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By email to: aggressivetaxplanning@oecd.org

19 September 2016

Dear Mr. Pross,

BEPS Public Discussion Draft: Branch mismatch structures

PricewaterhouseCoopers International Limited on behalf of its network of member firms (PwC) welcomes the opportunity to comment on the OECD's *Public Discussion Draft on Branch Mismatch Structures under Action 2 (Neutralising the Effects of Hybrid Mismatch Arrangements) of the BEPS Action Plan*.

We have made a number of general observations on the proposal and then gone on to consider each of the five types of 'branch mismatch' identified in the Discussion Draft and the recommendations associated with each of them.

General comments

1. We would note that the proposals contained in the original Action 2 final report on neutralizing the effects of hybrid mismatch arrangements are extremely complex as evidenced by the fact that the report extends to over 400 pages. The proposals contained in this Discussion Draft add further significant complexity. A number of the concerns raised in the Discussion Draft regarding branch mismatches may well be addressed or at least reduced through other parts of the BEPS Action Plan for example Action 7: Preventing the Artificial Avoidance of Permanent Establishment Status. We believe therefore that consideration should be given to providing Member States with the option of implementing the recommendations addressing hybrid entities and hybrid instruments contained in the original Action 2 report but without the need to extend them to branches as contemplated in the Discussion Draft.

2. We would note that branches are very common for financial institutions. It is not uncommon for financial institutions to have a very large number of inter-branch transactions every year which have nothing to do with tax planning. Such transactions may well be subject to regulatory scrutiny. To avoid a disproportionate administrative burden for financial institutions we believe that consideration should be given to allowing Member States who chose to adopt the branch mis-match rules to exclude regulated entities from those rules.

Disregarded/ diverted branch structures

3. The Discussion Draft sets out a potential recommendation that the residence territory adjust the branch exemption so that amounts that are disregarded, exempt or excluded from taxation in the branch territory are treated as if they had been received directly by the head office (and outside the exemption for branch income). It would appear that this recommendation is intended to apply to any payment (regardless of whether it is made within a controlled group or under a structured arrangement). This amounts to introducing a 'subject to tax test' in a Member State's branch exemption. This appears to be going significantly further than merely neutralizing hybrid mismatches and indeed would be inconsistent with the territorial (or quasi territorial) tax policies adopted by a number of Member States. To the extent such Member States feel the need to introduce some level of protection from base erosion this could be done by applying CFC rules to the branch. We believe therefore it may be more appropriate to limit the counter action in these cases to disallowing a deduction for payments made in a controlled group or under a structured arrangement (subject to the point noted below) where there is no income inclusion due to a branch mismatch.
4. If however a decision is taken to include a recommendation that treats a payment as being received directly by the head office we note that it will be important to also ensure that any related expenses are treated as incurred by the head office otherwise there will be the anomalous result that where the branch mismatch rules apply the head office jurisdiction is taxable on the gross receipt whereas had there been no mismatch the recipient would only be taxable (in either the branch or the head office) on the net profit.
5. To the extent there is a rule that denies a deduction for all payments made to a branch where there is no taxation in either the head office or the branch this would appear to give rise to a disallowance even in situations where, were the payment made to a company located in the jurisdiction of the branch no disallowance would arise under the main Action 2 recommendations . This could occur for example with branches in non taxing territories. Payments to companies located and carrying on business in a non taxing jurisdiction are generally not within the scope of the main Action 2 recommendations since the lack of taxation in the payee does not arise due to hybridity. Consideration should be given to addressing this inconsistent approach to branches and ensuring that there is no disallowance for a payment where had it been paid to a company located in the jurisdiction of the branch there would still have been no taxation for reasons other than hybridity.
6. Similarly, and as noted in the Discussion Draft, there should be an exception to the disallowance in cases where the head office jurisdiction would not tax the receipt irrespective of the existence of the branch.
7. We agree that inclusion of the income in a CFC calculation should be treated as giving rise to ordinary income.

