FOLLOW UP WORK ON BEPS ACTION 6: PREVENTING TREATY ABUSE

ICAEW welcomes the opportunity to comment on the Public Discussion Draft *Follow up work on BEPS Action 6: Preventing treaty abuse* published by OECD on 21 November 2014

This response of 9 January 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.

The Institute of Chartered Accountants in England and Wales
Chartered Accountants' Hall
Moorgate Place London EC2R 6EA UK
icaew.com/taxfac

T +44 (0)20 7920 8646
F +44 (0)20 7920 0547
E taxfac@icaew.com

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For more information, please contact ICAEW Tax Faculty: taxfac@icaew.com

icaew.com

GENERAL COMMENTS

ICAEW comments on initial OECD public discussion draft published on 14 March 2014

1. ICAEW was one of the many organisations which responded to the original paper issued in March 2014. The full set of papers are available on the OECD website at http://www.oecd.org/tax/treaties/comments-action-6-prevent-treaty-abuse.pdf

2. In Annex 3 to that earlier response we set out a number of scenarios of international tax planning which we suggested should be covered in any guidance issued in relation to the Action 6 work of OECD.

RESPONSES TO SPECIFIC ISSUES RAISED IN THE CURRENT DISCUSSION DRAFT

A Issues related to the LOB provisions

Non CIV funds: applications of the LOB and treaty entitlement

3. The definition of the term "qualified person" for LOB purposes (in paragraph 16 of the Report) begs the question of what is a "person" for treaty purposes. While the US Model Income Tax Treaty defines "person" broadly to include, for example, trusts and partnerships such a broad definition is not generally adopted in bilateral treaties. This can cause problems in particular for institutional investors that are constituted as common law trusts when investing in civil law countries. Investment funds that are constituted as partnerships face similar problems in cases where the treaty status of partnerships is not addressed.

4. The exclusion of alternative funds/private equity funds from the definition of CIVs for the purposes of the 2010 Report (on the grounds that they generally are not widely held, do not hold a diversified portfolio of securities and are not subject to investor protection regulation in the country of establishment) is rather artificial. Whether or not these funds meet these conditions (and some of them clearly do), it is more relevant that they are formed for a genuine business purpose of collective investment. If it is accepted that in principle a person's participation in a collective investment fund should not lead to a lower level of treaty entitlement than would be accorded to a similar direct investment by that person – which is surely a goal to be supported if cross-border investment is to be encouraged – the form that the fund takes should not be a factor in determining the treaty entitlement of the participating investors.

Pension funds

5. We welcome the extension to EU Pension funds.

Commentary on the discretionary relief provisions of the LOB rule

6. If the withholding tax rate provided in the Convention is not lower than the corresponding withholding tax rate in the tax treaty between the State of source and the third state then we believe that should, of itself, be sufficient to establish that the conditions for granting the discretionary relief are met.

7. At the moment the Commentary in paragraph 18 suggests that "that fact would not, in itself, be sufficient to establish that the conditions for granting the discretionary relief are met".

8. We suggest that this statement be removed from the Commentary.

Alternative LOB provisions for EU countries

9. We welcome the recognition that there needs to be an alternative version of the LOB for EU and EEA countries.

10. We believe that the provisions in Article 2 c)iii) re intermediate owners being a resident of either Contracting State would breach the EU Treaty freedom of establishment and would not be appropriate in treaties between member countries of the EU/EEA. We note that the provision is in brackets and paragraph 23 of the current document indicates that this is

because "some States consider that the requirement is unduly restrictive". While that may be the case it would also be helpful to recognise the EU/EEA difficulties with such a provision.

Requirements that each intermediate owner be a resident of either Contracting State

11. A substantial number of collective investment funds (whether or not they meet the CIV definition in the 2010 Report) that pool funds from different treaty country investors are based in offshore jurisdictions that have limited access to tax treaties. The funds are based in offshore locations for commercial reasons, namely that the jurisdiction concerned provides an enabling legal framework for such funds and reliable local fund administration and professional advisory services. If the jurisdiction does not have access to a suitable tax treaty network the fund will often seek to establish a subsidiary holding company in a country that has treaties with the countries where the fund's portfolio investments are situated. It would be helpful if the OECD recognised that this is not necessarily an inherently abusive situation, at least to the extent that the fund's use of an intermediary entity is not generating any greater treaty benefits than would have been available to a similar direct investment by a participant in the fund.

Issues related to the derivate benefit provision

12. The derivative benefits test in draft LOB article 4a) should not be restricted by reference to the number of shareholders in the company concerned that are equivalent beneficiaries. Limiting the relief to companies with seven or fewer shareholders would unjustifiably exclude from treaty relief widely-owned companies that are not engaged in any tax avoidance.

Conditions for the application of the provision on publicly-listed entities

13. We agree that provision needs to be made re the LOB rule and the publicly listed entity requirement where small countries are involved and the listed parent company is listed on a foreign stock exchange e.g. because of the lack of sufficient liquidity on the local stock exchange. We would suggest that such a provision should at a minimum allow listing in a regional stock exchange. For example, within the EU listing on an exchange in another EU Member State should in our view be accepted as a local listing.

14. While this point is not specifically raised in the current Discussion Draft we are concerned that the other main listed company route to "qualified person" status involves a new and untested concept of a company's "primary place of management and control" which - despite the definition in the draft LOB article 6d) - will surely require a court to determine its meaning in a particular context. If a company that is resident in country A where its main class of shares is listed subsequently obtains a secondary listing for those shares in country B it would need to ensure that its primary place of management and control remains in country A, otherwise it would risk losing access to treaty benefits if its shares became primarily traded in country B.

Clarification of the "active business" provisions

15. US groups with UK subsidiaries should be able to rely on activities in other EU countries to satisfy the test.

16. Draft LOB article 3a) specifically excludes from the definition of an active business a business of "making or managing investments for the resident's own account". The Commentary should clarify that this does not exclude the business of a resident that involves the making or managing investments on behalf of other persons.

B Issues related to the PPT rule

Inclusion in the Commentary of the suggestion that countries consider establishing some form of administrative process ensuring that the PPT is only applied after approval at a senior level

17. The principles set out in paragraph 32 are reasonable but it needs to be borne in mind that the application of the GAAR is by exception but in the UK you have to apply for treaty relief and you need to know whether the GAAR is going to apply or not. There needs to be some

limitation in the period of time, say 2 months, during which the administrative process should be completed.

Whether some form of discretionary relief should be provided under the PPT rule

18. We suggest that the use of intermediary owners in appropriate circumstances, see our comments under Requirements that each intermediate owner be a resident of either Contracting State is an instance where treaty relief would be justified.

Drafting of the alternative "conduit-PPT rule"

19. Given that the object of many collective investment funds is to distribute the whole of their returns to their investors (whether or not in the form of dividends), it would be quite inappropriate to characterise a fund or a fund-owned subsidiary holding company as a conduit solely on the basis of this fact pattern. The Commentary should make this clear.

C Other issues

Application of the new treaty tie-breaker rule

20. We believe that it will be absolutely essential to put in place a tight deadline in respect of requests made under this new law. We would recommend that the deadline should ideally be 1 month but it certainly should not be longer than 3 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 should 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 icaew.com/en/technical/tax/tax-faculty/~/media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx)