any of the objective tests and we endorse its inclusion. However, we would note from the U.S. experience that the discretionary grant of treaty benefits based on this standard is a lengthy and cumbersome process in which a company will not know whether it is eligible for treaty benefits until the end of the process. In other words, it would not be a realistic response to the restrictive nature of the proposed article.

5. To make Paragraph 4 more practical, we suggest (i) that the relevant Competent Authority be compelled to complete the process within a reasonable time frame, say six months, with the automatic grant of the requested benefits if the time requirements are not met and (ii) the OECD provide guidelines for the factors to be considered by the Competent Authority, including examples. The examples could include: (i) a company that is acquired by private equity interests that met the LOB criteria prior to the acquisition, (ii) the privatization of a former governmental entity, (iii) a family owned company that met the 7 or fewer requirement of the derivative benefits standard but now has more than 7 owners due to the expansion of the family ownership, and (iv) a company that is created by the legislative body of its country of residence.

Other forms of Treaty Abuse

Footnote 3 of the Discussion Draft states that where a resident of a Contracting State that is the source State seeks to obtain treaty benefits through use of an entity resident in the other Contracting State, this could also be viewed as a form of treaty shopping. USCIB does not believe this is a form of treaty shopping as treaty shopping is the use of a bilateral treaty by residents of a *third* jurisdiction. Thus, trying to tackle this kind of structure using rules designed to deal with treaty shopping will complicate the treaty shopping rules and lead to incorrect outcomes. For example, a resident of the Contracting State that is the source State should be able to enter into a joint venture with a resident of the other State without being concerned about the limitation on benefits rules. If a source State resident is obtaining a benefit that is viewed as inappropriate, the proper recourse is the domestic laws of the source State. In the United States, for example, our CFC rules and our PFIC rules address this concern. These are inherently domestic policy concerns that should be addressed domestically, not through treaty limitation on benefits provisions. Alternatively, if a narrow anti-abuse rule is needed, that should be addressed explicitly in a particular article.

Comments on the Main Purpose Test

1. As noted, the inclusion of a main purpose rule in the treaty would eliminate the principal benefit of a LOB article, providing certainty and predictability, and seriously erode the role of tax treaties in promoting bilateral trade and investment. The uncertainty and subjectivity of the main purpose test is underscored by the Discussion Draft's explanation of the test in paragraphs 24 through 31 which makes clear its broad and uncertain scope. A large part of the concern about treaty shopping can be mitigated in the standards a country applies in deciding to enter into a treaty relationship.[4] Decisions on which countries are appropriate treaty partners and restraints built into individual treaties to address areas of concern based on the domestic laws of the potential treaty partner can go a long way towards alleviating concern about treaty shopping. This is a far better way to address the concern than adopting a broad, subjective test of taxpayer intent.

   Further, a main purpose test puts too much discretion in the hands of tax authorities; this invites abuse of that discretion in two ways. At one extreme, countries may agree to a main purpose test which they have no intention of enforcing. Thus, it seems that there are restrictions on the use of the treaty but these would be illusory. In another example, if a country A has a treaty in place with country B that it knows is used primarily by non-residents of country B for tax planning purposes, should country A be able to single out one company or a handful of companies and deny benefits? Why this company and not that company? Does the longstanding nature of these arrangements argue that the country A is estopped from denying benefits because it has acquiesced in the use of the treaty to access its markets?

2. The main purpose test has been proposed in U.S. tax treaties and soundly rejected by the U.S. Senate, the legislative body whose approval is required for U.S. ratification of a tax treaty. The rejection was explained by the Senate committee with jurisdiction over tax treaties as follows:

   > "The new main purpose tests in the proposed treaty are subjective, vague and add uncertainty to the treaty. It is unclear how the provisions are to be applied. In addition, the provisions lack conformity with other U.S. tax treaties. This uncertainty could create difficulties for legitimate business transactions, and can hinder a taxpayer's ability to rely on the treaty.
   >
   > In the past, the United States has determined that subjective tests are not appropriate in the treaty context. For example, older U.S. treaties containing limitation on benefits provisions (which address an abuse of a treaty whereby residents of third countries try to take advantage of the treaty provisions through what is known as treaty shopping) applied broad subjective tests looking to whether the acquisition, maintenance, or operation of an entity did not have "as a principal purpose obtaining benefits under" the treaty. These subjective

[4] USCIB strongly supports the addition of the new section C to the Commentary. A careful look at how two countries tax laws interact should be a part of the preparation for any income tax treaty negotiation between two countries.

