

Tax insights

BEPS Action 6 follow-up: Preventing treaty abuse



Snapshot

- On 21 November 2014, the OECD, as part of its work on the Action Plan to address Base Erosion and Profit Shifting ('BEPS'), released a follow-up Discussion Draft on Action 6 in relation to preventing treaty abuse.
- This Discussion Draft provides stakeholders with the opportunity to comment on how greater certainty could be provided through the model treaty and/or commentary in certain open areas.
- Issues to be addressed as part of the follow-up work include the limitation on benefits (LOB) rule, the principal purposes test (PPT) and a new treaty tie-breaker test.
- Comments should be sent to the OECD by 9 January 2015.

When the OECD issued the Action 6 deliverable on 16 September 2014, it acknowledged that further follow-up work was required in relation to certain aspects of the work on Action 6. In particular, further work was required in relation to the LOB rule and policy considerations relevant to treaty entitlement of collective investment vehicles (CIVs) and non-CIV funds, amongst other matters.

Deloitte Comments and Business Next Steps

This follow-up Discussion Draft invites comments on a number of areas, which were either not covered or fully covered in the September 2014 paper.

This Discussion Draft provides stakeholders with the opportunity to comment on how greater certainty could be provided through the model treaty and/or commentary in these open areas. We summarise below some of these open issues.

Issues to be addressed as part of the follow-up work: Limitation on benefits

Comments are invited on the following in respect of the LOB rule:

Widely held vehicles	Whether the recommendations of the 2010 OECD Report, 'The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles' are adequate or whether improvements could be made.
Non-CIV funds	These funds may not qualify as residents and, even if they do, may fail to meet the current draft of the LOB rule. This could include, for example, sovereign wealth, alternative and private equity funds.
Pension funds	The residence of pension funds, the exemption of income where both States generally exempt from tax the investment income of domestic pensions, the 50% ownership test in the LOB rule and the definition of pension funds.
Competent authority discretionary relief	The factors that competent authorities should take into account when determining whether relief should be available.
Derivative benefit provisions/ equivalent beneficiaries	Comments are invited on possible ways in which a derivative benefits test could be included to allow intermediate companies used for valid commercial reasons to access treaty benefits.
Timing issues	In particular, how to treat a company which becomes or ceases to be publicly-listed during a taxable period.
Small countries with non-substantial stock exchanges	Modifying the publicly-listed provision to reflect the fact that listings may not be sought on smaller local markets whilst ensuring that the entity has sufficient nexus to warrant the application of the treaty.
Interpretation of the active business provision	Including head office operations, and the combination of different activities (for example, manufacturing and investment) carried on in the same country.

Other issues to be addressed as part of the follow-up work

New treaty tie-breaker rule:	The need to encourage competent authorities to address requests that will be made under the new rule as quickly as possible.
Triangulation/permanent establishment in third state:	Comments are invited on whether the rule should be extended to situations beyond where the profits of the permanent establishment are exempt, and whether the exemptions from the rule are broad enough.

Issues identified with the principal purposes test

The Discussion Draft identifies a number of possible issues with the PPT:

Establishing an administrative process to ensure that the PPT is only applied after senior approval:	There is recognition that general anti-abuse rules found in domestic law may be subject to approval by a committee of senior officials. The commentary on the PPT could include the suggestion that countries consider establishing a similar process for applying the PPT.
Arbitration:	The majority of countries support the application of the PPT being a matter that is suitable for arbitration.

Issues to be addressed as part of the follow-up work: Principal purposes test

Comments are invited on:

Extending the list of examples in the PPT commentary

Alignment with LOB commentary	In particular, comment is sought in respect of the competent authority discretionary LOB rule which also considers purpose.
Availability of discretionary relief	As currently drafted, if the PPT applies, the relevant income would be taxable under domestic law without any treaty benefits. In some cases, however, it may be appropriate to provide some form of treaty relief. The example given is a transaction which transforms dividends into a capital gain on shares. Tax authorities may consider it appropriate to apply the relief provided under the dividends article.
The alternative 'conduit-PPT rule'	This is the alternative to the PPT which States may use to address treaty-shopping conduit strategies that would not be caught by the LOB rule. The commentary could include possible examples, which could be taken from the exchange of notes between the United Kingdom and United States in respect of the conduit arrangement rules in the 2001 treaty.

Timetable

Comments should be sent to the OECD by 9 January 2015. A public consultation meeting will be held on 22 January 2015.

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