18th ANNUAL TAX TREATY MEETING

26-27 September 2013 - OECD Conference Centre, Paris

Session Material

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

ORGANISATION DE COOPÉRATION ET DE DÉVELOPPEMENT ÉCONOMIQUES

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BETTER POLICIES FOR BETTER LIVES

AGENDA

OECD 18TH ANNUAL TAX TREATY MEETING
26 – 27 SEPTEMBER 2013

OECD Conference Centre
2 rue André Pascal, Paris 16th, France

THURSDAY, 26 SEPTEMBER 2013

09.00 – 09.30 **REGISTRATION**

09.30 – 9.45 **OPENING OF THE MEETING**

Chair:	Andrew DAWSON, *Chair of Working Party 1*
Practical arrangements:	David PARTINGTON, *OECD Secretariat*

9.45 – 11.00 **PLENARY SESSION 1:** ***BACKGROUND TO THE BEPS PROJECT AND THE DEVELOPMENT OF THE ACTION PLAN***

The first plenary session will provide an overview of the OECD's work on base erosion and profit shifting (BEPS) and will introduce the July 2013 Action Plan presented to the G20.

Chair:	Andrew DAWSON, *Chair of Working Party 1*
Speaker:	Pascal SAINT-AMANS, *Director, OECD Centre for Tax Policy and Administration*

11.00 – 11.30 **Coffee Break**

11.30 – 13.00 **PLENARY SESSION 2:** ***OVERVIEW OF WORK RELATED TO TRANSFER PRICING AND OTHER TOPICS***

This second plenary session will examine in greater detail some of the actions listed in the Action Plan (including work related to transfer pricing, transfer pricing documentation, dispute resolution, disclosure of tax planning arrangements, harmful preferential regimes and the collection and analysis of data) that will not be further discussed during the other sessions of the meeting.

Chair:	Andrew DAWSON, *Chair of Working Party 1*
Speakers:	Marlies de RUITER, *OECD Secretariat* Pierre LEBLANC, *OECD Secretariat* Joe ANDRUS, *OECD Secretariat* Edward BARRET, *OECD Secretariat*

13.00 – 14.30 **Lunch Break**

THURSDAY, 26 SEPTEMBER (CONTINUED)

14.30 – 17.30 PARALLEL SESSIONS

14.30 – 17.30 PARALLEL SESSION A: *PREVENTING THE ARTIFICIAL AVOIDANCE OF PERMANENT ESTABLISHMENT STATUS*

This parallel session will examine the artificial avoidance of permanent establishments, including through the use of commissionnaire arrangements and the specific activity exemptions of paragraph 4 of Article 5. The session will discuss the problems that have been experienced, possible solutions and related profit attribution issues.

Chair: Mansor HASSAN, *Malaysia*

Speakers:
Claudine DEVILLET, *Belgium*
Astera Primanto BHAKTI, *Indonesia*
Lee HARLEY, *United Kingdom*
David PARTINGTON, *OECD Secretariat*

14.30 – 17.30 PARALLEL SESSION B: *NEUTRALISING THE EFFECTS OF HYBRID MISMATCH ARRANGEMENTS*

Hybrid entities and transactions are sometimes used to take advantage of asymmetries or mismatches in the treatment of these entities and transactions in two or more states. The session will examine the problem by focusing on practical examples and discuss possible solutions including those adopted in countries' domestic legislation and bilateral conventions.

Chair: Živilė KVEDYTĖ, *Lithuania*

Speakers:
Charles MAKOLA, *South Africa*
David VARLEY, *United States of America*
Arnaud DE GRAAF, *Netherlands*
Eamonn O'DEA, *Ireland*
Jakob SCHOU, *Denmark*
John PETERSON, *OECD Secretariat*
Edward BARRET, *OECD Secretariat*

14.30 – 17.30 PARALLEL SESSION C: *PREVENTING TREATY ABUSE*

The abuse of tax treaties, including treaty shopping, is a core concern raised in the BEPS work. The session will explore possible changes that could be made to treaties and domestic law in the light of the guidance that is already provided in the Commentary on Article 1, the experience of countries and the provisions that have been included in bilateral treaties and domestic law.

Chair: Natalia Aristizabal MORA, *Colombia*

Speakers:
Sophie CHATEL, *Canada*
Henry LOUIE, *United States of America*
Jacques SASSEVILLE, *OECD Secretariat*

16.00 – 16.30 Coffee Break

17.45 COCKTAIL *(OECD CHÂTEAU DE LA MUETTE)*

Participants are invited to attend a cocktail in Salle Marshall of the Château de la Muette, hosted by the Inland Revenue Authority of Singapore.

FRIDAY, 27 SEPTEMBER 2013

PLENARY SESSIONS

9.00 – 9.45 PLENARY SESSION 3: *SUMMARY OF THE DISCUSSIONS IN THE PARALLEL SESSIONS*

During this session, the rapporteurs will summarise the discussions in the three parallel sessions of the previous afternoon, i.e. session A "Preventing the artificial avoidance of permanent establishment status"; session B "Neutralising the effects of hybrid mismatch arrangements" and session C "Preventing treaty abuse".

Chair: Andrew DAWSON, *Chair of Working Party 1*

Speakers:
Mansor HASSAN, *Malaysia*
Živilė KVEDYTĖ, *Lithuania*
Natalia Aristizabal MORA, *Colombia*

9.45 – 10.50 PLENARY SESSION 4: *STRENGTHENING CONTROLLED FOREIGN CORPORATION (CFC) RULES*

Some countries have responded to the deferral of taxation through income being accumulated off-shore in controlled foreign corporations (CFC) by adopting domestic provisions that attribute the current income of a CFC to its shareholders. The session will discuss the role that CFC rules can play in preventing profit shifting and base erosion and the experiences of countries in designing and implementing CFC provisions.

Chair: Carmel PETERS, *New Zealand*

Speakers:
Lizeng FENG, *People's Republic of China*
Dieter EIMERMANN, *Germany*
Sandy RADMANESH, *OECD Secretariat*
John PETERSON, *OECD Secretariat*

10.50 – 11.20 Coffee Break

11.20 – 12.30 PLENARY SESSION 5: *LIMITING BASE EROSION VIA INTEREST DEDUCTIONS AND OTHER FINANCIAL PAYMENTS*

The deductibility of interest expense can give rise to double non-taxation in both inbound and outbound investment scenarios. From an inbound perspective, the concern regarding interest expense deduction is primarily with lending from a related entity which benefits from a low-tax regime, to create excessive interest deductions for the issuer without a corresponding interest income inclusion by the holder. From an outbound perspective, a company may use debt to finance the production of exempt or deferred income. This session will focus on these base erosion strategies involving interest deductions and other financial payments and on possible ways of addressing these strategies. It will examine, in particular, the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income.

Chair: Matias DE SAINTE LORETTE, *France*

Speakers:
Lyn REDMAN, *Australia*
Serena FIORELLI, *Italy*
Tebogo MATHOSA, *South Africa*
Oliver PETZOLD, *OECD Secretariat*
John PETERSON, *OECD Secretariat*
Joe ANDRUS, *OECD Secretariat*

12.30 – 14.00 Lunch Break

FRIDAY, 27 SEPTEMBER (CONTINUED)

14.00 – 16.00 PLENARY SESSION 6: *TAX ISSUES RELATED TO THE DIGITAL ECONOMY*

It is important to examine how enterprises of the digital economy add value and make their profits in order to determine whether and to what extent it may be necessary to adapt the current international tax rules in order to take into account the specific features of that industry and to prevent BEPS. This session will explore some of the main business models used in the digital economy and the main difficulties that they raise for the application of existing international tax rules.

