FOLLOW-UP DRAFT OF REPORT ON ACTION 6 (TREATY ABUSE) AND PUBLIC COMMENTS RELEASED

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Comments on the O.E.C.D.'s public discussion draft to the follow-up work on B.E.P.S. Action 6 (the "Follow-Up Draft") were released on January 12, 2015. Action 6 of the B.E.P.S. Action Plan focuses on preventing treaty abuse and treaty shopping, which the O.E.C.D. has identified as being one of the most important sources of B.E.P.S. concerns.

The Follow-Up Draft modifies the "Report on Action 6 (Prevent the granting of treaty benefits in appropriate circumstances)" and identifies 20 issues on which interested parties may provide comments. It focuses on matters related to the application of the limitation on benefits ("L.O.B.") rule and principal purpose test ("P.P.T.") as well as the treaty entitlement of collective investment vehicles ("C.I.V.'s") and non-C.I.V. funds. The 20 issues identified by the Follow-Up Draft and addressed in the comments are as follows:

Issues Related to the L.O.B. Provision

- C.I.V.'s: application of the L.O.B. and treaty entitlement,
- Non-C.I.V. funds: application of the L.O.B. and treaty entitlement,
- Commentary on the discretionary relief provision of the L.O.B. rule,
- Alternative L.O.B. provisions for E.U. countries,
- Requirement that each intermediate owner be a resident of either Contracting State,
- Issues related to the derivative benefit provision,
- Provisions dealing with "dual-listed company arrangements,"
- Timing issues related to the various provisions of the L.O.B. rule,
- Conditions for the application of the provision on publicly-listed entities, and
- Clarification of the "active business" provision.

Issues Related to the P.P.T. Rule

Application of the P.P.T. rule where benefits are obtained under different treaties,

- The suggestion that countries consider establishing some form of administrative process,
- Whether the application of the P.P.T. rule should be excluded from the arbitration process,

- Aligning the Commentary on the P.P.T. rule and the L.O.B. discretionary relief provision,
- Whether some form of discretionary relief should be provided under the P.P.T. rule, and
- Drafting of the alternative "conduit-P.P.T. rule."

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Other Issues

- List examples in the Commentary of the P.P.T. rule,
- Application of the new treaty tie-breaker rule,
- Design and drafting of the rule applicable to permanent establishments located in third States, and
- Proposed commentary on the interaction between tax treaties and domestic anti-abuse rules.

Over 750 pages of comments were submitted by interested parties. The main concern reflected throughout the comments is that the procedures for claiming treaty benefits are already onerous and that the Follow-Up Draft's proposals may be a disproportionate response to remedying treaty abuse. Overall, the comments acknowledge the need to prevent treaty abuse but conclude that Action 6 should remain focused on removing double taxation and promoting international trade. There also appears to be a general consensus among commentators that resolving abusive tax avoidance should be achieved primarily through domestic law.

The majority of the comments were concerned with the Follow-Up Draft's implementation of the L.O.B. and P.P.T. provisions, which is seen as causing significant uncertainty and making treaty application more complicated. The L.O.B. provisions eliminate the subjectivity of determining when treaty benefits apply, but are technical and complex in their application. On the contrary, the P.P.T. provisions embrace a simple approach but their subjectivity does not offer much guidance on whether treaty benefits will be allowed.

Commentators warn that in order to comply with the L.O.B. rules, the C.I.V.'s will be overburdened with tedious documentation requirements, which could hinder legitimate transactions. Many comments advise against a uniform approach to C.I.V.'s because the various structures and diverse investment base of C.I.V.'s would prevent them from accessing treaty benefits. For determining eligibility for treaty benefits, many commentators suggest that non-C.I.V.'s should be considered "look at" rather than "look through" entities, which seems to mean opaque rather than transparent. This would prevent increased reporting requirements and would be consistent with the Foreign Account Tax Compliance Act ("F.A.T.C.A.") and the Common Reporting Standards, which do not have a requirement to "look through" these entities.

There is significant concern that the L.O.B. provision requiring each intermediate owner to be a resident of a Contracting State would deny treaty benefits when there is a legitimate entitlement to such benefits. Although the L.O.B. provision is designed to deny treaty benefits when there is treaty shopping, the L.O.B. provision will also deny treaty benefits in situations when there is no treaty abuse, especially where intermediary companies are being tested along with the ultimate beneficial owners.

Many commentators favored eliminating the testing of intermediary companies because it would facilitate international trade, eradicate double taxation, and prevent companies not engaged in treaty shopping from being denied treaty benefits. Overall, there is a consensus that the L.O.B. rule should focus on the state of the ultimate beneficial owner and not the intermediate companies.

The comments in response to the Follow-Up Draft on Action 6 collectively acknowledge the need to prevent treaty abuse but are concerned that Action 6's proposals create onerous and unnecessary compliance requirements that would preclude the enjoyment of treaty benefits.

The entire report of comments on the Follow-Up Draft can be accessed through the following link: http://www.oecd.org/ctp/treaties/public-comments-action-6-follow-up-prevent-treaty-abuse.pdf.