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Grant Thornton discussion draft response

BEPS Action 6: Prevent Treaty Abuse

Grant Thornton International Ltd, with input from certain of its member firms, welcomes the opportunity to comment on the OECD Revised Discussion Draft entitled BEPS Action 6: Prevent Treaty Abuse, issued on 22 May 2015.

Our observations and detailed comments are set out below. We have confined our comments to areas of the Revised Discussion Draft where we still have concerns about the OECD's proposals and followed the numbering of this document.

Issues related to the LOB provision

Collective investment vehicles: application of the LOB and treaty entitlement

The revised discussion draft notes that due to the general support for the conclusions of the 2010 CIV report and the fact that subparagraph 2(f) of the LOB rule effectively reflects the conclusions of the CIV report, there was no need for further changes to the report on Action 6.

The revised discussion draft also notes that the application of the recommendations of the TRACE project is critical for the application of the conclusions of the CIV report.

Comment: We note that references to subparagraph 2(f) in the revised discussion draft relate to the LOB rule in section A of the OECD report on Action 6 and also to the LOB rule in the annex of the revised discussion draft.

We consider that the operation of an LOB rule to CIVs would be administratively onerous and would restrict and limit the ease with which CIVs invest and operate across borders. We welcome the exclusion of CIVs from the LOB provisions (as incorporated in subparagraph 2(f)) and would also welcome further commentary on the issues surrounding the application of any LOB rule to CIVs to be clarified and included in the commentary to the model convention.

In the meantime, there would need to be widespread implementation amongst OECD member countries of the recommendations of the 2010 CIV report and the TRACE package before the application of LOB rule to CIVs. Therefore, a 'grandfathering' provision in the latest proposed text is necessary to achieve this effect.

Non-CIV funds: application of the LOB and treaty entitlement

The revised discussion draft introduces a specific reference to the conclusions of the 2008 REIT report in the commentary to subparagraph 2(f) of the LOB rule and recognises that pension funds should be considered to be a 'resident' of the State in which it is constituted regardless of whether it benefits from a limited or complete exemption from taxation in that State. However, there has been minimal progress in addressing the issues and consequences of subjecting non-CIVs to an LOB rule. Although solutions to resolve issues surrounding the treaty entitlement of non-CIVs will be explored and work on addressing these issues and arriving at a solution will continue after the September 2015 deadline for the adoption of the final report on Action 6, there are concerns that this work would not be completed before the December 2016 deadline for the negotiation of the multilateral instrument that will implement the conclusions of Action 6.

Comment: Although the discussion draft did not ask for comments with respect to REITS, we welcome the inclusion of the footnote in the commentary which references the 2008 REIT report. The inclusion of the reference provides greater certainty for the wider REIT industry.

We consider that this is an unfortunate outcome. It also gives rise to additional uncertainties and is yet another indication that the BEPS project may not be concluded in entirety before the end of 2015. Non-CIVs play an important role as investors in capital markets and any denial of treaty benefits to non-CIVs could have adverse implications to cross-border trade and investment. Whilst the importance of investment funds is recognised in the revised discussion draft, neither the extent to which the LOB rule could impact non-CIVs nor possible solutions of ways to ensure treaty benefits may be granted to non-CIVs have been considered. Issues and concerns raised in relation to the application of an LOB rule to securitisation vehicles and the securitisation industry have also not been addressed.

We also note that aside from confirmation that pension funds may be considered to be 'residents' of a contracting State, guidance and commentary on the actual application of an LOB rule to pension funds has also not been provided in the revised discussion draft.

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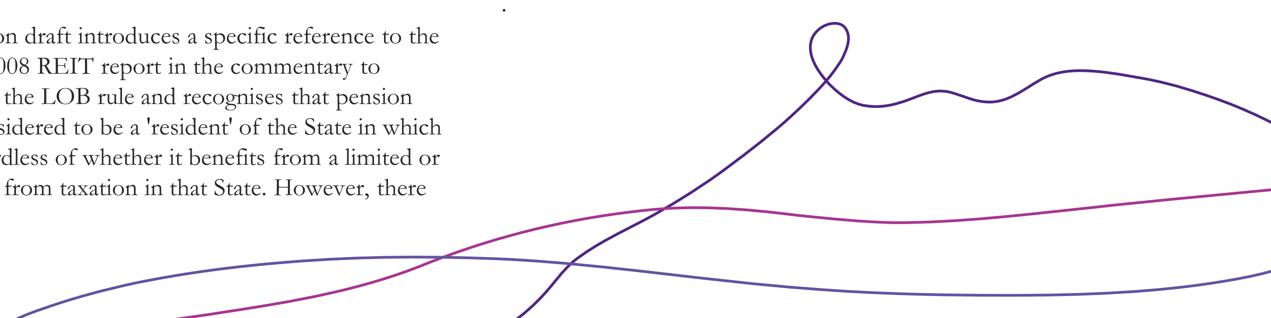

Commentary on the discretionary relief provision of the LOB rule

In order to provide clarity and further guidance, the revised discussion draft replaces paragraphs 63 to 65 of the proposed changes to the commentary on paragraph 5 of the LOB rule.