Chair: Fergus HARRADENCE, *United Kingdom*

Speakers: Jesse EGGERT, *OECD Secretariat*
Jacques SASSEVILLE, *OECD Secretariat*
Piet BATTIAU, *OECD Secretariat*

16.00 – 16.45 PLENARY SESSION 7: *CHANGING THE RULES*

The work that will follow the release of the Action Plan will likely result in recommendations regarding domestic law provisions, as well as in changes to the OECD Model Tax Convention and the Transfer Pricing Guidelines. Changes to the OECD Model Tax Convention, however, are not directly effective without amendments to bilateral tax treaties; left to purely bilateral negotiations, such amendments can take a long time before becoming effective. This panel will discuss possible ways that could be used to ensure that changes resulting from the BEPS work are implemented quickly.

Chair: Nicola BONUCCI, *OECD Secretariat*

Speaker: René MONFROOIJ, *OECD Secretariat*

16.45 – 17.00 CLOSING REMARKS

Chair: Andrew DAWSON, *Chair of Working Party 1*

Speaker: Marlies de RUITER, *Head, Tax Treaty and Transfer Pricing Division.*

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ORDRE DU JOUR

18ÈME RÉUNION ANNUELLE DE L'OCDE SUR LES CONVENTIONS FISCALES 26 ET 27 SEPTEMBRE 2013

Centre de conférences de l'OCDE
2 rue André Pascal, 75016 Paris, France

JEUDI 26 SEPTEMBRE 2013

09.00 – 09.30 **INSCRIPTION**

09.30 – 09.45 **OUVERTURE DE LA RÉUNION**

Présidence : Andrew DAWSON, *Président du Groupe de travail 1*

Dispositions pratiques : David PARTINGTON, *Secrétariat de l'OCDE*

09.45 – 11.00 **SESSION PLÉNIÈRE 1 :** ***INFORMATIONS GÉNÉRALES SUR LE PROJET BEPS ET SUR L'ÉLABORATION DU PLAN D'ACTION***

La première session plénière décrira, dans leurs grandes lignes, les travaux de l'OCDE concernant l'érosion de la base d'imposition et le transfert de bénéfices (BEPS), et présentera le Plan d'action soumis au G20 en juillet.

Président: Andrew DAWSON, *Président du Groupe de travail 1*

Orateurs: Pascal SAINT-AMANS, *Directeur, Centre de politique et d'administration fiscales, OCDE*

11.00 – 11.30 **Pause café**

11.30 – 13.00 **SESSION PLÉNIÈRE 2 :** ***APERÇU DES TRAVAUX RELATIFS AUX PRIX DE TRANSFERT ET À D'AUTRES SUJETS***

La deuxième session plénière examinera plus en détail certaines des mesures prévues dans le Plan d'action (y compris les travaux portant sur les prix de transfert, la documentation des prix de transfert, la résolution des litiges, la divulgation des dispositifs de planification fiscale, les régimes préférentiels dommageables et la collecte et l'analyse des données) qui ne seront plus évoquées au cours des autres sessions de la réunion.

Président: Andrew DAWSON, *Président du Groupe de travail 1*

Orateurs:
Marlies DE RUITER, *Secrétariat de l'OCDE*
Pierre LEBLANC, *Secrétariat de l'OCDE*
Joe ANDRUS, *Secrétariat de l'OCDE*
Edward BARRET, *Secrétariat de l'OCDE*

13.00 - 14.30 **Pause déjeuner**

JEUDI 26 SEPTEMBRE (SUITE)

14.30 – 17.30 SESSIONS PARALLÈLES

14.30 – 17.30 SESSION PARALLÈLE A : *EMPÊCHER L'ÉVITEMENT ARTIFICIEL DU STATUT D'ÉTABLISSEMENT STABLE*

Cette session parallèle examinera les mesures visant à éviter artificiellement le statut d'établissement stable, y compris le recours à des accords de commissionnaire et aux exemptions dont bénéficient des activités spécifiques visées par le paragraphe 4 de l'article 5. Cette session étudiera les problèmes qui ont été rencontrés, envisagera des solutions et traitera d'aspects connexes liés à l'attribution des bénéfices.

Président: Mansor HASSAN, *Malaysie*

Orateurs: Claudine DEVILLET, *Belgique*
Astera Primanto BHAKTI, *Indonésie*
Lee HARLEY, *Royaume-Uni*
David PARTINGTON, *Secrétariat de l'OCDE*

14.30 – 17.30 SESSION PARALLÈLE B : *NEUTRALISER LES EFFETS DES MONTAGES HYBRIDES*

Les entités et transactions hybrides sont parfois utilisées pour tirer parti des asymétries ou des différences de traitement de ces entités et transactions entre deux États ou plus. Cette session examinera le problème en s'appuyant sur des exemples pratiques et réfléchira à des solutions possibles, notamment celles adoptées dans les législations nationales et les conventions bilatérales.

Président: Živilė KVEDYTĖ, *Lithuanie*

Orateurs: Charles MAKOLA, *Afrique du Sud*
David VARLEY, *Etats-Unis*
Arnaud DE GRAAF, *Pays Bas*
Eamonn O'DEA, *Irelande*
Jakob SCHOU, *Danemark*
John PETERSON, *Secrétariat de l'OCDE*
Edward BARRET, *Secrétariat de l'OCDE*

14.30 – 17.30 SESSION PARALLÈLE C : *EMPÊCHER L'UTILISATION ABUSIVE DES CONVENTIONS*

L'utilisation abusive des conventions fiscales, y compris le chalandage fiscal, est l'un des principaux vecteurs des pratiques d'érosion de la base d'imposition et de transfert de bénéfices. Cette session analysera les modifications qui pourraient être apportées aux conventions et à la législation nationale à la lumière des instructions qui figurent déjà dans les Commentaires sur l'article 1, de l'expérience des pays et des dispositions qui ont été intégrées dans les conventions bilatérales et dans les législations nationales.

Président: Natalia Aristizabal MORA, *Colombie*

Orateurs: Sophie CHATEL, *Canada*
Henry LOUIE, *Etats-Unis*
Jacques SASSEVILLE, *Secrétariat de l'OCDE*

16.00 – 16.30 Pause café

17.45 COCKTAIL *(CHÂTEAU DE LA MUETTE, OCDE)*

Les participants sont invités à un cocktail, offert par l'Administration fiscale de Singapour, qui aura lieu au Château de la Muette, salle Marshall.

VENDREDI 27 SEPTEMBRE 2013

SESSIONS PLÉNIÈRES

09.00 – 9.45 SESSION PLÉNIÈRE 3 : *RÉSUMÉ DES DISCUSSIONS TENUES AU COURS DES SESSIONS PARALLÈLES*

Au cours de cette session, les rapporteurs résumeront les discussions tenues au cours des trois sessions parallèles de l'après-midi précédent, à savoir la session A « Empêcher l'évitement artificiel du statut d'établissement stable », la session B « Neutraliser les effets des montages hybrides » et la session C « Empêcher l'utilisation abusive des conventions ».

Président: Andrew DAWSON, *Président du Groupe de travail 1*

Orateurs: Mansor HASSAN, *Malaysie*
Živilė KVEDYTĖ, *Lithuanie*
Natalia Aristizabal MORA, *Colombie*

09.45 – 10.50 SESSION PLÉNIÈRE 4 : *RENFORCER LES RÈGLES RELATIVES AUX SOCIÉTÉS ÉTRANGÈRES CONTRÔLÉES (SEC)*

Pour éviter que le paiement de l'impôt soit différé par l'accumulation de revenus dans des sociétés étrangères contrôlées (SEC) situées à l'étranger, certains pays ont adopté des dispositions nationales qui attribuent le revenu de l'exercice en cours d'une SEC à ses actionnaires. Cette session examinera le rôle que les règles relatives aux SEC peuvent jouer pour empêcher le transfert de bénéfices et l'érosion de la base d'imposition, et étudiera l'expérience des pays en matière de conception et de mise en œuvre de ces règles.