tests have been replaced in recent treaties (including the proposed treaty) with limitation on benefits provisions that apply clear, bright-line objective tests (such as ownership and base erosion tests, public company tests, as well as active business tests). The reasons for moving away from subjective standards are illustrated by a statement in the Technical Explanation to the limitation on benefits provision of the proposed treaty that acknowledges in connection with a principal purpose test that a "fundamental problem presented by this approach is that it is based on the taxpayer's motives in establishing an entity in a particular country, which a tax administrator is normally ill-equipped to identify." Although this criticism is specific to a principal purpose test with respect to an anti-treaty shopping provision, the same concern applies with respect to subjective tests in general.

The main purpose standard in the relevant provisions of the proposed treaty is that "the main purpose or one of the main purposes" is to "take advantage of" the particular article in which the main purpose tests appear. This is a subjective standard, dependent upon the intent of the taxpayer, that is difficult to evaluate. Such a standard is inconsistent with present U.S. treaty policy. In addition, the Committee is concerned that a broad standard based on whether one of the main purposes of a taxpayer is to take advantage of a particular treaty provision does not adequately distinguish between legitimate business transactions and tax avoidance transactions. While it is true that under U.S. domestic law, "a principal purpose" test is used as an anti-abuse rule in a variety of contexts, its use generally has been limited to circumscribed situations. The Committee is concerned that the circumstances for inclusion of a main purpose test in the proposed treaty are not well-defined and that the standard potentially has much broader implications in the treaty context then in its analogs under U.S. domestic law. The Committee believes that consideration should be given to alternative formulations of anti-abuse standards including objective standards such as those contained in the limitation on benefits provisions of modern U.S. income tax treaties.

It is also unclear how the proposed main purpose tests would be administered. The Technical Explanation indicates that the tests are intended to be self-executing. In the absence of a taxpayer applying the tests to itself, the tax authorities of one of the countries may, on review, deny the treaty benefits. The Committee is concerned that the Treasury Department has not provided adequate assurances that the tests will not be used by treaty partners to deny treaty benefits for legitimate business activity.”

3. The Discussion Draft states that it is intended that the main purpose test be supplemented by detailed Commentary that would explain its main features and provide examples. Perhaps this is to suggest that the subjectivity of the test could be mitigated by the detailed Commentary. However, if it is really possible to provide greater objectivity and certainty of result by standards expressed in the Commentary,

we suggest those standards, after public consideration, should be the rule, rather than an explanation of the rule.

4. The examples set forth in the Discussion Draft are examples at either end of the spectrum and, therefore, do not add clarity but rather add more questions regarding its scope. The examples illustrating where the main purpose would apply involves facts that should be addressed by domestic anti-abuse rules. The examples illustrating where it does not apply may infer its application in similar circumstances that are not within the scope of the example. For example, Example C involves a decision by a company regarding where to locate manufacturing facilities to take advantage of lower labor cost and concludes that including in its considerations the availability of treaty benefits does not violate the main purpose test. This example raises the question of whether the same result should apply if the activity, rather than manufacturing, is the common practice of multinational enterprises to concentrate holding company and financing center operations in separate companies for reasons unrelated to taxation. If an MNE chooses to locate its affiliate that performs the financing center function in a jurisdiction that has a favorable network of tax treaties, is that a violation of the main purpose test? We submit it should not be but absent an example confirming this analysis, a multinational enterprise would, in effect, be penalized for placing its holding company or treasury center in a jurisdiction with a broad network of tax treaties. Countries should also adopt appropriate rules dealing with the assignment of income, which would deal with many of the abusive cases identified in the Discussion Draft.

   The main purpose test also could have a chilling effect on cross-border mergers and acquisitions. When one MNE group purchases other legal entities, the group structures may not be compatible. Structures that might have incurred little or no withholding tax prior to the acquisition may become subject to substantial withholding tax. Will it be possible to reorganize following such an acquisition or will such a reorganization be considered to run afoul of the main purpose test?

5. Appropriate domestic laws can address treaty abuse that is not addressed by the limitations on benefits provisions. The Commentary should be clarified to confirm that, in order to be compatible with treaty obligations, domestic law anti-abuse rules can be considered consistent with treaty obligations only if those rules legitimately operate within general domestic law principles to determine the true facts on which tax liability arises.

