UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

September 11, 2018

VIA EMAIL
The Platform for Collaboration on Tax
GlobalTaxPlatform@worldbank.org

Dear Platform Organisations,

USCIB[1] is writing to comment on version 2 of the toolkit on offshore indirect transfers ("OIT"). In our view, this draft is improved over the prior version. We agree that this version does not state an express preference for either Method 1 or Method 2.[2] The revised discussion draft has also reduced the emphasis on tax avoidance. USCIB is also pleased to see the strong statement that the report and toolkit do not "purport to provide binding rules or authoritative provisions of any kind nor does it aim to establish an international tax policy standard of any kind."[3] We also support the recommendation that any changes be prospective and contain appropriate transitional rules.[4] Nevertheless, the discussion draft would benefit from further improvement.

General Comments

- The toolkit is intended as a guide to developing countries to develop policy on OIT. It should, therefore, contain a more complete discussion of other factors that influence tax policy such as simplicity, growth, certainty, and horizontal and vertical equity.
- The toolkit continues to gloss over significant issues. While it may be impossible to address all the difficulties that may arise with minority shareholders, valuation issues, the treatment of losses, and how economic and juridical double taxation would be avoided, (among others) the toolkit should emphasize the importance of dealing with those issues, including by using "should" instead of "could" throughout the draft when discussing policy choices where there ought to be a clear preference for addressing an issue.[5] Providing a fuller analysis of those issues is critical to providing developing countries with a practical understanding of the implications of their policy choices and therefore a sound basis on which to make policy decisions.

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[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.
[2] See page 8 -9, and 11. Although the draft still seems to favor Method 1.
[3] See page 11.
[4] See page 40.
[5] Although different policy choices might be made over how to address an issue.

- The toolkit assumes that taxpayers are non-compliant with clear obligations under the tax law.[6] USCIB's corporate members take their tax obligations in all countries seriously and fully comply with applicable tax laws. Statements that imply low rates of compliance should be deleted.
- The toolkit at various points raises the possibility of domestic overrides of treaty obligations to implement tax on an OIT.[7] The toolkit should not suggest that a treaty override is an appropriate avenue for implementing an OIT. These references are in the disadvantages sections, that is, it is a disadvantage that a country might need to override its treaties to implement an OIT. The toolkit should acknowledge that the proposed Models may not be consistent with existing treaties and that treaties would need to be amended before a contrary domestic law could be fully implemented. References to overriding treaties should be deleted.
- The paragraph at the bottom of page 53 concerning expanding the definition of immovable property should be deleted. The toolkit is just that, a toolkit to assist developing countries to implement policies that are internationally accepted. This paragraph is recommending further thought on expanding the definition of immovable property and raises the issue that unilateral expansion of the definition, even if possible, might conflict with negotiated positions and would require consultation with treaty partners. As noted above, the toolkit should avoid suggesting treaty overrides – creating a definition that conflicts with the negotiated position could override the negotiated position. This is, therefore, inappropriate and ought to be deleted.

<u>Specific Comments</u>

Structuring Transactions and Revenue Implications

These sections are focused on the possible choices – sale of assets versus sale of stock -- and the revenue implications of those choices. A flaw in this analysis is the lack of consideration of non-tax factors in the choice of structure. While taxpayers do consider tax consequences, the business consequences may be far more important and may drive the structure of the transaction. Sellers are not usually selling to realize gains, as such. They are selling because an asset no longer fits with their business plan. That may drive the structure of the transaction from the seller's perspective. Does the seller want to get rid of the entire business or only a part? The buyer has a separate perspective. What does the buyer want to buy? Frequently the buyer has a strong non-tax preference for buying assets: the buyer may not want the whole business; the buyer may be concerned about liabilities (including unknown liabilities) which remain with the corporate entity but do not attach to assets. Conversely, the buyer may prefer purchasing stock. Purchasing stock would generally leave existing contractually relationships in place; supply chains would not need to be renegotiated. These concerns are far more likely to drive the structure of the transaction in most cases than tax considerations.

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[6] See page 47.

[7] See pages 44 and 51.

The revenue implications generally relate to the difference between immediate taxation in the location country (in the absence of special rules governing OIT) and deferred taxation and the distortions this difference may create. USCIB agrees that one principle of good tax design is efficiency; that is, the tax rules should not distort investors' decisions.[8] There are, however, other principles of good tax design that the discussion draft does not consider or considers cursorily. These include: simplicity, certainty, economic growth, and horizontal and vertical equity. These principles frequently require balancing as achieving one may conflict with achieving one or more of the others.

The toolkit – especially given that it is intended to help developing countries decide on the appropriate policy for their country -- would benefit from a more balanced discussion of good tax policy design and the need to make trade-offs and how an appropriate balance might be struck. The discussion draft focuses primarily on efficiency and mentions certainty in the context of stating that adoption of one of the models would increase certainty over the unilateral actions that might result from the political reaction to the loss of tax revenue, particularly in cases when the assets are perceived as national assets (natural resources or telecom licenses). This abbreviated discussion distorts the principles of good tax design. Efficiency has other aspects including horizontal and vertical equity. The discussion draft considers one aspect of efficiency, but ignores other aspects including unequal treatment of joint venture partners and double taxation. Among other omissions, Model 1 would impose tax on partners who do not dispose of their interest and may not have the ability to pay; Model 2 does not deal with double taxation down a chain of intervening entities. Certainty has many elements. A few of those elements are: is a transaction subject to tax, how much income is subject to tax, what is the process for filing a return and paying tax or claiming a refund, how are values determined, will double taxation be avoided? Thus, merely adopting one of the models would not provide needed certainty, the models would have to be expanded to deal with the issues that the toolkit glosses over before certainty could be achieved.