Président: Carmel PETERS, *Nouvelle Zélande*

Orateurs: Lizeng FENG, *République populaire de Chine*
Dieter EIMERMANN, *Allemagne*
Sandy RADMANESH, *Secrétariat de l'OCDE*
John PETERSON, *Secrétariat de l'OCDE*

10.50 – 11.20 Pause café

11.20 – 12.30 SESSION PLÉNIÈRE 5 : *LIMITER L'ÉROSION DE LA BASE D'IMPOSITION VIA LES DÉDUCTIONS D'INTÉRÊTS ET AUTRES FRAIS FINANCIERS*

La déductibilité des dépenses d'intérêt peut aboutir à une double exonération, à la fois sous l'angle de l'investissement entrant et sortant. S'agissant de l'investissement entrant, la déduction des dépenses d'intérêt est problématique si une entité liée faiblement taxée accorde des prêts en vue de permettre à l'émetteur de procéder à des déductions excessives d'intérêt, sans que le détenteur ne comptabilise un revenu d'intérêt correspondant. Du point de vue de l'investissement sortant, une entreprise peut recourir à l'emprunt pour financer la production d'un revenu exonéré ou différé. Cette session s'intéressera aux stratégies d'érosion de la base d'imposition qui font intervenir des déductions d'intérêts et d'autres frais financiers et aux moyens possibles de les combattre. Elle analysera notamment le recours à l'emprunt auprès d'une partie liée ou d'une tierce partie en vue de réaliser des déductions excessives d'intérêts ou de financer la production d'un revenu exonéré ou différé.

Président: Matias DE SAINTE LORETTE, *France*

Orateurs: Lyn REDMAN, *Australie*
Serena FIORELLI, *Italie*
Tebogo MATHOSA, *Afrique du Sud*
Oliver PETZOLD, *Secrétariat de l'OCDE*
John PETERSON, *Secrétariat de l'OCDE*
Joe ANDRUS, *Secrétariat de l'OCDE*

12.30 – 14:00 Pause déjeuner

VENDREDI 27 SEPTEMBRE (SUITE)

14.00 – 16.00 SESSION PLÉNIÈRE 6 : *PROBLÈMES FISCAUX POSÉS PAR L'ÉCONOMIE NUMÉRIQUE*

Il est important de comprendre par quels mécanismes les entreprises de l'économie numérique créent de la valeur et réalisent des bénéfices afin de déterminer si, et dans quelle mesure, les règles actuelles de la fiscalité internationale doivent être modifiées afin de prendre en compte les particularités de ce secteur et d'empêcher l'érosion de la base d'imposition et le transfert de bénéfices. Cette session étudiera quelques-uns des principaux modèles économiques en vigueur dans l'économie numérique et les principales difficultés qu'ils posent concernant l'application des règles fiscales internationales existantes.

Président: Fergus HARRADENCE, *Royaume-Uni*

Orateurs: Jesse EGGERT, *Secrétariat de l'OCDE*
Jacques SASSEVILLE, *Secrétariat de l'OCDE*
Piet BATTIAU, *Secrétariat de l'OCDE*

16.00 – 16.45 SESSION PLÉNIÈRE 7 : *CHANGER LES RÈGLES*

Les travaux qui seront engagés après la diffusion du Plan d'action aboutiront probablement à des recommandations concernant les dispositions des législations nationales, ainsi qu'à des modifications du Modèle de Convention fiscale de l'OCDE et des Principes applicables en matière de prix de transfert. Néanmoins, pour être applicables, les modifications du Modèle de Convention fiscale de l'OCDE nécessitent une révision des conventions fiscales bilatérales ; si l'on s'en remet uniquement à des négociations bilatérales, il faudra probablement beaucoup de temps avant que ces modifications prennent effet. Cette session réfléchira aux moyens possibles de faire en sorte que les changements induits par le projet BEPS soient rapidement appliqués.

Président: Nicola BONUCCI, *Secrétariat de l'OCDE*

Orateur: René MONFROOIJ, *Secrétariat de l'OCDE*

16.45 – 17.00 REMARQUES DE CONCLUSION

Président: Andrew DAWSON, *Président du Groupe de travail 1*

Orateur: Marlies de RUITER, *Chef de Division,*
Conventions fiscales, prix des transferts & transactions financières, CPAF

BETTER POLICIES FOR BETTER LIVES

ORDEN DEL DÍA

18ª REUNION ANUAL DE LA OCDE SOBRE CONVENIOS TRIBUTARIOS 26 - 27 SEPTIEMBRE DE 2013

Centro de Conferencias de la OCDE
2 rue André Pascal, Paris 16th, France

JUEVES, 26 DE SEPTIEMBRE DE 2013

09.00 - 09.30 INSCRIPCIÓN

09.30 – 09:45 APERTURA DE LA REUNIÓN

Presidente: Andrew DAWSON, *Presidente del Grupo de Trabajo 1*

Disposiciones prácticas: David PARTINGTON, *Secretaría de la OCDE*

09:45 - 11.00 PRIMERA SESIÓN PLENARIA: ***ANTECEDENTES DEL PROYECTO BEPS Y ELABORACIÓN DEL PLAN DE ACCIÓN***

La primera sesión plenaria proporcionará un panorama general de la labor de la OCDE relativa a la erosión de la base imponible y el traslado de beneficios (BEPS, en inglés) y dará a conocer el Plan de Acción de julio de 2013 presentado al G20.

Presidente: Andrew DAWSON, *Presidente del grupo de trabajo 1*

Ponentes: Pascal SAINT-AMANS, *Director del centro de la OCDE para la política tributaria y administración*

11.00 - 11.30 Pausa para el café

11.30 - 13.00 SEGUNDA SESIÓN PLENARIA: ***PANORAMA GENERAL DE LA LABOR RELATIVA A LA FIJACIÓN DE PRECIOS DE TRANSFERENCIA Y DE OTROS TEMAS***

En esta segunda sesión plenaria se examinarán con más detalle algunas de las acciones enumeradas en el Plan de Acción (incluida la labor relativa a la fijación de precios de transferencia y a la documentación relativa a esta, la solución de controversias, la divulgación de los mecanismos de planificación fiscal, los regímenes preferentes nocivos y la recopilación y el análisis de datos) que ya no se examinarán más detenidamente durante las demás sesiones de la reunión.

Presidente: Andrew DAWSON, *Presidente del grupo de trabajo 1*

Ponentes:
Marlies DE RUITER, *Secretaría de la OCDE*
Pierre LEBLANC, *Secretaría de la OCDE*
Joe ANDRUS, *Secretaría de la OCDE*
Edward BARRET, *Secretaría de la OCDE*

13.00 - 14.30 Pausa para el almuerzo

JUEVES, 26 DE SEPTIEMBRE (CONTINUACIÓN)

14.30 - 17.30 SESIONES PARALELAS

14.30 - 17.30 SESIÓN PARALELA A: *EVITAR SITUACIONES DE ELUSIÓN ARTIFICIAL DE ESTABLECIMIENTOS PERMANENTES*

En esta sesión paralela se examinará la elusión artificial de establecimientos permanentes, en particular mediante los contratos de comisión y las exenciones específicas del párrafo 4 del artículo 5. En esta sesión se examinarán los problemas que se han planteado, las posibles soluciones y las cuestiones de atribución de beneficios conexas.

Presidente: Mansor HASSAN, *Malasia*

Ponentes:
Claudine DEVILLET, *Bélgica*
Astera Primanto BHAKTI, *Indonesia*
Lee HARLEY, *Reino Unido*
David PARTINGTON, *Secretaría de la OCDE*

14.30 - 17.30 SESIÓN PARALELA B *NEUTRALIZAR LOS EFECTOS DE LOS MECANISMOS HÍBRIDOS*

Las entidades y transacciones híbridas sirven a veces para aprovechar las asimetrías y discordancias en el tratamiento de estas entidades y transacciones en dos o más Estados. En la sesión se examinará este problema, prestando especial atención a ejemplos prácticos, y se analizarán posibles soluciones, entre las que cabe mencionar las adoptadas en la legislación interna y en los convenios bilaterales.

