PwC's comments on Action 6

A Issues related to the Limitation on Benefits

1 Collective investment vehicles

The Discussion Draft notes that the Commentary on the LOB rule includes a discussion of how CIVs could be dealt with as well as a number of alternative provisions that correspond to the various approaches included in the 2010 OECD Report *The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles* (the CIV Report). The Discussion Draft then invites comment on whether a preferred approach should be sought.

The original draft of the Action 6 recommendations on entitlement to treaty benefits omitted any reference to CIVs, an omission that was corrected in the September report. The September report recognised that the typical LOB article does not adequately address CIVs and we endorse the Discussion Draft's use of the CIV Report as the starting point. The CIV Report was the result of a concerted effort to provide CIV investors with the opportunity to enjoy the benefits and efficiencies of collective investment without being penalised by the loss of the treaty relief that they would have received if investing directly. We do not believe a preferred approach is practical given the variety of structures for CIVs which are dictated by local law considerations, the targeted investor base, and the targeted investments.

The Treaty Relief and Compliance Enhancement (TRACE) implementation package is an important complement to an effective LOB approach for CIVs. TRACE's investor documentation and reporting mechanisms are needed to have an effective and efficient means of establishing investor attributes when interests in CIVs are widely held and frequently traded. TRACE will provide assurances that the claims investors make for treaty relief are appropriate.

2 Non-CIV funds

This section of the Discussion Draft includes within its scope Real Estate Investment Trusts (REITs), sovereign wealth funds (SWFs), pension funds and alternative funds (including private equity funds). Each is a major source of capital and exists for the principal purpose of the efficient investment of capital. With the exception of SWFs and pension funds, they serve as a means for collective investment. Like CIVs, they may take various forms unrelated to treaty benefits and the goal for these investment vehicles is tax neutrality, in the sense that the taxation of these vehicles should not penalize an investor for investing through the collective vehicle rather than investing directly. The alternative means of determining treaty eligibility in the CIV Report should apply to REITs and alternative funds.

The Discussion Draft questions whether the fact that a SWF or pension plan may invest through vehicles created outside their country of residence raises concerns. We do not see any concern about extending treaty benefits for income arising through such an intermediary. If the SWF or pension fund could have received treaty benefits by direct investment, the same treaty benefit should be available whether the income is received directly or through an intermediary vehicle. Most SWFs and pension funds have an extensive amount of capital to invest. Their investments tend to be diverse and often complex. As noted in the Discussion Draft, they are major investors in alternative funds and to restrict them to local funds to

avoid a tax penalty or loss of treaty entitlement would be extremely disruptive. Outside the alternative fund arena, when these investors invest outside their country of residence, issues of limited liability and other non-tax considerations may dictate the use of a special purpose vehicle where it may be necessary or appropriate that the vehicle be formed outside the country of residence.

With regard to pension funds, they fundamentally provide important social ends by providing a means of savings and retirement security for their participants. We endorse the broad application of treaty benefits to these funds. The Discussion Draft invites comments on the “issue” of residency highlighted in paragraphs 8.6 and 8.7 of the Commentary on Article 4. This is a technicality that should not impede in any manner the ability of these funds to claim treaty benefits. In many treaties, pension funds are directly addressed in the residency article of the treaty and we suggest that is the right way to resolve any concern over whether a fund is technically liable to tax in their home jurisdiction. We also endorse making clear in Paragraph 69 of the Commentary on Article 18 that income exempt from home country taxation should also be exempt from source country taxation. Any other result would undercut the home country’s policy of providing exemption from tax for their pension funds. We recommend against any attempt to distinguish between portfolio investment and non-portfolio investment. Often funds may use an intermediary vehicle, whether it be a special purpose entity wholly-owned by the funds or a joint investment vehicle. Drawing lines between portfolio investment and non-portfolio investment would be a complex and impractical restraint which serves no policy end when the income is received by a tax exempt fund.