In our view, adding in the business considerations that influence the structure of the deal and dealing more fully with good tax policy design would support limiting the application of OIT rules to the cases in which taxes are likely to play an important role in structuring the transaction – where tax considerations are likely to be more important and create distortive results. This would lead one to conclude that: reorganizations ought to be excluded[9]; sales of publicly traded stock ought to be excluded; and there ought to be thresholds to avoid creating unreasonable burdens for transactions for which tax is likely a less important factor.

For example, the concept of directly and indirectly could be the source of significant complexity, both for purposes of determining the level of ownership of shares and the level of assets. Should all assets be deemed to be owned pro rata by all shareholders regardless of the

[8] See page 23.

[9] USCIB appreciates that the discussion draft mentions reorganizations and states that the report is not concerned with transfers of this kind. (Page 12.) However, this is an important issue for many companies. A best practice would exclude internal reorganizations. As such, the discussion draft should include an additional subsection covering reorganizations in Box 5: Change in Control.

level of the shareholder's ownership interest? Or should there be a *de minimis* threshold, beyond which ownership of underlying assets is not attributed? Similarly, is there a *de minimis* threshold for attributing stock ownership through a chain? Adopting simplifying assumptions would likely increase certainty with respect to which transactions are or not subject to tax. Certainty that publicly traded shares will not be subject to tax may increase investors' willingness to invest in a developing country and have a positive impact on growth.

Business certainly hopes to avoid double taxation, whether in the same country or by multiple countries. USCIB finds it somewhat mystifying that recently international organizations have indicated that preventing legal double taxation by the same country[10] is something that ought to be addressed by international fora. The historical scope of double taxation addressed in international agreements or in international fora was the conflict between two states for the right to tax the same income. The toolkit essentially dismisses the possibility of double taxation by different countries.[11] If there is, however, widespread adoption of Model 1 or 2 and Article 13(4) and 13(5) of the UN Model, then it is quite likely that double or even triple taxation of the same gains will occur. Economic double taxation of significant gains will create a disincentive to foreign direct investment. This should be pointed out and countries should be encouraged to resolve issues of double taxation – both within the source country and between different countries -- in advance.

The simplified legislative provisions that the discussion draft sets forth punt on these issues essentially because these issues are too complex for the simplified toolkit.[12] While it may be difficult to draft comprehensive provisions, some guidance in the draft legislation, particularly on bright lines, would be useful. For example, an additional subsection could be added to Box 5 providing that subsection 3 does not apply to the extent the change in direct or indirect ownership would satisfy Country L provisions concerning corporate reorganizations if the transaction were a domestic transaction. Similarly, a reorganization by a company resident in a treaty partner jurisdiction that satisfies the domestic provisions of that treaty partner jurisdiction, would not be subject to subsection 3. As another example, a subsection could be added to the source rule in Box 6 exempting publicly traded stock. These types of provisions would highlight the need to consider such exemptions and perhaps serve as acknowledgement that such exceptions are sensible. No one should expect the language of the toolkit to be adopted as is, but placeholders for important issues could serve an important function.

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[10] See page 40 and 41. See also, OECD Additional Guidance on the Attribution of Profits to a Permanent Establishment under BEPS Action 7, http://www.oecd.org/tax/beps/additional-guidance-attribution-of-profits-to-a-permanent-establishment-under-beps-action7.htm, paragraph 35, page 15 and paragraph 41, page 16.

[11] See page 44, which cites the existence of territorial systems or no or low jurisdictions as mitigating the double taxation problem but does not indicate that Location Countries should take any steps to further mitigate double taxation. Such mitigation might require an income tax treaty that assigns the primary right to tax to Country L and requires the other country to eliminate double taxation; it might also require a treaty to call for appropriate basis adjustments or other mechanisms for mitigating double taxation. That should be pointed out.

[12] See page 40.

Another possible approach to the complexities that the OIT toolkit presents would be to encourage countries to work cooperatively in designing any new laws with both the platform partners and stakeholders, including business, that would be affected by any law changes. While some countries are quite open to public debate on policy, others are not. Transparency as part of the legislative process is important to both the perceived legitimacy of the eventual law and getting it right.

Three Illustrative Cases

The three illustrative cases mentioned in the discussion draft all involve significant assets and asserted or estimated tax liabilities.[13] Any thresholds that an OIT regime might include would nevertheless certainly capture all these cases. High-profile cases, such as these, might be more appropriately dealt with through more narrowly targeted rules that would eliminate the need for burdensome rules that might have a negative impact on investment because of the investment disincentive that would be created by rules that apply to transactions that are not distortive.

Sincerely,

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Chair, Taxation Committee
United States Council for International Business (USCIB)

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[13] As the discussion draft points out, In Vodafone, the Indian government asserted a tax liability of nearly 11 billion US dollars; in Petrotech the foregone tax revenue was estimated at 482 million US dollars; and in Zain 85 million US dollars.