UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

June 28, 2016

VIA EMAIL

Mr. Pascal Saint-Amans
Director, Center for Tax Policy and Administration (CTPA)
OECD, 2, rue Andre Pascal
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France

Dear Mr. Saint-Amans:

USCIB response to the OECD's request for comments on specific technical issues on implementation and on issues related to the development of the MAP arbitration provision, described in the Public Discussion Draft on Development of a Multilateral Instrument ("MLI") to Implement the Tax Treaty related BEPS Measures (the "Discussion Draft").

General Comments

USCIB[1] appreciates the opportunity to comment on this highly unusual discussion draft and requests the opportunity to present comments at the public consultation on July 7, 2016. We believe that the MLI represents an important opportunity to ensure that the BEPS outcomes are implemented consistently across jurisdictions. Consistent implementation will be an important aspect of ensuring that the BEPS outcomes do not increase the incidence of double taxation, which would have a negative impact on cross-border trade and investment. USCIB understands consistent implementation to mean that countries agree on the standard to be applied to determine appropriate taxation under a bi-lateral tax treaty, so that they have a standard to be applied for resolving disputes.

We are concerned, however, that the pressure to complete the MLI by the end of this year is causing the OECD to short-circuit the comment process. This discussion draft is highly unusual 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.

that there is no draft language for stakeholders to comment on.[2] We believe that the OECD should release a draft of the MLI in order to solicit comment on the detailed document. We understand that it is the view of both the OECD and at least some of the countries involved that this is both unnecessary and inappropriate because the process of developing the MLI is akin to the negotiation of a bilateral treaty, which is not subject to public comment. We respectfully disagree with this view. The issue is not with the substantive provisions of the MLI – which we agree have already been the subject of extensive public comment[3] – but rather the manner in which the agreed provisions are being incorporated into existing bi-lateral tax treaties. This is a novel exercise which is important to the overall success of the BEPS project. If the provisions do not work as expected that will be a major set-back for the BEPS project, delaying or even preventing consistent implementation of the BEPS outcomes, which might take years to fix. USCIB therefore strongly urges you to reconsider the decision not to issue the MLI as a discussion draft.

Technical Comments

The use of compatibility clauses to implement the BEPS outcomes creates the possibility of real confusion for both taxpayers and tax administrations in trying to identify and apply the treaties that will be modified by the MLI. Given the enormous variation in treaty language the MLI cannot propose "surgical" changes to treaty language, so a taxpayer or tax administration might not be sure whether a particular bilateral treaty is intended to be amended by the MLI nor what the amended language of the bilateral treaty they are trying to apply actually is. This will significantly increase the likelihood that taxpayers will not understand their rights and obligations under the treaty; that Competent Authorities will disagree on how the treaty applies to particular facts and circumstances; and that courts will be unable to interpret the treaty appropriately and consistently.

<u>Possible approaches to achieving agreed treaty language</u>

Some possible solutions to this problem would be to implement the MLI through a two-step process. The first step would be for countries to sign and ratify the MLI. The MLI would not, however, enter into force (or its provisions would not have effect) between two countries until

[2] The OECD released a discussion draft on profit splits that did not contain draft language. In that case, however, draft language is expected to be released for comment.

[3] While this is generally true we note that the Action 6 Final Report deferred the completion of the limitation on benefits provisions to take into account the proposed changes to the U.S. Model. That review was supposed to be completed by the first part of this year and the results made part of the MLI. Thus, it is possible that the LOB provisions that are included in the MLI have not been subject to public comment as part of the OECD BEPS process. USCIB might have additional comments on an LOB provision that is based on the U.S. Model and that might be, in our view, overly restrictive. Permitting comment on new LOB provisions would be another reason to release a draft of the MLI.

those countries exchanged instruments of ratification or deposited declarations with a designated Depositary under the MLI. The instruments of ratification or declarations would be unique to each bilateral treaty. That is, the two countries in a bilateral relationship both of which signed and ratified the MLI would evidence the extent of their agreement on the MLI provisions they consider to be incorporated into their bilateral treaty pursuant to the compatibility clauses in the MLI. Ideally, such instruments of ratification or declarations would be accompanied or followed shortly by an agreed consolidated text of the amended bilateral treaty, which could be published by the bi-lateral partners and/or deposited with the MLI Depositary and made publicly available. Another option that is similar, but perhaps less bureaucratic, would be to have the "surgical" changes set forth in a Competent Authority agreement that would be required to be entered into between any two pairings of countries as part of the MLI.