Finally, we recommend eliminating the requirement that at least 50% of pension plan participants or beneficiaries be resident in the home country of the fund. This test increasingly becomes a trigger point for inappropriate denial of access to tax treaties. Many employers in today’s economy are global in scale and may move employees from country-to-country in the course of their careers. Further, in smaller countries, it may not be uncommon for employees to retire to another country. Where an employee is when the employee starts receiving benefits under the plan has nothing to do with treaty shopping. Most plans are established in the country of residence of the employer and that should establish sufficient nexus as should be the fact that the plan was established in the treaty country of residence and subject to its requirements for qualification for exemption. Given the clear overriding social importance of pension funds and the fact that they are almost always tax exempt in whatever jurisdiction they are formed, there should be no need for a restraint on eligibility based on the residency of the participants/ beneficiaries.

3 The discretionary relief provision

An effective and timely discretionary grant process will be increasingly important if the objective tests in the proposed LOB article are overly restrictive, with the result that, absent an efficient discretionary relief mechanism, a treaty intended to provide benefits for tax residents of the treaty partners only provides benefits for a limited class of tax residents. In the US, the discretionary grant has been described as the “safety net” in recognition that the objective tests in the LOB article may unintentionally deprive bona fide residents of the treaty country access to the treaty. In contrast to the constructive tone of most of the discussion draft, the discussion of the discretionary relief provision conveys a surprisingly restrictive approach, similar to many other aspects of the proposed LOB article. Our concerns over the restrictive nature of the discussion draft include the following:

- The statement that the fact that a tested subsidiary company would obtain a treaty rate reduction no greater than could have been obtained by the parent company under its resident country's treaty with the source country is not sufficient to establish the lack of a treaty shopping motive. If there has been no greater treaty benefit obtained by an investment through the subsidiary company than would have been obtainable by the parent company, the subsidiary could not have been formed or availed for a principal purpose of obtaining the treaty benefit. There may be other tax benefits obtained by use of the subsidiary company as the investment vehicle but any such

non-treaty benefits that are in conflict with BEPS principles should be dealt with directly, such as through CFC rules, hybrid rules, harmful tax practices and the like.

- The discussion draft does not give adequate attention to the serious problems presented by lengthy procedures that can leave a taxpayer deserving of access to the treaty being subjected to an extended period of uncertainty and deprivation of treaty benefits during the pendency of the procedure. Simply suggesting the Commentary should "encourage" Competent Authorities to process requests expeditiously does not do justice to this concern. Taxpayers should bear the responsibility of establishing that they are not treaty shopping. Tax authorities should have the responsibility of expeditiously confirming treaty access. We recommend adoption of a six month deadline.

- The discussion draft suggests that if a tax authority has "properly exercised" its discretion, that decision should be final and not subject to the treaty's mutual agreement procedure. It is unclear who is the arbiter of whether the tax authority has properly exercised its authority; this underscores the wisdom and fairness of making the process subject to review with the treaty partner. This endorsement of a unilateral denial of treaty benefits to a resident of the treaty partner is in contrast to the Discussion Draft's recommendation that determinations by a tax authority that a transaction violates the PPT should be subject to the treaty's mutual agreement procedure. When a tax authority is considering denying a resident of a treaty partner access to the treaty, there should be a full and fair airing of that decision with the treaty partner. Subjecting a treaty resident to the potential of double taxation or excessive taxation should be viewed as sufficiently harsh to mandate procedures to protect against inappropriate unilateral action by the source state's tax authority.

We suggest the following basic principles should apply in developing the proper discretionary grant procedures and policies:

- The standards to be applied by the requested tax authority must be clear and public.

- If the requesting taxpayer is claiming a treaty benefit that it, or its affiliated group, could have obtained without use of the treaty, the standard should be considered met.

- There should be strict time limits set on the amount of time the tax authority has to provide a conclusion with model guidelines set forth in the Commentary subject to bilateral variations or embellishments agreed upon between the treaty partners.

- If a tax authority proposes to deny the request, procedures should be included that require the tax authority to present its tentative decision to the treaty partner's tax authority with a complete explanation of the reason for the proposed denial of treaty benefits. If the tax authority of the treaty partner does not agree to the proposed denial of treaty benefits, the matter should be resolved through the mutual agreement procedure.

