TAXREP 34/15 (ICAEW REPRESENTATION 92/15)

PREVENT TREATY ABUSE: OECD PUBLIC DISCUSSION DRAFT

ICAEW welcomes the opportunity to comment on the public discussion draft Prevent Treaty Abuse published by OECD on 2 May 2015.

This response of 17 June 2015 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

Contents

	Paragraphs
Introduction	1 – 2
General comments	3 – 10
Specific comments	11
Ten Tenets for a Better Tax System	Appendix 1

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ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

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INTRODUCTION

1. We welcome the opportunity to comment on the public discussion draft Prevent Treaty Abuse published by OECD on 22 May 2015.

2. We submitted responses to two earlier discussion drafts on this same topic, namely TAXREP 3/15 in January 2015 and TAXREP 18/14 in April 2014..

GENERAL COMMENTS

3. We believe that the main response to potential treaty abuse should be by using an LOB or a GAAR based on a PPT (principal purpose test).

4. We are concerned that the current discussion draft ties the use of the simplified LOB to treaties which combine it with a principal purpose test (PPT) test, which means it would only be available to the limited number of treaties where both treaty partners agree to this combined test.

5. The LOB and the PPT are directed to distinct treaty shopping issues – eligibility of treaty residents for treaty benefits in the case of the LOB and combatting abusive use of treaties by eligible treaty residents in the case of the PPT. These independent standards should not be confused.

6. Some countries will prefer to deal with anti-abuse through a PPT and others may consider a more targeted anti-abuse rule the best avenue. That choice should not dictate whether a simplified LOB is used. We believe the OECD should opt for the simplified version, leaving it to bilateral negotiation to tailor a treaty LOB to the needs of the treaty partners.

7. We are also concerned about proposals for partial treaty termination if there are changes to the tax regime in one of the contracting parties ie an exemption from taxation to resident companies for substantially all foreign source income. This could, for instance, turn off the provisions of the particular treaty in relation to Article 10 (dividends), Article 11 (interest), Article 12 (Royalties) and Article 21 (other income). We believe it should be up to the contracting parties to introduce such a provision, in relation to their own bilateral treaty, and not include such a provision at the Model Convention level.

8. The new proposal for an alternative “simplified” LOB rule also has the potential to leave the treaty entitlement of a significant number of bona fide residents to be determined under the competent authority procedure if they don’t fit into any of the simplified categories of qualified persons.

9. This approach would most obviously disadvantage institutional investors (including those pension funds and charities which are specifically treated as treaty residents under the US model treaty and would stand to benefit under the model LOB article included in the OECD’s September 2014 Action 6 report “Preventing the granting of treaty benefits in inappropriate circumstances”). Not only would they face substantial delay in the determination of their treaty entitlement but it would also make it impracticable for any treaty relief to be granted at source. There would be a significant increase in the number of claims for refunds of tax withheld at source in excess of the treaty rate, which is likely to prolong the delays in obtaining refunds that bona fide claimants currently experience and to increase the amount of tax at source that cannot be reclaimed in practice because the source state does not provide a cost effective refund procedure.

10. For the first time, and at the very end of the BEPS process, the discussion draft introduces two new proposals viz exclusion with relation t0 special regimes and partial treaty termination that would reflect fundamental changes in treaty policy. A major shortcoming of the BEPS process is the truncated time period allowed to address complex, untested principles. Neither time nor the request for brevity allows us to properly critique the rules proposed in the discussion draft for these novel concepts that can have a major impact on entitlement to treaty benefits and the viability of a tax treaty. Determining how these rules would work, the definitional standards to be applied, the appropriateness of the "remedy" and the local constitutionality of the partial termination proposal on which we have commented briefly above in paragraph 8 are among the more obvious issues that should be vetted in a careful, deliberative process. The BEPS process has been an iterative process where new rules are aired, stakeholders respond, revisions are proposed and further input is provided by stakeholders before the end product is produced. We urge that the final report on Action 6 should not attempt to formulate rules that could be faulty and could be embedded in the Model or the multilateral convention, making hastily developed decisions difficult to reverse. Rather, it would be appropriate to set forth general principles for further consideration and development in a deliberative manner.

SPECIFIC COMMENTS

Item 18 – application of the new treaty tie-breaker rule

11. We believe there should be a maximum time limit for resolution of dual residence issues via the competent authority route and we suggest that this should be fixed at 6 months.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. Certain: in virtually all circumstances the application of the tax rules shoulpd be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.

4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see via http://www.icaew.com/en/about-icaew/what-we-do/technical-releases/tax).