6. The main purpose test fails to recognize that treaties are not used solely by multinationals. Treaties are equally important in allocating taxing jurisdiction with respect to investment income. The best known example involves a resident of Country X investing in an investment fund organized under the laws of Country Y which may earn dividends or other income from an investment in a company resident in Country Z. For any number of reasons, a main purpose test does not work well in this fact pattern. All countries agree that the goal in such cases should be to tax the ultimate

investors/beneficial owners only once. The unfortunate reality is that sometimes treaties have to be used to attain that goal. In such cases, the fund might literally be said to have as its main purpose claiming treaty benefits, but nothing about that is abusive.

7. The Discussion Draft equates two very different formulations of the test: Paragraph 29 states that it applies if "obtaining that benefit was one of the main purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention." However, the paragraph twice phrases the test as "where one of the main purposes of certain transactions or arrangements is to secure a benefit under a tax treaty and obtaining that benefit in these circumstances would be contrary to the object and purpose of the relevant provisions of the tax convention." Under the first formulation, if you have the proscribed main purpose, the test automatically applies unless you can show that getting treaty benefits is somehow consistent with the treaty. It is a rebuttable presumption with the burden of proof on the taxpayer. But under the second formulation, the test does not apply until you fail both prongs of the test – you have to have a main purpose and you have to be inconsistent with the treaty. Here, the burden clearly seems to be on the treaty country wishing to deny treaty benefits. It would have to explain why what the taxpayer did was in some way inconsistent with the treaty. This is far more workable.

8. If it is ultimately concluded to recommend a main purpose test, the OECD needs to recommend effective procedures so that the uncertainty of such a test is not magnified by a lengthy period of uncertainty regarding the propriety of its application. A taxpayer should have the right to know what its tax responsibilities are without having a lengthy process for resolving whether the application of the main purpose test is appropriate. If this uncertainty cannot be resolved by an effective advance ruling process or an expedited process for dispute resolution after a government claim that it applies, the cost to the business and investment community will be excessive. We further recommend that if an enterprise meets any of the other criteria in a LOB article for eligibility for treaty benefits, the burden be placed on the tax authority challenging the access to treaty benefits to demonstrate by clear and convincing evidence that the main purpose test applies, and that such evidence not take into account the status of the owners of the enterprise as nonresidents of the enterprise's State of residence, since that factor is comprehensively addressed under the other provisions of the LOB article. In addition, to ensure that a single Competent Authority does not violate the spirit of the main purpose test by aggressive interpretation of the standards, a decision by a Competent Authority to apply the main purpose test should require acceptance of that decision by the Competent Authority of the treaty partner with mandatory binding arbitration to resolve disputes. Finally, to mitigate the unpredictability of reliance on the judgment of each tax authority as to taxpayer intent, changing a main purpose to the main purpose would provide taxpayers a measure of protection against over-zealous use of this tool by tax authorities.

Comments on Changes to the Preamble to Treaties

1. In our introductory comments we noted our fundamental concern about the lack of balance in the Discussion Draft; that is, it is singularly focused on combating tax abuse without due regard for the impact overbroad anti-abuse rules would have on enterprises that are not engaging in abusive practices. This concern carries over to the proposed change in the Preamble language which makes clear that preventing abuse of treaties, including treaty shopping, is a basic tenet of tax treaties. Accordingly, we recommend that the balance be restored by rewording the recommended change to the Preamble as follows:

    Desiring to further develop their economic relationship <u>and the promotion of bilateral trade and investment by removing artificial barriers and promoting greater certainty and predictability of tax results to residents</u> and to enhance their cooperation in tax matters,

    Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty shopping arrangements aimed at obtaining reliefs provided in this Convention <u>principally</u> for the indirect benefit of residents of third States)…

Comments on Targeted Anti-Abuse Rules

1. The Discussion Draft recommends that cases of dual residency be resolved by agreement between the Competent Authorities. This approach is practical only to the extent the procedures for reaching a Competent Authority agreement are practical. In the United States, a mutual agreement procedure can take two years or more to reach a conclusion. We are aware that many jurisdictions have resource limitations on their ability to expeditiously handle a mutual agreement procedure. We urge that the OECD provide a discipline to the procedure so that taxpayers are not left with uncertainty for an inordinate amount of time. If a dispute cannot be resolved within a reasonable period of time, mandatory binding arbitration should be required. Guidelines for resolution of dual residency issues, together with mandatory time limits, would be helpful.

2. In endorsing the use of domestic anti-abuse rules, the OECD should make clear that it is not acceptable for a State to override its treaty obligations in the guise of an anti-abuse rule. A clear distinction should be drawn between domestic laws that address treaty abuse and domestic laws that reflect a change in policy that is in conflict with its treaty obligations.