We offer the following examples of cases where the discretionary grant should be given[1]:

- **Treasury centre**: A multinational enterprise places its global or regional treasury function in a separate company. In choosing the country of residence of the treasury centre, the enterprise considers a variety of factors, including creditor rights laws, banking laws, stability of the government, an established infrastructure of professional support, labour laws and various regulatory laws. Also considered are the local tax burden and the network of double tax agreements that avoid excessive taxation of interest income.

---

[1] We note that we participated in the formulation of the comment letter of the US Council for International Business and the examples provided here are similar to those included in the USCIB letter.

- **Local financing**: Company D would meet the relevant base erosion test except for the fact that it obtains bank financing from a local bank that does not qualify for the exceptions to the base erosion test because the local bank is a subsidiary of a public bank holding company and the exception from the base erosion test only applies to payments to local publicly traded companies.

- **Joint venture (1)**: Company E, resident of treaty partner X under the X/Y treaty and Company F a resident of treaty partner Y, form a joint venture in the form of a corporation resident in Country Y. The joint venture is a 50-50 undertaking but to avoid deadlock on corporate decisions, Company E is given an additional vote. Because the ownership/ base erosion test only treats residents of Country Y as "good" owners, the joint venture company fails the ownership part of the ownership/ base erosion test.

- **Joint Venture (2)**: Companies G and H agree to establish a joint business venture. Company G is agreeing to provide substantial capital to the venture, critical to the venture's viability. Company G already has significant business and investment activities based in Country X, a country that has a broad network of tax treaties. By reason of Company G's other activities in Country X, Company G has strong local ties in Country X, including relationships with local financial institutions, professionals, and government agencies. Company G, therefore, insists that the joint venture be formed in Country X. Even though Company G holds a minority interest in the venture, the venture will not be viable without Company G's investment and, therefore, Company H agrees to have the venture establish a Country X company.

- **Organic expansion**: Company A was established one hundred years ago as a family business (we know of examples that go back 200 or 300 years) created in the family's country of residence. Over the years the business has grown from a local business to a global enterprise. While management remains in the home country, the local business has diminished in size relative to the global business, causing the company to fail the trade or business test.

- **Ownership expansion**: Company B was established by three family members, all resident in the country of residence of all three family members, Country B. Company B has formed a regional holding company in Country C that holds investments in Country D. The treaties between Country B and Country D and between Country C and Country D provide identical benefits. Over the generations, the family has grown to the point that ownership is now shared by 12 descendants of the three original founders, most retaining residence in Country B. As a result of the family expansion, the derivative benefits test is failed since it requires tracing ownership to seven or fewer equivalent beneficiaries.

- **Going private**: A multinational enterprise, based in Country C, is acquired by a private equity fund. The taxpayer establishes by clear and convincing evidence that the acquisition was driven by solid non-tax business reasons.

- **Holding company**: A multinational enterprise establishes a holding company in Country D to hold its ownership interests in its various affiliates. Most of the affiliates are in the EU and the enterprise selects Country D because it is a jurisdiction within the EU. Included in the criteria for selecting Country D is the fact that the jurisdiction has a wide network of tax treaties. Subsequent to the establishment of the holding company, the enterprise decides to expand into Country E, outside the EU, and acquires a major company in Country E. The enterprise chooses to place ownership of the new company in the holding company, with the result that the income tax treaty between Countries D and E will apply to dividends paid by the new company. Consideration of the fact that a jurisdiction has a wide network of tax treaties should be a neutral factor in determining whether the establishment of the holding company in the chosen jurisdiction has a principal purpose of attaining access to one or more specific treaties. Further, the later addition of the new company to the holdings of the holding company would not, in the absence of extraordinary

circumstances, be a basis for concluding that placing the new company under the holding company had a principal purpose of attaining access to the treaty between Countries D and E.

4 Alternative LOB provisions for EU countries

The discussion draft states that "there is therefore a need to draft alternative provisions that would accommodate the concerns of EU member states." (Paragraph 22, page 8.)