8. We would also note that it will be important to ensure that the rules do not apply where the head office taxes worldwide income but grants a credit for any overseas tax suffered in the branch.
9. Finally, we note that on a practical level, in structured arrangements that involve third parties, it may be even harder for a payer to identify whether there is a mismatch than where the payment is to, say, a hybrid entity because the payer is unlikely to have knowledge of any internal branch allocation being carried out by the recipient. To avoid uncertainties on the application of the rule consideration could therefore be given to limiting the application of the branch mismatch rules to payments within a controlled group.

Deemed branch payments

10. We agree with the Discussion Draft that in the deemed branch payments recommendations care will need to be taken to ensure that mere differences in the method of profit attribution between a branch and its head office do not give rise to mismatches (where none exists in reality).

Double deduction (DD) branch payments

11. The Discussion Draft sets out a recommendation to apply the Action 2 Report in such a way that the primary response would be for the head office territory to deny duplicate deductions unless they are set against dual inclusion income.
12. This could potentially result in branch losses becoming stranded, which would seem to go beyond the scope of the BEPS objectives. If the recommendation were instead to be that there should be a disallowance of the deduction in the head office jurisdiction if and only if the deduction is set off against non dual inclusion income in the branch location, this would mean that relief remains available in the head office jurisdiction for branch losses (which have not been deducted locally).
13. We note here that a number of jurisdictions already have 'dual consolidated loss rules' which deny a deduction for losses which are also deductible overseas. It will be important that Member States are given sufficient flexibility where necessary to ensure that any double deduction branch payment rules may be implemented in a manner consistent with those existing rules.

Imported branch mismatches

14. We are reminded that the BEPS Action Plan broadly sought to ensure that the tax burden in a jurisdiction reflected the activities and value added in that jurisdiction. Where there is a perceived erosion of the tax base(s) as a result of a mismatch in the tax treatment of a transaction (or entity), the logical focus would be on the recipient jurisdiction taxing the receipt or for the ultimate parent jurisdiction taxing the sum under CFC/ remittance rules. The denial of a deduction is a suitable proxy alternative only where the expense in question is an expense which would not otherwise have been incurred were it not for the no or low taxation on the recipient side. To deny deductions in other circumstances seems to ignore the fundamental objective of the hybrid rules to stop the use of hybridity to give rise to deductions that would not otherwise have arisen. The imported mismatch rules risk shifting the tax burden to the jurisdiction that is paying expenses that it would have incurred whatever the taxation in the recipient jurisdiction (or further up the chain). This creates a reallocation of taxing rights that does not align with the location of substance and value driving activities. Consideration should be given to limiting the application of the imported mismatch rule to situations where an expense is being incurred that would not otherwise have arisen but for the existence of the hybrid mismatch arrangement. We would note that this

suggestion applies equally to the imported mismatch proposals in the original Action 2 report as it does to the recommendations in the Discussion Draft.

15. There is however an additional point that can be made regarding the imported mismatches as they apply to branches. The taxation of branches often requires the head office and/ or the branch jurisdiction to determine whether the activities in the branch rise to the level of a permanent establishment for the purposes of a treaty. This is often a difficult question. The imported mismatch rule requires a tax payer to potentially identify the tax treatment of an arrangement in four separate jurisdictions (payer jurisdiction, payee jurisdiction, branch jurisdiction and head office jurisdiction). It also potentially requires knowledge of the treaty analysis in the head office and branch jurisdictions. Taken together this clearly creates a significant burden for tax payers. Consideration should therefore be given to allowing Member States to 'opt out' from the application of the imported mismatch rules to branch situations.

For any clarification of this response, please contact the undersigned or any of the contacts below. We look forward to discussing any questions you have on the points we raise above or on other specific matters raised by respondents to the Discussion Draft and would welcome the opportunity to contribute to the discussion as part of the public consultation meeting in October.

Yours faithfully,

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