Comments on Tax policy considerations that, in general, countries should consider before deciding whether to enter into a tax treaty with another country

USCIB agrees with this section of the Discussion Draft. That is, tax treaties are entered into for purposes of promoting bilateral trade and investment and other geo-political reasons. However, tax considerations should play a key role in determining whether a treaty is appropriate and the scope of that treaty.

USCIB would also like to point out that the concern with double non-taxation is undercut when countries insist on including tax sparing clauses in their treaties. Consistency in this regard would require that such requests be dropped.

Sincerely,

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APPENDIX

ARTICLE X
LIMTATION ON BENEFITS

1. ***Except as otherwise provided in this Article, a resident of a Contracting State shall not be entitled to the benefits of this Convention otherwise accorded to residents of a Contracting State unless such resident is a "qualified person" as defined in paragraph 2.***

2. ***A resident of a Contracting State shall be a qualified person for a taxable year if the resident is:***

a) an individual;

b) a Contracting State, or a political subdivision or local authority thereof, or a statutory body, agency or instrumentality of such State, political subdivision or local authority;

c) a company, if:

i) the principal class of its shares (and any disproportionate class of shares) is regularly traded on one or more recognized stock exchanges,[5] ***or***

ii) at least 50 percent of the aggregate voting power and value of the shares (and at least 50 percent of any disproportionate class of shares) in the company is owned directly or indirectly by five or fewer companies entitled to benefits under subdivision i) of this subparagraph

d) a person, other than an individual, that

i) was constituted and is operated exclusively for religious, charitable, scientific, artistic, cultural, or educational purposes,

ii) was constituted and is operated exclusively to administer or provide pension or other similar benefits, provided that more than 50 per cent of the beneficial interests in that person are owned by individuals there were resident in either Contracting State at the time they became participants in the plan, or

iii) was constituted and is operated to invest funds for the benefit of persons referred to in subdivision ii), provided that substantially all the income of that person (not including fees for administering or managing the plan or its funds) is derived from investments made for the benefit of these persons.

[5] While we urge that a substantial presence test not be included, if the decision is made to include such a test the criteria should be as follows: "***A) its principal class of shares is primarily traded on one or more recognized stock exchanges located in the same economic region as the Contracting State of which the company is a resident; or B) the company's governing board normally meet, and the chief executive officers predominately exercise their responsibilities, in the Contracting State of which it is a resident.***

e) ***a person other than an individual, if:***

i) ***on at least half the days of the taxable year, persons who are residents of a Contracting State and that are entitled to the benefits of this Convention under subparagraph a), subparagraph b), subdivision i) of subparagraph c), or subparagraph d) of this paragraph own, directly or indirectly, shares or other beneficial interests representing at least 50 percent of the aggregate voting power and value (and at least 50 percent of any disproportionate class of shares) of the person, and***

ii) ***less than 50 percent of the person's gross income for the taxable year is paid or accrued, directly or indirectly, to persons who are not residents of either Contracting State entitled to the benefits of this Convention in the form of payments that are deductible[6] for purposes of the taxes covered by this Convention in the person's Contracting State of residence (but not including arm's length payments in the ordinary course of business for services or tangible property).***

f)

i) ***The resident is engaged in the active conduct of a trade or business in the Contracting State of which it is resident (other than the business of making or managing investments for the resident's own account, unless these activities are banking, insurance or securities activities carried on by a bank, insurance company or registered securities dealer respectively),***

ii) ***substantially all of its income is derived in connection with, or is incidental to, that trade or business[7], and***

iii) ***If a resident of a Contracting State derives an item of income from a trade or business activity conducted by that resident in the other Contracting State, or derives an item of income arising in the other Contracting State from an associated enterprise, the trade or business activity carried on by the resident in the first-mentioned Contracting State is substantial in relation to the trade or business activity carried on by the resident or associated enterprise in the other Contracting State. Whether a trade or business activity is substantial for the purposes of this paragraph will be determined based on all the facts and circumstances.*** [8]

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[6] If the OECD adopts something along the lines suggested in the recently issued Discussion Draft on Tax Challenges in the Digital Economy which would limit interest expense to interest paid on external debt, then interest should not be considered a base eroding payment for these purposes because the ability to erode a particular jurisdiction's tax base would be eliminated.