In both cases, the "surgical" language would go through the appropriate State Department or Foreign Ministry process for approving the treaty in both country's languages so that the treaty could be equally authentic in both languages, even if the languages are not English or French. If there is no formal process for authenticating the translations, it is difficult to see how the original English and French versions would not be perceived as being more authoritative than any other language into which the MLI would be translated.

A two-step process along these lines would certainly result in slower implementation of the MLI, but the end result would be more certainty for taxpayers and tax authorities. A two-step process would also allow the countries in a bilateral relationship to make judgment calls about retaining provisions that are similar to BEPS measures or that exceed the minimum standard to ensure that those provisions are retained.

Scope of the MLI

In order to be meaningful and create basic consistency in global taxation systems, countries that sign up to the MLI should be required to commit to the provisions relating to minimum standards. This would mean that all countries which sign up to the MLI must agree to the portions of the MLI relating to the prevention of granting treaty benefits in inappropriate circumstances[4] and the elements of the dispute resolution recommendations that formed the minimum standards. If the country agreed to the minimum standards, then there should be optionality with respect to other aspects of the MLI and thus countries should be able to choose among those standards that are only recommendations. If, however, countries are permitted to make global changes to their treaty network without having to adopt the minimum standards, then it becomes very likely

[4] The fact that the OECD has not released the final LOB language gives us some pause in suggesting that countries be required to sign onto the minimum standard. Nevertheless, we recommend this approach because it seems inappropriate to facilitate adoption of some BEPS measures will allowing countries to walk away from the minimum standards.

that the minimum standards will not, in fact, be adopted. From the business perspective, the "carrot" for many of the BEPS changes was the promise of improved dispute resolution. If countries can adopt the other treaty changes without adopting the minimum standard on dispute resolution, then there will be no leverage to achieve improved dispute resolution, which will likely lead to increased double taxation and less cross-border trade and investment.

Commentary

USCIB believes that the Commentary will be an essential part of the MLI. This is especially true if the OECD does not adopt some form of the suggestion above that would require countries to identify the "surgical" changes to their bilateral agreement, so that it is not clear what the words on the page are. In addition to the need for a Commentary on the provisions of the MLI, there is also the issue of the relationship of the Commentary on the MLI to the Commentary of the OECD Model more generally.

As part of the process of signing on to the MLI, countries should have to commit to the relevant portions of the broader Commentary on the OECD Model.[5] The BEPS treaty changes were based on the principles contained in the OECD Model and Commentary to that model. It will be extremely difficult, if not impossible, for countries to adopt the BEPS changes while rejecting the principles underlying the OECD Model. For example, the loosening of the permanent establishment standard, particularly with respect to the requirement that all of the activities in Article 5(4) meet a preparatory or auxiliary standard, will increase pressure on the permanent establishment standard test contained in Article 5(1). What does it mean to have a fixed place of business? What does "at the disposal of" mean? How will those pieces of the Commentary be incorporated into the MLI? USCIB believes that it is necessary to have a common interpretation of not only the MLI, but also the related treaty provisions that support the MLI. The MLI Commentary should identify those provisions of the OECD Model Commentary that are relevant to the interpretation of the MLI and need to be adopted as part of the MLI Commentary.