We agree that it is arguable that ECJ case law, especially the Open Skies cases, would support the view that a derivative benefits provision should be included. It is also arguable that this is not gainsaid by the ACT Class IV case, insofar as the latter dealt with companies in different situations i.e., entitled/ not entitled to the UK's treaty based half tax credit on dividends from UK resident companies.

We also consider that ECJ case law, especially the Papillon and SCA cases, requires entitlement to any treaty benefit to be traced via any EU company, and not just companies resident in the treaty partner states. See also 5 below.

5 Requirement that each intermediate owner be a resident of either contracting state

The discussion draft (at paragraphs 23 and 24) notes that some states consider the requirement found in subdivision 2 *c(ii)* and 2 *e)(i)* requiring that each intermediate owner of a tested company be a resident of either contracting state may be unduly restrictive and states that further work is required in order to determine whether and how the requirement could be relaxed without creating opportunities for treaty-shopping. The same issue exists in the draft provision on derivative benefits. We urge that these requirements be eliminated in all three provisions as they serve no legitimate policy concern.

These restrictions potentially would eliminate access to treaty benefits for many if not most multinational enterprises. These enterprises typically involve 100s, if not 1000s, of affiliated companies and where a tested entity is situated within the multinational group's organizational structure may be the result of a variety of factors. Some common examples are:

- A multinational enterprise has acquired another corporate group with an existing organisational structure. For example, Company X, resident in Country A, acquires Company Y, resident in Country B. Company Y has a subsidiary in Country A, owned either directly or somewhere down the chain of ownership of the Company Y group.

- A multinational enterprise has organised its corporate ownership structure along regional lines. For example, Company X, resident in Country A, has created a regional holding company in Country B to oversee and own affiliated entities in the EMEA region and one of those affiliates is resident in Country A.

- The comparable fact pattern may exist where Company X has organised its structure based on lines of business. For example, Company X, resident in Country A, has created a company in Country B to oversee and own all affiliates that are in a single line of business, amongst the various lines of business in the enterprise. One of those subsidiaries is a resident of Country A.

Each of the above examples are very common and are simplified examples of why a tested company may be several tiers removed from its parent company with intermediate owners resident in a variety of countries. It often would be costly to restructure to avoid the "no bad intermediate owners" rules. For instance, there may be exit taxation resulting from the extraction of the tested company from its current line of ownership. In addition to being costly, it may be legally impossible or impractical because of regulatory restraints or other local law restrictions, or because of covenants in existing bank or public debt documents. Similarly, shares in the tested company may be held by a lender as security for the loan with

restrictions on any change of ownership. In addition to these economic and legal impediments to changing ownership, doing so would disrupt organisational efficiency creating unnecessary and complex reworking of corporate governance.

We see no policy justification for the rule and have seen no explanation justifying its existence, other than a statement that it may lead to treaty shopping without any explanation or example of how this might be the case. The closest we have seen to any explanation is an example in the discussion of the derivative benefits test in the original discussion draft where an intermediate owner pays a royalty to an affiliate in another country that provides preferential tax treatment for royalty income. But that same royalty could have been paid by the tested entity, with no intermediate owner between the tested entity and the ultimate parent, or it could have been paid by the parent company. The only legitimate concern is the ability of the payee of the royalty to receive favourable tax treatment of the royalty income but that has nothing to do with where the payer is in its corporate chain.

The only impact of having an intermediate owner is that the tested company can pay dividends to the intermediate owner out of treaty-benefited income. However, that dividend payment is not deductible. The treaty benefited income of the tested income has not been reduced by the dividend payment and, accordingly remains in the tax base of the tested company. While the dividend may not be subject to tax by the residence country of the intermediate owner, depending on how its tax system deals with parent/subsidiary dividends, it is likely that the parent company's country of residence has a similar system for not subjecting dividends to tax. Hence, in most cases, the tax results would be the same whether the tested company paid the dividend to the intermediate company or if the tested company paid the dividend directly to the parent company. If the intermediate company was not in the chain of ownership but a sister company to the tested company, the dividend could be paid to the parent company and then the funds could be contributed down by the parent company to the sister company. In other words, no tax advantage, or treaty abuse, has occurred by reason of the intermediate owner being in the ownership chain. The only practical effect would be to eliminate access to treaty benefits for a large portion of the multinational population.