Presidente: Živilė KVEDYTĖ, *Lithuania*

Ponentes:
Charles MAKOLA, *Sudáfrica*
David VARLEY, *Estados Unidos de América*
Arnaud DE G*RAAF, Países Bajos*
Eamonn O'DEA, *Irlanda*
Jakob SCHOU, *Dinamarca*
John PETERSON, *Secretaría de la OCDE*
Edward BARRET, *Secretaría de la OCDE*

14.30 - 17.30 SESIÓN PARALELA C: EVITAR LA UTILIZACIÓN ABUSIVA DE LOS CONVENIOS

La utilización abusiva de los convenios fiscales, en particular la búsqueda del convenio más favorable, es una de las principales preocupaciones planteadas con respecto a la labor relativa al BEPS. En esta sesión se estudiarán posibles modificaciones que podrían introducirse en los convenios y en el derecho interno a la luz de las orientaciones proporcionadas en el Comentario sobre el artículo 1, la experiencia de los países y las disposiciones que se han incluido en los convenios bilaterales y en el derecho interno.

Presidente: Natalia Aristizabal MORA, *Colombia*

Ponentes:
Sophie CHATEL, *Canadá*
Henry LOUIE, *Estados Unidos de América*
Jacques SASSEVILLE, *Secretaría de la OCDEt*

16.00 - 16.30 Pausa para el café

17.45 CÓCTEL *(CHÂTEAU DE LA MUETTE-OCDE)*

Los participantes están invitados a asistir a un cóctel en Salle Marshall del castillo de la Muette, organizada por la Autoridad Tributaria de Singapur.

VIERNES, 27 DE SEPTIEMBRE DE 2013

SESIONES PLENARIAS

09.00 - 09:45 SESIÓN PLENARIA 3: ***RESUMEN DE LOS DEBATES CELEBRADOS EN LAS SESIONES PARALELAS***

Durante esta sesión, los ponentes resumirán los debates celebrados en las tres sesiones paralelas de la tarde anterior, es decir, la sesión A "Evitar situaciones de elusión artificial de establecimientos permanentes", la sesión B "Neutralizar los efectos de los mecanismos híbridos" y la sesión C "Evitar la utilización abusiva de los convenios".

Presidente: Andrew DAWSON, *Presidente del grupo de trabajo 1*

Ponentes: Mansor HASSAN, *Malasia*
Živilė KVEDYTĖ, *Lithuania*
Natalia Aristizabal MORA, *Colombia*

09.45 - 10.50 SESIÓN PLENARIA 4: ***FORTALECIMIENTO DE LAS NORMAS RELATIVAS A LAS COMPAÑÍAS FORÁNEAS CONTROLADAS***

Algunos países han respondido al aplazamiento del pago de impuestos mediante la acumulación de ingresos en el extranjero por conducto de compañías foráneas controladas adoptando disposiciones de derecho interno en las que se atribuyen los ingresos corrientes de las compañías foráneas controladas a sus accionistas. En esta sesión se examinará la función que pueden desempeñar las normas sobre compañías foráneas controladas en la prevención de la erosión de la base imponible y el traslado de beneficios, y las experiencias de los países al formular y aplicar las disposiciones sobre compañías foráneas controladas.

Presidente: Carmel PETERS, *Nueva Zelanda*

Ponentes: Lizeng FENG, *República Popular de China*
Dieter EIMERMANN, *Alemania*
Sandy RADMANESH, *Secretaría de la OCDE*
John PETERSON, *Secretaría de la OCDE*

10.50 - 11.20 Pausa para el café

11.20 - 12.30 SESIÓN PLENARIA 5: ***LIMITAR LA EROSIÓN DE LA BASE IMPONIBLE MEDIANTE DEDUCCIONES DE INTERESES Y OTROS PAGOS FINANCIEROS***

La posibilidad de deducir los pagos de intereses puede dar lugar a una doble exención, tanto en el supuesto de las salidas como de las entradas de inversión. Desde la perspectiva de las entradas de inversión, la preocupación por una deducción de los intereses pagados se refiere principalmente a préstamos de una entidad vinculada que se beneficia de un régimen tributario atractivo para establecer deducciones de intereses excesivas para el emisor sin los correspondientes ingresos de intereses para el tenedor. Desde la perspectiva de las salidas de inversión, una empresa puede endeudarse para financiar la generación de ingresos exentos o diferidos. En esta sesión se prestará especial atención a estas estrategias de erosión de la base imponible que implican deducciones de intereses y otros pagos financieros, y a las posibles formas de dar solución a estas estrategias. En particular, se examinará la utilización de deuda de terceros y de empresas vinculadas para lograr deducciones de intereses excesivas o para financiar la generación de ingresos exentos o diferidos.

Presidente: Matias DE SAINTE LORETTE, *Francia*

Ponentes: Lyn REDMAN, *Australia*
Serena FIORELLI, *Italia*
Tebogo MATHOSA, *Sudáfrica*
Oliver PETZOLD, *Secretaría de la OCDE*
John PETERSON, *Secretaría de la OCDE*
Joe ANDRUS, *Secretaría de la OCDE*

12.30 - 14:00 Pausa para el almuerzo

VIERNES, 27 DE SEPTIEMBRE (CONTINUACIÓN)

14.00 - 16.00 SESIÓN PLENARIA 6: *CUESTIONES TRIBUTARIAS RELATIVAS A LA ECONOMÍA DIGITAL*

Es importante examinar la manera en que las empresas de la economía digital agregan valor y obtienen beneficios para determinar si, y en qué medida, puede ser necesario adaptar las normas tributarias internacionales vigentes para tener en cuenta las características específicas de dicha rama de actividad y evitar el fenómeno BEPS. En esta sesión se estudiarán algunos de los principales modelos de negocio utilizados en la economía digital y las principales dificultades que pueden surgir en la aplicación de las normas tributarias internacionales vigentes.

Presidente: Fergus HARRADENCE, *Reino Unido*

Ponentes: Jesse EGGERT, *Secretaría de la OCDE*
Jacques SASSEVILLE, *Secretaría de la OCDE*
Piet BATTIAU, *Secretaría de la OCDE*

16.00 - 16.45 SESIÓN PLENARIA 7: *REFORMA NORMATIVA*

Es probable que la labor subsiguiente a la puesta en marcha del Plan de Acción se traduzca en la formulación de recomendaciones relativas a disposiciones de derecho interno, así como en la modificación del Modelo de Convenio Tributario de la OCDE y de las directrices de la OCDE aplicables en materia de precios de transferencia. No obstante, las nuevas normas introducidas en el Modelo de Convenio Tributario de la OCDE no serían directamente aplicables sin la correspondiente modificación de los convenios fiscales bilaterales; si esas modificaciones son objeto de negociaciones puramente bilaterales, podría transcurrir mucho tiempo antes de que entraran en vigor. Este grupo de expertos examinará las distintas modalidades que podrían utilizarse para garantizar que las modificaciones resultantes de la labor relativa al fenómeno BEPS se apliquen rápidamente.

Presidente: Nicola BONUCCI, *Secretaría de la OCDE*

Ponente: René MONFROOIJ, *Secretaría de la OCDE*

16.45 - 17.00 OBSERVACIONES FINALES

Presidente: Andrew DAWSON, *Presidente del grupo de trabajo 1*

Ponente: Marlies de RUITER, *Jefe, tratado impuesto y Transfer Pricing división.*

18th ANNUAL TAX TREATY MEETING

Paris, 26-27 September 2013

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PLENARY SESSION 1

BACKGROUND TO THE BEPS PROJECT AND THE DEVELOPMENT OF THE ACTION PLAN

Note: Not for publication or distribution beyond invited Delegations

BACKGROUND TO THE BEPS PROJECT AND THE DEVELOPMENT OF THE ACTION PLAN

PLENARY SESSION 1 (Thursday, 26 September 09:45 – 11:00; Room CC1)

Chair: Andrew DAWSON (Chair of Working Party 1)

Speaker: Pascal SAINT-AMANS (Director, OECD Centre for Tax Policy and Administration)

Session: **During the session, Pascal Saint-Amans, Director of the Centre for Tax Policy and Administration of the OECD, will reflect on the developments leading up to the publication of the BEPS Action Plan, on relevant subsequent developments and on the process through which the 15 Action Points will be developed. Following this introduction, participants will be invited to ask questions, share their views and comments and engage in an interactive dialogue.**

Background

On 25 June 2013, the OECD's Committee on Fiscal Affairs (CFA), at a meeting in which all G20 countries participated, approved an ambitious plan to put an end to base erosion and profit shifting (BEPS). BEPS refers to the tax planning schemes that multinational enterprises (MNEs) use to artificially shift their profits out of the countries where they are earned, resulting in very low taxes or even double non-taxation.