The MLI is very different from a bilateral negotiation where if a country has a view that differs from the view reflected in the Model and the Commentary, both countries have an opportunity to understand the exact nature of the disagreement and draft language that both countries are willing to accept. If an accommodation cannot be reached; then a bilateral treaty would not be concluded. In the context of the MLI, however, if the words are acceptable but a country

[5] Relevant has two meanings here. The first meaning relates to the provisions of the MLI the country is opting into. That is, the permanent establishment commentary is only relevant if the country is attempting to use the MLI to modify the permanent establishment provisions of its bi-lateral treaties. So, the PE commentary would not be relevant for a country that was not opting into those provisions. The second meaning relates to the interaction between the MLI and the OECD Model. Not all of the Commentary on the OECD Model is necessarily relevant to the interaction between the MLI and the OECD Model.

understands those words to mean something very different from the usual interpretation, it would be unfair to other countries, to allow the non-conforming country to sign onto the MLI without resolving the inconsistency. We see two possible resolutions. First, the non-conforming country could commit to the standard interpretation (and therefore abandon its position) for purposes of the MLI. If this route is taken, the country should be clear that it is abandoning its reservation or observation with respect to the relevant portion of the Commentary. Second, if the non-conforming country is unwilling to commit to the standard interpretation, it would not be permitted to use the MLI to modify its bilateral treaties with respect to the relevant issue unless the first country explicitly reserved its position with respect to the Commentary and other countries modifying their bilateral treaties with the first country explicitly accepted the non-conforming interpretation. Similarly, if a relevant portion of the Commentary permits more than one interpretation of a treaty provision, then countries should be required to identify which of those interpretations they will apply in their bilateral treaties. Bilateral treaties would only be modified under the MLI if the countries agree on the same interpretation.

Mechanisms that could be used to ensure consistent application and interpretation of the MLI

USCIB believes that the principal mechanism for ensuring consistent application and interpretation of the MLI should be agreement between the Competent Authorities of a pair of countries that have signed onto the MLI. That is, the function of the MLI is to modify an existing bilateral income tax treaty. Thus, any dispute as to how that treaty is modified is properly within the purview of the Competent Authorities of those two countries. It is not clear that broader consistency is either necessary or achievable.

USCIB believes broader consistency is not necessary because the treaty is defining the taxing jurisdiction of the parties to the bilateral treaty. For example, assume two OECD countries sign onto the MLI and include the changes that would make the exceptions in paragraph 4 of Article 5 conditional on the activities being preparatory or auxiliary. If they agree on the parameters of that rule that would limit so-called “source country” taxation, why should other countries be obligated to limit their right to tax in the same manner? There is no need for consistency across countries as long as the two treaty partners are satisfied with the division of taxing jurisdiction.

USCIB also believes broader consistency is not achievable. Broader consistency might require some supranational tax body to adjudicate the terms of the MLI. Requiring countries to agree to a supranational tax body that would issue binding decisions on the meaning of the MLI might severely limit the number of countries willing to sign onto the MLI. Many countries, including many developing countries, argue that mandatory binding arbitration (MBA) limits their sovereignty and therefore is unacceptable. There is disagreement over whether this claim is valid with respect to MBA, but it would clearly be valid in the case of a supranational tax body. In

which case, the number of countries willing to sign onto the MLI might be fewer than those willing to commit to MBA.

Mandatory binding arbitration

USCIB previously submitted a letter to the OECD on MBA, which is attached to this letter. Our position on MBA remains the same. We summarize the points made in the earlier letter for convenience.

USCIB strongly supports the adoption of mandatory, binding arbitration in general and would prefer the generic treaty provision to be accompanied by a sample implementing agreement which uses short-form or last-best-offer arbitration as its preferred format. Short-form arbitration would benefit not only the business community, but also the countries agreeing to it, as more certainty and efficiency in tax administration would attract and incentivize business investment. Thus, widespread adoption of a mandatory, binding arbitration provision such as that found at Article 25(5) of the OECD Model Tax Convention or Article 25(5) Alternative B of the UN Model Tax Convention, preferably accompanied by implementing agreements based upon a short-form arbitration model, would be a major step in the right direction for dispute resolution.

Sincerely,

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