Any concern with dividend income being held by an intermediate company where the parent company's country of residence does tax dividends should be addressed directly, such as in the context of CFC rules, rather than making the major tests for the treaty qualification of subsidiary companies inaccessible to many, if not most, multinational enterprises.

6 Issues related to derivative benefits

The discussion draft solicits comments on the definition of equivalent beneficiary and the need for each intermediate owner to be an equivalent beneficiary. We have addressed the intermediate owner test immediately above.

The first discussion draft cited a preferential tax rate as the reason for omitting a derivative benefits test. We note that all three companies in the example would be entitled to the same source country tax reduction under the relevant treaties, so the establishment of the tested company in State S does not provide any treaty benefit that would not otherwise be available. Further, the Parent in State T could also pay a royalty to the affiliate in State R and that apparently does not raise BEPS concerns. If the preferential tax regime for royalties in State R is considered a BEPS concern, then the proper avenue for addressing it is in the harmful tax practices Action Item. If the preferential regime is not harmful, then there is no reason to consider that preferential regime in determining whether derivative benefits are appropriate.

The derivative benefits test provides a level of certainty that is not available with other tests. For example, the active trade or business may be difficult to apply and lead to uncertain results (see discussion below).

Listed below are some instances where it is appropriate to apply a derivative benefits test. Many of these overlap with the cases discussed above and the rationales supporting the application of a derivative benefits provision are the same as those supporting discretionary relief.

Examples of situations in which the derivative benefits test is important include: joint ventures, treasury and regional holding companies, organic expansion, and acquisitions.

7 Provisions dealing with "dual-listed company arrangements"

We welcome the Working Group's recognition of the unique circumstances of dual-listed company arrangements. These arrangements are commonly referred to as an "economic merger" of two previously independent publicly traded companies. Ignoring the shares holding special voting rights to effectuate the economics of the arrangement would appear to allow the two previously unaffiliated companies to continue to test their eligibility for the publicly traded test independently which is consistent with the purpose of the publicly traded test and we support this end. We also support further study of this area, as there are likely collateral issues, such as the appropriate application of the subsidiary of a publicly traded corporation that merit careful consideration and how to apply the substantial presence test.

8 Timing issues related to the various provisions of the LOB rule

Timing issues are dealt with differently under various provisions of the LOB rule. For instance, the definition of "qualified person" in paragraph 2 applies at the time when a benefit would otherwise be accorded. In our view, this general view is sound for individuals and governments. We offer the following comments for the categories:

8.1 The publicly traded test (and subsidiary of publicly traded entity)

The proposed Commentary on the publicly traded test states that the conditions of subparagraph *c)* must be satisfied throughout the taxable period of the company or entity. This standard raises several practical concerns:

- First, as noted in the Discussion Draft, this creates a problem in the year the company becomes listed. Similarly, this creates a problem in the year a company de-lists. In these "short-year" situations, there should be no reason to deprive a publicly traded company of treaty benefits in the first or last year of its publicly traded status. Rather, as with the general rule for paragraph 2, the test should be applied at the time the potentially benefitted income is received. As long as a company meets the publicly traded standards (including the "regularly traded" requirement) at the time the payment is received, treaty benefits should be accorded. There are sufficient safeguards in the publicly traded test (including the regularly traded test and the listed stock exchange requirement) to prevent abuse without a requirement that the publicly traded test be met throughout the relevant year. Absent testing at the time of receipt, it would become impractical to administer the withholding regime.