These practices, if left unchecked, undermine the fairness and integrity of our tax systems. They fundamentally distort competition, because businesses that engage in cross-border BEPS strategies gain a competitive advantage compared with enterprises that operate mostly at the domestic level. This, in turn, leads to an inefficient allocation of resources by distorting investment decisions towards activities that have lower pre-tax rates of return, but higher after-tax rates of return. Ultimately, if other taxpayers (including ordinary individuals) think that multinational corporations can legally avoid paying income tax, these practices also undermine the legitimacy of the tax system and the government as a whole.

Time to Modernise the Rules for the Taxation of MNEs

This is not primarily an issue of compliance. While there are certainly companies that do not pay the taxes they legally owe, there is a more fundamental policy issue, which is that the international tax rules have not kept pace with the changing business environment. Developments brought about by globalisation have put a strain on these rules, which were first designed more than 100 years ago. Over time, they have revealed weaknesses that create opportunities for MNEs to avoid taxes by shifting their taxable profits out of the jurisdictions where those profits are created into low or no tax regimes, or in some cases by making taxable profits disappear altogether.

Fifteen actions to put an end to BEPS

The digital economy provides a good illustration of the types of challenges facing the international tax system, including novel and ever-changing business models, the importance and mobility of intangible assets, and the ability to provide goods and services without a physical presence. While the actions in the BEPS action plan will clearly have an impact on BEPS in the digital economy, there is also a need for a thorough analysis of this sector. Action 1 of the BEPS action plan thus establishes a dedicated task force will identify the issues raised

by the digital economy and possible actions to address them. The work of the task force on the digital economy will cut across the work done on the other actions, which are organised according to three main principles:

Preventing double non-taxation due to the gaps that exist between countries' tax rules

Tax policy is at the core of countries' sovereignty, and each country has the right to design its tax system in the way it considers most appropriate. At the same time, the increasing interconnectedness of domestic economies has highlighted the gaps that can be created by interactions between domestic tax laws. Currently, there are no international standards to address these gaps and prevent the double non-taxation that can arise as a result. The action plan thus will develop a fundamentally new set of standards designed to prevent double non-taxation. The actions will, for example, prevent companies from making taxable income disappear due to mismatches in different countries' tax rules (so-called hybrid mismatch arrangements). They will also prevent the use of excessive leverage to erode the taxable base via interest payment as well as the use of offshore subsidiaries to stash income in low or no tax jurisdictions (i.e., CFC rules).

Aligning taxation with substance

Existing tax treaty and transfer pricing rules are generally effective, and prevent double taxation of profits, but may in some cases facilitate the separation of taxable profits from the value-creating activities that give rise to those profits. The action plan will restore the intended effects of these standards by aligning taxation with substance, while at the same time continuing to prevent double taxation. In particular, the current interpretation of the arm's length principle is challenged by the ability of MNEs to artificially shift profits by transferring easily movable assets (such as intangibles and capital). The action plan will fix these issues with measures, either within or beyond the arm's length principle, to ensure that taxable profits can no longer be artificially shifted away from the countries where value is created. The action plan will also ensure that shell companies cannot be used to achieve double non-taxation by inappropriately claiming treaty benefits.

Improving transparency

Addressing BEPS will also require greater transparency between taxpayers and tax administrations, and among tax administrations. The action plan will level the playing field between companies and tax administrators by creating a common template for MNEs to report to all relevant governments their global allocation of profits, economic activity, and taxes paid among countries. At the same time, work will be done to provide the necessary certainty to encourage global investment and make sure that disputes are resolved quickly.

An inclusive process: the OECD/G20 Project on BEPS

BEPS is a global issue and requires a global solution. The BEPS action plan marks a turning point in the history of international co-operation on taxation and it is critical that the work include all relevant stakeholders. Therefore, all interested G20 countries (including those that are not members of the OECD) will be invited to participate in the BEPS project on an equal footing. Other non-OECD countries will also be involved through consultations during meetings such as this one, though the participation of some of them as invitees or participants in the OECD Working Parties through which important parts of the BEPS work will be carried out and though other mechanisms. International organisations such as the UN will also be involved through their participation in the meetings of the OECD Committee on Fiscal Affairs. Finally, business and civil society will be invited to comment on the different proposals developed in the course of the work and a high-level policy dialogue with all interested parties will be organised on an annual basis.

Time is of the essence

All of the actions will be delivered within 18 to 24 months. Addressing BEPS is critical for most countries and must be done in a timely, inclusive and effective manner, not least to prevent the existing consensus-based framework from unravelling. The pace of the project must ensure that concrete actions can be delivered quickly. Political expectations are very high in most countries and the results and impact of the BEPS work will be in line with these political expectations.

To ensure that the actions can be implemented quickly, a multilateral instrument to amend bi-lateral treaties will be developed. The delivery of certain actions will result in changes to the OECD Model Tax Convention, which are not directly effective without amendments to bilateral tax treaties. If undertaken on a purely treaty-by-treaty basis, the sheer number of treaties in effect may make such a process very lengthy, the more so where countries embark on comprehensive renegotiations of their bilateral tax treaties. A multilateral instrument, which is innovative in the area of international taxation, will greatly speed this process.

18th ANNUAL TAX TREATY MEETING

Paris, 26-27 September 2013

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PLENARY SESSION 2

OVERVIEW OF WORK RELATED TO TRANSFER PRICING AND OTHER ISSUES

Note: Not for publication or distribution beyond invited Delegations

OVERVIEW OF WORK RELATED TO TRANSFER PRICING AND OTHER ISSUES

PLENARY SESSION 2 (Thursday, 26 September 11:30 – 13:00; Room CC1)

Chair: Andrew DAWSON (Chair of Working Party 1)

Speakers: Marlies de RUITER (OECD Secretariat)
Pierre LEBLANC (OECD Secretariat)
Joe ANDRUS (OECD Secretariat)
Edward BARRET (OECD Secretariat)

Session: **This second plenary session will examine in greater detail some of the actions listed in the Action Plan (including work related to transfer pricing, transfer pricing documentation, dispute resolution, disclosure of tax planning arrangements, harmful preferential regimes and the collection and analysis of data) that will not be further discussed during the other sessions of the meeting.**

Background

The Action Points to be introduced during this session are included in Action Points 5 and 8 - 14 as summarised below.

