Irish Tax Institute

Leaders in Tax

Irish Tax Institute

Response to OECD Discussion Draft:

BEPS Action 6

Preventing Treaty Abuse

June 2015

About the Irish Tax Institute

The Irish Tax Institute is the leading representative and educational body for Ireland's AITI Chartered Tax Advisers (CTA) and is the only professional body exclusively dedicated to tax. Our members provide tax expertise to thousands of businesses and individuals in Ireland and internationally. In addition many hold senior roles within professional service firms, global companies, Government, Revenue and state bodies.

The Institute is the leading provider of tax qualifications in Ireland, educating the finest minds in tax and business for over thirty years. Our AITI Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice.

A respected body on tax policy and administration, the Institute engages at the most senior levels across Government, business and state organisations. Representing the views and expertise of its members, it plays an important role in the fiscal and tax administrative discussions and decisions in Ireland and in the EU.

The Irish Tax Institute welcomes the opportunity to comment on the revised Action 6 Discussion Draft published on 22 May 2015. As requested in the Discussion Draft, we have kept our comments as short as possible.

1. Principal Purposes Test (PPT)

The revised proposals require that a treaty include a PPT unless the more detailed version of the Limitation on Benefits (LOB) clause is included. Given the concerns previously expressed by many respondents about the detailed LOB, it is likely that many countries will opt to include a PPT in their tax treaties.

As highlighted in our January 2015 submission, we are concerned that businesses operating in a large country will find it much easier to conclude that they pass a PPT than businesses operating in a smaller country.

A company carrying out arrangements and transactions in a larger economy will find it easier to demonstrate the natural business advantages that arise from that economy, than a company in a smaller economy.

In this context, it is more likely that the positive benefits of access to the tax treaty to avoid double taxation in relation to the cross border transaction or business arrangements will be more evident in the case of the taxpayer based in the smaller economy. Smaller country businesses face considerable uncertainty as to whether they can ever pass the PPT test and actually may find it impossible to conclude with certainty that they do so.

The commentary on the interpretation of the PPT should acknowledge that it is legitimate to recognise that an important aspect in deciding to establish and continue to conduct business in a jurisdiction is the existence of a tax treaty and the benefits it affords. The commentary should make explicit that this can be especially the case for smaller economies where some of the wider business related benefits on offer in the case of larger economies are not present. Any evaluation of the purpose of an arrangement or transaction should take into account the relatively larger weight of importance that the existence of a treaty benefit is likely to present in this scenario.

Our concerns outlined above could be minimised by the addition of further examples in the commentary of the PPT.

We welcome the addition of further examples on the PPT into the commentary in the revised discussion draft although we note that the examples focus on situations where an entity is ultimately owned by a public company. Cross border trade is not conducted solely by entities which are members of publicly listed groups. This is likely to be the case for businesses based in smaller economies which may have less ready access to capital markets. Express acknowledgement in the commentary that the nature of the business transactions and activities which are cited in the examples could equally be carried on by groups which are privately held would be welcome.

The additional examples F,G,H and I for insertion in paragraph 14 of the proposed commentary on the PPT rule are helpful in providing more specific examples of the factors that would be relevant in evaluating whether the PPT test would be satisfied or not.

However, we would recommend that it be made clear in paragraph 14 of the proposed commentary that it is not necessary that a particular transaction or commercial arrangement precisely fit within one of the examples in order for it to be considered to pass the PPT test. Instead it should be clarified that the examples provide illustrations of the determining factors which should be considered as relevant in evaluating whether the test is satisfied or not. As noted above, for example, the precise ownership of the company (i.e. publicly listed group) cannot be taken as determinative. In this regard, perhaps it could be illustrated that, for example, if a privately held company or non-listed group (which may or

may not have diverse ownership) were to carry on activities outlined in examples G and H, these could be taken as examples of the type of activities capable of meeting the PPT.

It should be made clear that in reviewing the examples, the PPT test would equally be satisfied where a significant number of the determining factors listed in the examples exist even if some of the background factors listed (e.g. in example G there is a reference to the country being a member of a regional grouping) did not exist in a particular fact pattern.

We would also welcome clarification (which perhaps may emerge when the final documents are prepared) that the PPT test remains a standalone test which contracting states can adopt without a LOB test (whether the detailed LOB or 'simplified' version).

2. Simplified LOB

We welcome the inclusion of a simplified LOB option which addresses many of the concerns previously highlighted with the LOB.

2.1 Active Business test

We note that within the active business test of the simplified LOB, the substantiality test for dealings with connected parties is included. As highlighted in our previous submissions, this requirement again impacts small countries disproportionately. Many small country operations that a reasonable person might think easily meets an Active Business test have, in practice, found it difficult to meet the Active Business test in US tax treaties. This simply illustrates the challenges that meeting this test presents and which will be magnified if adopted across multiple jurisdictions.

We suggest that the OECD proposals are amended to clarify that business support activities (where the workforce in the smaller economy conducts substantial managerial and operational activities over those support services) can qualify as an active business. This is even in circumstances where those activities are provided for the benefit of related group parties and where there are no or limited sales of the relevant Group's products / services in the small country concerned.

In addition, an appropriately designed "safe harbour test" should be included. We included more detailed suggestions on this test in our previous submission on Action 6 in January 2015 and these are set out in Appendix 1.

2.2 Discretionary relief

As noted in the Discussion Draft, both the PPT rule and the discretionary relief provision of the LOB rule include a test based on whether one of the principal purposes is the obtaining of benefits under a tax treaty. Our concerns with the possible application of the PPT on smaller economies are equally applicable to the discretionary relief section of the LOB. For that reason, amendments to the commentary, similar to those outlined above regarding the PPT, should also be included in the commentary on the discretionary relief element of the LOB.

2.3 Combination of Simplified LOB and PPT

While the simplified LOB is welcome, we note that the Discussion Draft proposes it should only be used in conjunction with a PPT. As previously highlighted in our response to the original Action 6 Discussion Draft, the combination of both tests will result in increased uncertainty for international businesses as to their entitlement to the benefits of double tax treaties and the application of the treaty provisions to their business activities.

The option should be available for treaties to adopt the simplified LOB without requiring a PPT to also be included where contracting states can be satisfied that sufficient protections exist against treaty abuse measures e.g. within the domestic tax framework of the contracting states.

3. Detailed LOB

We note that there are no significant changes to the detailed LOB proposed in the revised Discussion Draft.

3.1 Special Tax Regime proposals

We note the new proposal to include in the LOB, the ability to deny treaty benefits where income has benefited from a "special tax regime". While the proposal is designed to address concerns about having a derivative benefits clause, we understand that it is designed to operate to deny treaty benefit to any claimant, regardless of whether or not they are seeking to rely on the derivative benefits clause.

This proposal as worded appears to be very broad and there is very little guidance as to how it should be applied. Further guidance would be necessary and more time should be given to consider the proposal.

Appendix 1 – Extract from Irish Tax Institute submission on BEPS Action 6, January 2015

Some US treaties contain a "safe harbour" whereby substantiality is assumed if, in prior years, the asset value, gross income and payroll of the small country activity are, for example, at least 7.5% of the equivalent numbers in the US, and the average of the three ratios exceeds 10%. In practice the US safe harbour can be difficult to meet because of the US source of income rules outlined above.

Options for a fair safe harbour might include a mathematical safe harbour which is similar to the ones in some US treaties but:

(i) with clarification that the resident country activity includes all sales / services from the resident country entity to counterparties outside the country concerned. This clarification would be required for the purposes of the general substantiality test and any mathematical safe harbour; and

(ii) with adjustment for the relative size of the economies concerned.