- Second, we suggest that the Commentary: (i) allow the taxpayer to apply the regularly traded test based on the prior tax year, if there is a full prior tax year, in order for the taxpayer to be confident that it can represent to withholding agents that it meets the test, relying on current year trading only where there has not been a full tax year of public trading in the preceding year, and (ii) provide an adjustment to the Commentary's numerical test of regularly traded (10% of the average outstanding shares traded during 60 days of trading) for short years -- that is, the first year of trading and the last year of trading. US tax regulations applying rules similar to the

publicly traded test substitute, in a short year, one-sixth of the number of days of the short year for the 60 days and adjusts the 10% of the average outstanding shares by multiplying 10% by a fraction, the numerator of which is the number of days in the short year and denominator of which is 365.

- Third, the statement in the proposed commentary that the conditions of subparagraph *c)* must be met throughout the taxable year should be clarified for purposes of applying the subsidiary of a publicly traded company to make clear that the subsidiary test applies at the time the benefit is claimed. In other words, the fact that a company becomes a subsidiary or ceases to be a subsidiary at some point during the taxable period should not impact the eligibility of the subsidiary for treaty benefits as long as the company met the subsidiary test at the time the treaty benefit is claimed.

8.2 The ownership/ base erosion test

This test looks to the percentage of qualifying ownership of the tested entity and whether certain deductible payments to non-qualified persons exceed 50% of the tested company's gross income. A critical timing consideration is that, with respect to items of income that are subject to withholding at the time of payment, the withholding agent must be able to determine the recipient's treaty status at the time of payment. Both elements of the test require testing ownership and base erosion payments over the full taxable year. It is not practical for the tested company to know whether it will meet those tests before the end of the year. To make the tests practical, we submit the tested entity should have the option of using the prior tax year for determining eligibility where such prior year exists. We further note, with respect to application of the base erosion test, the same timing issues exist under the derivative benefits test. Accordingly, companies should have the option of applying the test based on the prior taxable year.

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

Fundamentally, we do not believe the conditions in 2 *c)i)A*) and *B)* (the substantial presence test) are relevant to treaty shopping concerns and should be eliminated. They are an element of the current US treaty LOB article but are there because of a domestic policy concern over so-called corporate inversions. Domestic policy concerns should be addressed under domestic law. Embedding them in a treaty means they will apply and limit access to treaties even if the domestic policy concerns have been addressed domestically and are no longer relevant in the treaty context.

There are two types of treaty shopping. One is the use of a treaty by a third country person who simply sets up an entity in a treaty state. It is virtually impossible to use a publicly traded entity for this type of treaty shopping, (which is the origin of the principle that publicly traded entities should be considered qualified residents in their jurisdiction of residence). The second type of treaty shopping involves conduit financing arrangements where a funding entity that is not eligible for treaty benefits uses a treaty-eligible entity as an intermediary to fund a company resident in the source country; publicly traded entities can be used to achieve these conduit financing results but would be subject to anti-conduit rules. Adding a substantial presence test adds a subjective and difficult hurdle to treaty eligibility that serves no treaty shopping end.

10 Clarification of the “active business” provision

One important role for the active business provision of paragraph 3 is to allow treaty benefits for dividends or other payments made by an active operating subsidiary to its active operating parent where they are engaged in the same of complementary lines of business, regardless of whether the parent is a

qualified resident. Unfortunately neither the text of paragraph 3 nor the commentary thereunder makes this as clear as it should be. Below, we suggest adding a new sentence at the end of subparagraph (a) which would help to clarify the intent of the test.

The Follow-Up Discussion Draft, at item 10, invited comments on the exact scope of the last sentence of paragraph 48 of the Commentary, which provides as follows:

"Since a headquarters operation is in the business of managing investments, a company that functions solely as a headquarters company will not be considered to be engaged in the active conduct of a business for purposes of paragraph 3."