[7] Note we have altered this test to provide that the test is met if substantially all of the resident's income is derived from the active conduct of its trade or business rather than limiting its application to income that is connected to the trade or business to simplify the test, with the added value that business connected income must be substantially all of the income of the tested entity and, for that reason, have added this to the category of qualified persons. To provide greater certainty in applying this, we recommend that substantially all be defined as at least 75% of the entity's gross income. Guidance on this provision should make clear that a look-through approach would apply for dividends and interest received from connected persons.

[8] We recommend the explanation of the substantiality test contained in the U.S. Treasury Technical Explanation to treaties be included in guidance on this standard. That explanation importantly makes clear that it is included to prohibit an enterprise from creating a nominal presence in the resident country in order to access the benefits of the treaty.

iv) ***For purposes of applying this paragraph, activities conducted by persons connected to a person shall be deemed to be conducted by such person. A person shall be connected to another if one possesses at least 50 percent of the beneficial interest in the other (or, in the case of a company, at least 50 percent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or another person possesses at least 50 percent of the beneficial interest (or, in the case of a company, at least 50 percent of the aggregate voting power and value of the company's shares or of the beneficial equity interest in the company) in each person. In any case, a person shall be considered to be connected to another if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same person or persons.***

3. A company that is a resident of a Contracting State shall also be entitled to the benefits of this Convention if:

a) at least 95 percent of the aggregate voting power and value of its shares (and at least 50 percent of any disproportionate class of shares) is owned, directly or indirectly, by seven or fewer persons that are equivalent beneficiaries, and

b) less than 50 percent of the company's gross income for the taxable year is paid or accrued, directly or indirectly, to persons who are not equivalent beneficiaries, in the form of payments (but not including arm's length payments in the ordinary course of business for services or tangible property) that are deductible for the purposes of the taxes covered by this Convention in the company's State of residence.

4. If a resident of a Contracting State is neither a qualified person pursuant to the provisions of paragraph 2 nor entitled to benefits with respect to an item of income under paragraph 3 of this Article, the competent authority of the other Contracting State shall nevertheless treat that resident as being entitled to the benefits of this Convention, or benefits with respect to a specific item of income, if such competent authority determines that the establishment, acquisition or maintenance of such person and the conduct of its operations did not have as one of its principal purposes the obtaining of benefits under this Convention.

5. For purposes of the preceding provision of this Article:

a) the term "recognized stock exchange" means:

i) the__________ Stock Exchange (of Contracting State A);

ii) the _______ Stock Exchange (of Contracting State B); and

iii) any other stock exchange agreed upon by the competent authorities of the Contracting States;

b) the term "principal class of shares" means the ordinary or common shares of the company, provided that such class of shares represents the majority of the voting power and value of the company. If no single class of ordinary or common shares represents the majority of the aggregate voting power and value of the company, the "principal class of shares" are those classes that in the aggregate represent a majority of the aggregate voting power and value of the company;

c) the term "disproportionate class of shares" means any class of shares of a company resident in one of the Contracting States that entitles the shareholder to disproportionately higher participation, through dividends, redemption payments or otherwise, in the earnings generated in the other Contracting State by particular assets or activities of the company.

d) the term "equivalent beneficiary" means a resident of any other State, but only if that resident

i) would be entitled to the benefits of a comprehensive convention for the avoidance of double taxation between that other State and the State from which the benefits of this Convention are claimed, provided that if such convention does not contain a comprehensive limitation on benefits article, the person would be entitled to the benefits of this Convention if such person were a resident of one of the States under Article 4 of this Convention; and

ii) with respect to income referred to in Articles 10, 11 and 12 of this Convention, the rate of tax that would be available under such convention to a company resident in such other State and eligible for benefits under such convention (and otherwise comparable to the company claiming benefits under this Convention) with respect to the particular class of income for which benefits are being claimed under this Convention is at least as low as the rate being claimed under this Convention. ; or

iii) is a resident of a Contracting State that is entitled to the benefits of this Convention by reason of paragraph 2 of this Article.

6. In the application of any general anti-avoidance rule of domestic laws of a Contracting State, a resident of a Contracting States that is entitled to the benefits of this Convention by reason of this Article X shall be presumed not to have a principal or main purpose of attaining the benefits of this Convention unless the Competent Authority of that Contracting States, with reasonable advance notification to the resident, determines by clear and convincing evidence, which shall not be based upon the residence status of such resident's owners, that such a principal or main purpose exists after consultation with Competent Authority of the other Contracting State and concurrence by that Competent Authority that the determination is reasonable.