Summary of the BEPS Action Plan by action

Action	*Description*	*Expected Output*	*Deadline*
1 - Address the Tax Challenges of the Digital Economy	*Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation. Issues to be examined include, but are not limited to, the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation due to the lack of nexus under current international rules, the attribution of value created from the generation of marketable location-relevant data through the use of digital products and services, the characterisation of income derived from new business models, the application of related source rules, and how to ensure the effective collection of VAT/GST with respect to the cross-border supply of digital goods and services. Such work will require a thorough analysis of the various business models in this sector.*	Report identifying issues raised by the digital economy and possible actions to address them	September 2014

Action	*Description*	*Expected Output*	*Deadline*
2 - Neutralise the Effects of Hybrid Mismatch Arrangements	*Develop model treaty provisions and recommendations regarding the design of domestic rules to neutralise the effect (e.g., double non-taxation, double deduction, long-term deferral) of hybrid instruments and entities. This may include: (i) changes to the OECD Model Tax Convention to ensure that hybrid instruments and entities (as well as dual resident entities) are not used to obtain the benefits of treaties unduly; (ii) domestic law provisions that prevent exemption or non-recognition for payments that are deductible by the payor; (iii) domestic law provisions that deny a deduction for a payment that is not includible in income by the recipient (and is not subject to taxation under controlled foreign company (CFC) or similar rules); (iv) domestic law provisions that deny a deduction for a payment that is also deductible in another jurisdiction; and (v) where necessary, guidance on co-ordination or tie-breaker rules if more than one country seeks to apply such rules to a transaction or structure. Special attention should be given to the interaction between possible changes to domestic law and the provisions of the OECD Model Tax Convention. This work will be co-ordinated with the work on interest expense deduction limitations, the work on CFC rules, and the work on treaty shopping.*	Changes to the Model Tax Convention	September 2014
		Recommendations regarding the design of domestic rules	September 2014
3 - Strengthen CFC Rules	*Develop recommendations regarding the design of controlled foreign corporation rules. This work will be co-ordinated with other work as necessary.*	Recommendations regarding the design of domestic rules	September 2015
4- Limit Base Erosion via Interest Deductions and Other Financial Payments	*Develop recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense, for example through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income, and other financial payments that are economically equivalent to interest payments. The work will evaluate the effectiveness of different types of limitations. In connection with and in support of the foregoing work, transfer pricing guidance will also be developed regarding the pricing of related party financial transactions, including financial and performance guarantees, derivatives (including internal derivatives used in intra-bank dealings), and captive and other insurance arrangements. The work will be co-ordinated with the work on hybrids and CFC rules.*	Recommendations regarding the design of domestic rules	September 2015
		Changes to the Transfer Pricing Guidelines	December 2015

Action	*Description*	*Expected Output*	*Deadline*
5 - Counter Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance	*Revamp the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for any preferential regime. It will take a holistic approach to evaluate preferential tax regimes in the BEPS context. It will engage with non-OECD members on the basis of the existing framework and consider revisions or additions to the existing framework.*	Finalise review of member country regimes	September 2014
		Strategy to expand participation to non-OECD members	September 2015
		Revision of existing criteria	December 2015
6 - Prevent Treaty Abuse	*Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. Work will also be done to clarify that tax treaties are not intended to be used to generate double non-taxation and to identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country. The work will be co-ordinated with the work on hybrids.*	Changes to the Model Tax Convention	September 2014
		Recommendations regarding the design of domestic rules	September 2014
7 - Prevent the Artificial Avoidance of PE Status	*Develop changes to the definition of PE to prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions. Work on these issues will also address related profit attribution issues.*	Changes to the Model Tax Convention	September 2015

Action	*Description*	*Expected Output*	*Deadline*
8 - Assure that Transfer Pricing Outcomes are in Line With Value Creation / Intangibles	*Develop rules to prevent BEPS by moving intangibles among group members. This will involve: (i) adopting a broad and clearly delineated definition of intangibles; (ii) ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with (rather than divorced from) value creation; (iii) developing transfer pricing rules or special measures for transfers of hard-to-value intangibles; and (iv) updating the guidance on cost contribution arrangements.*	Changes to the Transfer Pricing Guidelines and possibly to the Model Tax Convention	September 2014
		Changes to the Transfer Pricing Guidelines and possibly to the Model Tax Convention	September 2015
9 - Assure that Transfer Pricing Outcomes are in Line With Value Creation / Risks and Capital	*Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members. This will involve adopting transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. The rules to be developed will also require alignment of returns with value creation. This work will be co-ordinated with the work on interest expense deductions and other financial payments.*	Changes to the Transfer Pricing Guidelines and possibly to the Model Tax Convention	September 2015
10 - Assure that Transfer Pricing Outcomes are in Line With Value Creation / Other High-Risk Transactions	*Develop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties. This will involve adopting transfer pricing rules or special measures to: (i) clarify the circumstances in which transactions can be recharacterised; (ii) clarify the application of transfer pricing methods, in particular profit splits, in the context of global value chains; and (iii) provide protection against common types of base eroding payments, such as management fees and head office expenses.*	Changes to the Transfer Pricing Guidelines and possibly to the Model Tax Convention	September 2015

Action	*Description*	*Expected Output*	*Deadline*
11 - Establish Methodologies to Collect and Analyse Data on BEPS and the Actions to Address It	*Develop recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis. This will involve developing an economic analysis of the scale and impact of BEPS (including spillover effects across countries) and actions to address it. The work will also involve assessing a range of existing data sources, identifying new types of data that should be collected, and developing methodologies based on both aggregate (e.g. FDI and balance of payments data) and micro-level data (e.g. from financial statements and tax returns), taking into consideration the need to respect taxpayer confidentiality and the administrative costs for tax administrations and businesses.*	Recommendations regarding data to be collected and methodologies to analyse them	September 2015
12 - Require Taxpayers to Disclose Their Aggressive Tax Planning Arrangements	*Develop recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures, taking into consideration the administrative costs for tax administrations and businesses and drawing on experiences of the increasing number of countries that have such rules. The work will use a modular design allowing for maximum consistency but allowing for country specific needs and risks. One focus will be international tax schemes, where the work will explore using a wide definition of "tax benefit" in order to capture such transactions. The work will be co-ordinated with the work on co-operative compliance. It will also involve designing and putting in place enhanced models of information sharing for international tax schemes between tax administrations.*	Recommendations regarding the design of domestic rules	September 2015

Action	*Description*	*Expected Output*	*Deadline*
13 - Re-examine Transfer Pricing Documentation	*Develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business. The rules to be developed will include a requirement that MNE's provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template.*	Changes to Transfer Pricing Guidelines and Recommendations regarding the design of domestic rules	September 2014
14 - Make Dispute Resolution Mechanisms More Effective	*Develop solutions to address obstacles that prevent countries from solving treaty-related disputes under MAP, including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases.*	Changes to the Model Tax Convention	September 2015
15 - Develop a Multilateral Instrument	*Analyse the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties. On the basis of this analysis, interested Parties will develop a multilateral instrument designed to provide an innovative approach to international tax matters, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution.*	Report identifying relevant public international law and tax issues	September 2014
		Develop a multilateral instrument	December 2015

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Paris, 26-27 September 2013

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PARALLEL SESSION A

PREVENTING THE ARTIFICIAL AVOIDANCE OF PERMANENT ESTABLISHMENT STATUS

Note: Not for publication or distribution beyond invited Delegations

PREVENTING THE ARTIFICIAL AVOIDANCE OF PERMANENT ESTABLISHMENT STATUS

PARALLEL SESSION A (Thursday, 26 September 14:30 – 17:30; Room CC 15)

Chair: Mansor HASSAN (Malaysia)

Speakers: Lee HARLEY (United Kingdom)
Astera Primanto BHAKTI (Indonesia)
Claudine DEVILLET (Belgium)
David PARTINGTON (OECD Secretariat)

1. The BEPS Action Plan that was made public in July 2013 included the following description of the work to be undertaken in relation to the artificial avoidance of PE status:

> The definition of permanent establishment (PE) must be updated to prevent abuses. In many countries, the interpretation of the treaty rules on agency-PE allows contracts for the sale of goods belonging to a foreign enterprise to be negotiated and concluded in a country by the sales force of a local subsidiary of that foreign enterprise without the profits from these sales being taxable to the same extent as they would be if the sales were made by a distributor. In many cases, this has led enterprises to replace arrangements under which the local subsidiary traditionally acted as a distributor by "commissionnaire arrangements" with a resulting shift of profits out of the country where the sales take place without a substantive change in the functions performed in that country. Similarly, MNEs may artificially fragment their operations among multiple group entities to qualify for the exceptions to PE status for preparatory and ancillary activities.
>
> *ACTION 7 – **Prevent the artificial avoidance of PE status***
>
> *Develop changes to the definition of PE to prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions. Work on these issues will also address related profit attribution issues.*
>
> The deadline set under the BEPS Action Plan for the completion of this work is September 2015.