We agree that the function of a headquarters company, standing on its own, should not meet the trade or business test. The role of the trade or business test is that, if a company is conducting an active trade or business in its country of residence, there is sufficient nexus to the country of residence to counter any treaty shopping concern with regard to income that is connected to that trade or business. A vital corollary is that a company should be tested for the trade or business test only after attributing to the tested company trade or business activities of affiliates conducted in the residence country of the tested company, as provided in subparagraph *c)* of paragraph 3. To not include activities of affiliates would limit the practical application of the test and deny treaty access to companies that are not treaty shopping. It is common practice to set up a holding company structure in the country where business activities take place. To deny attribution would force companies to distort their organisation structure by having to place the management activities and business activities in the same company. It serves no policy goal to disrupt normal corporate policy as the anti-treaty shopping goal is met as long as the affiliated group has a meaningful business presence and only income connected to that business presence is treaty protected.

This same logic applies to testing for whether income from the source country is connected to the business conducted in the residence country. Often that income is sourced with affiliates in the source country and, therefore, is "filtered" through payments made by the affiliate in the form of interest and dividends. As long as the dividend or interest is sourced from earnings of a business connected to the business of the tested company, the connectivity test should be met whether the connected income is received directly or through such dividends or interest. This policy is reflected in many US tax treaties which address, in the technical explanations to the treaty, the treatment of dividends and interest sourced to the conduct of the same or similar business as that conducted by the tested company and allow the taxpayer to use any reasonable method for determining what portion of the dividend or interest income is sourced from good earnings. In order to clarify this tracing through payments made by affiliates, we suggest adding the following sentence at the end of paragraph 3 *a)*: **"An item of income shall be considered to be derived in connection with an active business if it consists of a dividend, interest, royalty or other payment from a related person conducting an active business in the other contracting state that engages in a business that is the same or complementary to the active business of the resident receiving such payment."**

B Issues related to the PPT rule

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

When a multinational enterprise is selecting the tax residency of an affiliate, a multitude of considerations will be relevant, as set out in our letter. One of those considerations will routinely be whether the jurisdiction has a wide network of tax treaties. Whilst we agree that the fact that the selection criteria have included a wide network of tax treaties should not preclude application of the PPT, it is equally important that the Commentary not imply that choosing a jurisdiction with a wide network of tax treaties triggers

the PPT. In other words, the fact that the jurisdiction has a wide network of tax treaties should be a neutral factor in the application of the PPT. To suggest otherwise would penalise a jurisdiction for entering into a wide network of treaties.

Moreover, we question whether it is necessary to expressly clarify the application of the PPT to the situation where the benefit(s) obtained are from both a treaty and domestic law. A principal purpose is ordinarily the dominant purpose, and ultimately should be evaluated with respect to what provides the maximum economic benefit whether or not there are also lesser benefits. In other words, if the economic benefit of an arrangement which arises from domestic law is significantly less than an economic benefit which arises from a tax treaty, the PPT would prima facie not be prevented from applying by virtue only of that domestic law benefit. It is also worth noting that in countries where treaties are only enabled by domestic law (so-called "duallist countries"), the focus on situations involving both treaty and domestic law benefits would in our view be misplaced since there is no fundamental distinction in that instance from monist countries where treaties directly enter into force without enabling domestic legislation.

12 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

We welcome this suggestion but it should be elevated to a recommendation or ideally a requirement. In the UK, for example, the GAAR (enacted in Finance Act 2013) which can override tax treaties, can only be invoked on a notice by HMRC and requires the involvement of a "designated HMRC officer" and a referral to an independent GAAR Advisory Panel (Schedule 43, FA 2013).

13 Whether the application of the PPT rule should be excluded from the issues with respect to which the arbitration provision of paragraph 5 of Article 25 is applicable

We support the majority view that the application of the PPT should be included in the paragraph 5 Article 25 arbitration scope. Denial of access to treaty benefits is a serious infringement on the right of a treaty resident to claim treaty benefits in order to avoid double taxation and excessive taxation and is a major issue for taxpayers. It should not be left to the unilateral action of one treaty partner, which may well be the source state, without the agreement of the residence state.

14 Aligning the parts of the Commentary on the PPT rule and of the Commentary on the LOB discretionary relief provision that deal with the principal purpose test

We agree that the Commentaries should be aligned. We have offered several examples in Section A point 3, above.