Comment: As a general comment, we welcome the decision to provide further guidance on the factors that should be taken into account by tax authorities in considering requests for discretionary relief. The specific requirement that a competent authority should process a request for relief expeditiously is useful but it would be more helpful if it prescribed a clear time limit, for example three months from the date of the request, so that this matter is not open to further interpretation or delay.

Alternative LOB provisions for EU countries

The revised discussion draft states that no changes will be made to the model provisions included in the report in order to specifically address critical EU law issues at hand. Notwithstanding this, the working party agreed that such issues should be addressed generically (so as to avoid giving preferential treatment to EU/EEA residents) in the commentary. We also note that revised wording has been proposed to allow greater foreign participation in a pension fund that constitutes a 'qualified person'.

Comment: Whilst we recognise the OECDs concerns about preferential treatment, we are disappointed that specific guidance on the LOB rule will not be provided in the commentary, especially in light of the Papillon (C-418-07) and RBS (C-311/97) cases.

We welcome the changes concerning the ownership of pension funds though we believe that obtaining the information needed to meet the alternative thresholds is likely to prove onerous in practice with the proposed 90% threshold being prohibitively high.

Issues related to the derivative benefits provision

The revised discussion draft states that various issues are unresolved and need to be addressed before a decision can be reached on the manner in which a derivative benefits test would operate. The revised discussion draft includes new treaty provisions on 'special tax regimes' including a definition of a 'special tax regime' and new provisions for Articles 11, 12 and 21 of the OECD model tax convention.

Comment: We consider that the inclusion of specific definitions in relation to 'special tax regimes' and the modification of articles 11, 12 and 31 of the OECD model tax convention would further complicate the operation of the derivative benefits provision and would confuse the underlying objective of Action 6.

The granting of treaty benefits to entities that are considered to be subjected to a 'special tax regime' should not, in itself, be considered to be 'abusive' within the context of Action 6. We consider that issues surrounding special tax regimes should be dealt with by contracting states through bilateral negotiations and where appropriate, the renegotiation of double tax conventions. We also consider that it would be more appropriate to address the issue of 'special tax regimes' under Action 5 of BEPS and through the OECD's continuing work on harmful tax practices. We consider that the other mechanisms of Action 6 (such as the LOB and PPT rules) appropriately capture the use of conduit entities and arrangements, even where those conduit entities or arrangements may be subject to a special tax regime.

Additionally, we note the September 2014 deliverable on Action 5 included a review of specific tax regimes in a number of OECD member and associate countries and concluded that many of these regimes were not harmful. Therefore, the inclusion of 'special' tax regime provisions does not appear consistent with the broader conclusions of the work on harmful tax practices. There should be a carve-out for regimes which the OECD considers are not harmful while the new proposed rule should only be adopted in cases where the activities benefiting from the relevant tax regime do not have sufficient substance.

Issues related to the PPT rule

Application of the PPT rule where benefits are obtained under different treaties

The revised discussion draft states that it was agreed by working party 1 that no changes to the commentary was required.

Comment: We welcome the OECDs decision not to amend the wording of the PPT rule itself. As noted in our letter dated 9 January 2015, an amendment to the rule would have resulted in a lack of clarity as to when the rule should and should not apply.

Nonetheless, in that same letter, we urged the OECD to amend the draft commentary to clarify the operation of the rule with respect to regional hub structures. Such structures are used for example where the UK or other EU territory is used as a holding location for European subsidiaries (where the ultimate parent is outside the EU), or where the US is used as a holding jurisdiction for the Americas, or Australia is used as a holding jurisdiction for the Asia-Pacific region.

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

The revised discussion draft proposes amendments to the commentary on the PPT rule. The proposed amendments indicate that countries establish their own administrative process so as to ensure that the PPT is only applied after approval at a senior level.

Comment: We welcome the OECDs proposal for individual countries to establish their administrative processes for the purposes of restricting the application of the PPT rule. However, to maintain consistency with the OECD's latest proposals for the discretionary relief rule we consider it essential that such processes should have as uniform a timeframe as possible, or at least that a competent authority should be encouraged to consider individual cases on a timely basis.

If you would like to discuss any of these points in more detail then please contact:

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