2. In accordance with this description, the following three topics will be examined during this session:

A. Discussion of the problems and options for changes to paragraph 5 (and related paragraphs) of Article 5 and the Commentary thereto to address the use of commissionaire arrangements to artificially avoid PE status, including related profit attribution issues.

B. Discussion of the problems and options for changes to paragraph 4 of Article 5 (specific PE exemptions) and the Commentary thereto to address the use of the specific PE exemptions to artificially avoid PE status, including related profit attribution issues.

C. Discussion of other artificial avoidance of PE status concerns.

3. Action 7 (Preventing Artificial Avoidance of PE Status) of the BEPS Action plan raises the possibility of changes to Article 5 itself rather than continued clarifications in the Commentary. A focus group has been established to undertake that work; it had its first meeting on 19-20 September. In view of the more comprehensive approach raised by the Action plan (including the possibility of changing the Article) and because work on Action 7 has only recently commenced, this session provides an opportunity for a wider discussion of the problems and possible solutions. The discussion will be led by the panel but we strongly encourage interventions from all participants on the questions and case studies.

4. The OECD's most recent work on the interpretation of paragraph 5 was included in the October 2012 discussion document, "OECD Model Tax Convention: Revised Proposals Concerning the Interpretation and Application of Article 5", which set out proposed clarifications regarding the permanent establishment definition as it is currently worded. Because the work on BEPS may involve changes to the Article 5 definition itself — and because the work on BEPS is only in its initial stages — it would be premature to finalise of the proposed guidance. As a result it is envisaged that the guidance will be postponed until after the BEPS PE related work has been completed. Excerpts from the discussion document relating to Action 7 are included in the Annex to this document.

PREVENTING THE ARTIFICIAL AVOIDANCE OF PERMANENT ESTABLISHMENT STATUS

PART A: Discussion of the problems and options for changes to paragraph 5 (or related paragraphs) of Article 5 and the Commentary thereto to address the use of commissionaire arrangements to artificially avoid PE status

Introduction

5. Paragraph 5 of Article 5 deems a permanent establishment (PE) to exist for the principal where its dependent agent habitually concludes contracts on its behalf:

> "5. Notwithstanding the provisions of paragraphs 1 and 2, where a person — other than an agent of an independent status to whom paragraph 6 — is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph".

6. In summary, for a dependent agent PE to exist, the following conditions must be met. The agent must:

- not be an independent agent;
- be acting on behalf of the enterprise;
- have an authority to conclude contracts;
- habitually exercise in the State that authority;
- do so in in the name of the enterprise; and
- not be conducting an activity that is deemed not to be a PE by paragraph 4.

7. Some enterprises attempt to avoid creating dependent agent PEs by arranging the contracts so that they are not in the name of the enterprise and by limiting the agent's authority to conclude contracts. In addition, the OECD's work on business restructuring identified arrangements whereby full function sales and distribution enterprises were being replaced by limited asset, function and risk agency/commissionaire structures. In these cases the commissionaire and the principal are often related.

8. The Commentary on paragraph 5 advocates less literal interpretations of some of the conditions. Court decisions around the world have also provided further insight as to how various arrangements are likely to be treated in different countries. The OECD's most recent work on the interpretation of paragraph 5 was included in the October 2012 discussion document, "OECD Model Tax Convention: Revised Proposals Concerning the Interpretation and Application of Article 5". This included items 19 (Meaning of "to conclude contracts in the name of the enterprise" (paragraph 32.1 of the Commentary)) and item 20 (Is paragraph 5 restricted to situations where sales are concluded? (paragraph 33 of the Commentary)). Excerpts from the discussion document, including the background, discussion of the issues and proposed changes to the Commentary are set out in the Annex to this document.

1. Issue for Discussion: How and to what extent is 5(5) being abused?

9. Before we examine specific issues, at a general level how and to what extent do you consider the dependent agent PE provision (paragraph 5 of Article 5) is being abused or circumvented?

2. Case Study: Conditions for establishing a dependent agent PE

The facts

TV CO a tax resident of State R, was engaged in the business of broadcasting television channels. During the relevant tax years, TV CO had appointed an agent in State S (hereafter referred to as "the State S agent") for collecting advertisements from State S customers. The State S agent was remunerated at arm's length. Details of the arrangement were as follows:

- All of the advertising orders from the State S customers were received through the State S agent, but this represented less than five percent of the State S agent's total income;
- TV CO had provided a rate card to the State S agent that was approved by TV CO and the State S agent did not have the authority to deviate from the rate card;
- The State S agent was merely permitted to forward the orders for advertisements to TV CO;
- TV CO had the absolute right to reject any advertisement;
- The State S agent's activities related to the TV CO were subject to control and direction of TV CO.

In addition, the counsel for TV CO contended that even if TV CO was to be hypothetically regarded as having a dependent agent PE in State S, since TV CO had paid arm's length compensation to the State S agent, no further income was attributable the TV CO's (hypothetical) PE in State S.

Relevant tax law

For the purposes of this case study, the tax treaty between States S and R follows the OECD Model Tax Convention.

Issues for Discussion

(i) Do you consider that TV CO has a dependent agent PE in State S and what factors do you think were important in arriving at your conclusion?

(ii) Do you consider your interpretation of Article 5(5) in respect of this case gives the right policy outcome?

(iii) Would your answer to (i) and (ii) above be any different if State S agent was a subsidiary company of TV CO?

(iv) TV CO argued that since TV CO had paid arm's length compensation to the State S agent, no further income was attributable the TV CO's (hypothetical) PE in State S. What are your thoughts on this?

3. Case Study: Meaning of "to conclude contracts in the name of the enterprise" in a commissionaire arrangement

10. The following example, which was developed in the course of the preparation of the branch reports and general report for the IFA 2009 Congress and included in the October 2012 OECD discussion document on PE issues, provides a useful illustration for discussion.

The facts

PARENTCO, a company resident of State R, and SUBCO, a company resident of State S, are parts of the same multinational group.

Until 2008, SUBCO is the distributor in State S of the products of PARENTCO, which it buys from its parent and resells in State S. In 2008, the distributorship arrangement is replaced by a contract of *commissionnaire*. Under that contract, SUBCO will act as an agent of PARENTCO to sell in State S products owned by PARENTCO. As such, SUBCO will accept orders, submit quotes and documents in tender offers and conclude sales contracts for PARENTCO's products and will be authorized to engage in price negotiations and to grant discounts or terms of payment with current or new customers without specific prior approval by PARENTCO.

In jurisdictions where agency law recognizes indirect representation, the contract will provide that SUBCO is acting as a *commissionnaire*. In jurisdictions where this is not possible, each contract concluded by SUBCO with a customer will specifically provide that the contract is exclusively between the parties and does not bind any other party, including PARENTCO.

In a separate agreement, PARENTCO has agreed to fully reimburse SUBCO for any amount that it may be required to pay customers under its contractual liability. PARENTCO will also control the types of products that will be sold through SUBCO.

Relevant tax law

For the purposes of this case study, the tax treaty between States S and R follows the OECD Model Tax Convention.

Issues for Discussion

(i) Does the phrase "to conclude contracts in the name of the enterprise" only refer to cases where the principal is legally bound vis-à-vis the third party, under agency law, by reason of the contract concluded by the agent, or is it sufficient that the foreign principal is economically bound by the contracts concluded by the person acting for it in order for a permanent establishment to exist (provided the other conditions are met)?

(ii) A more restrictive interpretation appears to be followed in civil law countries. What are country's experiences?

(iii) The discussion document proposed changes to Commentary on paragraph 32.1 to add support to the view that an undisclosed principal would still meet the condition of Article 5(5) to "conclude contracts in the name of the enterprise". Is that sufficient or does Article 5(5) need to be changed?

4. Issue for Discussion: What changes to Article 5(5) or related Article 5 paragraphs and Commentaries should the BEPS Focus Group on Action 7 consider?