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

We agree that some form of discretionary relief should be provided in the example given and other similar situations. The denial of benefits under the PPT rule should be proportionate to the perceived abuse. We would advocate a target period for resolution of discretionary relief of six months from the PPT denial of the relevant treaty benefit.

16 Drafting of the alternative "conduit-PPT rule"

As an anti-abuse rule, the conduit rule should be targeted to cases where it is clear an intermediary company has been used for a principal purpose of accessing treaty benefits. The rule is inherently subjective in nature, particularly when one takes into account that money is fungible and thus tracing funds derived from one source to funds ultimately provided to another party ordinarily is an arbitrary exercise. There is a high risk that, unless carefully circumscribed, the conduit rule could lead to inappropriate denial of treaty benefits and extensive controversy. Accordingly, we consider that the "all or substantially all" threshold coupled with the principal purpose test is the right standard to apply. Conversely. we consider that the "at any time" provision is far too broad, as it would lead to an indefinite period of uncertainty, as any future transaction could be taken into account to deny treaty benefits.

We would moreover point out that the OECD Model Convention Articles 10-12 (Dividends, Interest and Royalties) already require the income recipient to be the "beneficial owner" of that income and that many common law jurisdictions including the UK and Canada have regard to such a test with respect to case law on beneficial ownership of the income such as Indofoods and Prevost Car. In our view, this approach works well as an anti-conduit test, suggesting that such an additional test is not necessary even where a PPT is not adopted.

If however such an anti-conduit rule were included, we would agree that more examples would be important and that those found in the Annex to the US/UK tax treaty exchange of notes should be included.

17 List of examples in the Commentary on the PPT rule

We agree regarding better articulation of the five existing examples and the addition of more examples would be important. We note the examples included in A 3 of this comment letter. Given the very nature of CIVs, we suggest that they should not be subject to the PPT. Similarly, there should be a presumption that, with respect to non-CIVs, any vehicle that is established for the principal purpose of providing a means for the collective investment of capital should be outside the scope of the PPT. A non-CIV should be subject to the PPT only in the rare circumstance where the use of the intermediary entity is clearly established to be a subterfuge for accessing treaty benefits.

C Other Issues

18 Application of the new treaty tie-breaker

We agree regarding the clarification that the tie-breaker rule should not prevent the person from being resident for the purposes of the provisions of the Convention that do not provide reliefs and exemptions to that person.

Moreover, we consider it essential that the new Competent Authority tie-breaker rule have a fixed deadline. We propose a maximum of six months.

19 The design and drafting of the rule applicable to permanent establishments (PEs) located in third States

We would urge the OECD to factor in the work on Action 7 (regarding the prevention of the artificial avoidance of PEs, including the anti-fragmentation proposals) so that any branch triangulation rule which might be adopted reflects the position re attributable PE profits after the impact of the recommendations of that other work stream. Further, the exclusion of income allocable to a PE is fundamentally a means of avoiding double taxation. As long as the standards used do not violate the principles being established for addressing harmful tax practices, the triangulation rule is unnecessary and inappropriate.

Clause e) is unduly restrictive. The premise of that clause should be that if the taxpayer has a legitimate nexus, or business purpose, for locating activities in the PE jurisdiction, with the active conduct of a trade or business being an example of such nexus, the triangulation rule should not apply. For example, where a CIV or non-CIV is managed by an asset manager that has active asset management staff in the PE jurisdiction, allocating assets under management to the situs of the asset manager should not cause the triangulation rule to apply. We further suggest that, with regard to clause f), the standard that the intellectual property must be produced or developed in the PE jurisdiction is too restrictive. The critical factor should be whether there is substantial activity in the PE jurisdiction. For example, a taxpayer may have an active staff of professionals in the PE jurisdiction responsible for the acquisition and management of IP. In that case, the nexus to the PE jurisdiction is clear and should not lead to application of the triangular rule.

20 Proposed Commentary on the interaction between tax treaties and domestic anti-abuse rules

The OECD's discussion to date pays insufficient attention to the constitutional position of those countries which provide for treaties to override domestic law.