11. Action 7 (Preventing Artificial Avoidance of PE Status) of the BEPS Action plan raises the possibility of changes to Article 5 itself rather than continued clarifications in the Commentary. Generally, what changes to Article 5(5) or related Article 5 paragraphs and Commentaries do you consider the Focus Group should consider?

5. Issue for Discussion: Dependent agent PE, but no attributable profits?

A number of recent court cases in India have decided that a dependent agent PE existed, but concluded that no additional profits should be attributed to the PE where the dependent agent was remunerated at arm's length because no additional assets, functions or risks are provided by the PE, over and above those of the agent. Does this highlight a problem or is it a logical conclusion, consistent with the OECD report *Attribution of Profits to Permanent* Establishments?

PART B: Discussion of the problems and options for changes to paragraph 4 of Article 5 (specific PE exemptions) and the Commentary thereto to address the use of the specific PE exemptions to artificially avoid PE status.

Introduction

12. Paragraph 4 of Article 5 lists various business activities that are specifically deemed not to be permanent establishments, even if the activity is carried on through a fixed place of business:

> "4. Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include:
>
> *a*) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
>
> *b*) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
>
> *c*) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
>
> *d*) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;
>
> *e*) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;
>
> *f*) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character."

13. A number of paragraph 4 interpretation and application issues were raised under items 12 to 19 in the OECD's October 2012 discussion document, "OECD Model Tax Convention: Revised Proposals Concerning the Interpretation and Application of Article 5". The background, discussion of the issues and proposed changes to the Commentary for those items are set out in the Annex to this document.

1. Issue for Discussion: Generally, what is the purpose of paragraph 4 of Article 5?

2. Issue for Discussion: Generally, how and to what extent are the specific PE exemptions of 5(4) being abused?

3. Issue for discussion: Warehouses used for delivery

Subparagraph 4 (*a*) of Article 5 deems the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise not to be a PE. The UN excludes delivery in this subparagraph of its model. It has been suggested that internet sales from outside a country can be facilitated through the use of warehouses situated in the source state. In addition, such warehouse may be used to support stripped function distribution structures.

(i) To what extent do participants consider that deeming such facilities not to be a PE is causing a problem?

(ii) The UN Model excludes delivery from subparagraph (*a*), what does this mean given that most storage is done for the purpose of delivery, whether to customers (in the case of sales) or within the enterprise (in the case of procurement)?

(iii) Should the focus of any consideration to remove "delivery" from subparagraphs (*a*) and (*b*) be on sales to third party customers or should it be in respect of all storage and deliver arrangements, including merchandise purchased stored and for delivery within the organisation?

(iv) If "delivery" was removed from subparagraphs (*a*) and (*b*), would you expect much profit would be attributed to the warehouse PE?

4. Case Study: Liaison Office

The facts

ARMA CO was tax resident of State R. It was engaged in the business of marketing defence equipment, including for the government of State S. ARMA CO had established two liaison offices (i.e. representative offices) in State S after obtaining approval from the regulatory body of State R. ARMA CO was able to sell a significant quantity of defence equipment to the government of State S.

The tax authorities of State S contended that the liaison offices were permanent establishments in State S and that ARMA CO had earned taxable income in State S though the offices. This was vigorously denied by ARMA CO and it submitted that:

– The liaison offices did not carry on any substantive business activity;
– the liaison offices did not enter into any contracts;
– ARMA CO performed all the substantive commercial activities in State R, and the liaison offices acted as mere communication channels;
– State S regulatory body's permission for establishing the offices prohibited them from performing any substantive business activities; and
– since the liaison offices performed only preparatory and auxiliary activities, they could not be regarded as PE in view of Art. 5(4) of the treaty.

Relevant tax law

For the purposes of this case study, the tax treaty between States S and R follows the OECD Model Tax Convention.

Issues for Discussion

(i) Do you consider that ARMA CO's liaison office in State S qualifies as an exempted PE under Article 5(4)?

(ii) If the liaison office qualifies as an exempted PE, is that the right policy outcome in view of the significant sales that ARMA CO makes to the government of State S?

(ii) If you consider that ARMA CO's liaison offices did constitute PEs, what profit do you consider would be attributed to the PEs?

4. Case Study: Procurement Office

The facts

ACTIVE FASHION, a resident of State R, was a leading wholesaler and retailer of active outdoors apparels with operations in North America, Europe and Asia. ACTIVE FASHION was engaged in creating innovative products and it carried out research and development for developing marketable products. It had set up a liaison office (i.e. a representative office, hereafter referred to as "LO") in State S for undertaking liaison activities in connection with purchase of materials in State S, India and Bangladesh. The LO was engaged in vendor identification, review of costing data, vendor recommendation, quality control and uploading of material prices into the internal product data management system of the taxpayer company. The LO also monitored vendors for compliance with the

taxpayer company's policies, procedures and standards related to quality, delivery, pricing and labour practices.

ACTIVE FASHION submitted that:

- It did not sell any products to customers in State S;
- the LO was only a cost centre (and not a profit centre);
- The LO did not maintain any stock of goods or merchandise for delivering the same to ACTIVE FASHION's customers.
- the LO only assisted ACTIVE FASHION by undertaking liaison activities related to purchase of goods,
- the LO's activities were of preparatory or auxiliary nature.
- Art. 5(4) (*d*) and Art. 5(4) (*e*) of the treaty applied and as a result, the LO did not amount to a PE.

The State S Revenue argued that the LO was a permanent establishment of ACTIVE FASHION on the basis that:

- In addition to purchasing materials from vendors, the LO also assisted ACTIVE FASHION with respect to vendor selection, quality control, compliance with environmental and other local regulations by the manufacturers, etc. Hence, the LO was actually performing the core business functions of the taxpayer company;
- An entity engaged in the business of designing, manufacturing and selling merchandise could not be regarded as earning a profit only from the sales function. Even other functions (such as designing, quality control, etc.) contributed towards the entity's income. Therefore, ACTIVE FASHION's contention that the LO did not contribute towards income was not acceptable;
- The LO amounted to a fixed place of business through which the taxpayer company's business was carried on; and
- The activities of the LO, were not confined to only purchase of goods or merchandise or for collecting information for the taxpayer company. As mentioned above, the LO's activities extended far beyond that. Hence Art. 5(4) (*d*) did not apply
- Because the LO was engaged in the taxpayer company's core business activities, the requirements of Art. 5(3) (*e*) of the treaty were not satisfied.

Relevant tax law

For the purposes of this case study, the tax treaty between States S and R follows the OECD Model Tax Convention.

Issues for Discussion

(i) Do you consider that ACTIVE FASHION's liaison offices in State S would qualify as an exempted PE under Article 5(4)?

(ii) If the liaison offices qualifies as an exempted PE, is that the right policy outcome in view of the LO's contribution towards ACTIVE FASHION's core business activity?

(iii) Generally, what profit would be attributed to the liaison office if it was considered to be a PE?

5. Case Study: Fragmented Procurement and Related Activities

The facts

Company R, a resident of State R, operates a manufacturing business in State R. It has a number of offices at separate geographic locations in State S that carry out the following activities:

- Purchasing Office. This identifies and purchases raw materials for the enterprise and it arranges for this to be shipped to State R.
- Warehouse. This receives and stores raw materials from various suppliers in State S.
- Some merchandise belonging to Company R is being further processed by unrelated companies in State S (contract manufacturers). This is later shipped to Company R's factory in State R.

The State S Revenue argued that Company R's activities in State S do not qualify for the PE exemption provided by paragraph 4 because the combined activities breach the conditions of subparagraphs *a*) to *d*) and are not auxiliary or preparatory activities.

Relevant tax law

For the purposes of this case study, the tax treaty between States S and R follows the OECD Model Tax Convention.

Issues for Discussion

(i) Do you consider that Company R's activities in State S would qualify for exemption under paragraph 4 of Article 5?

(ii) If the activities in State S qualify as an exempted PEs, is that the right policy outcome?

PART C: Discussion of other artificial avoidance of PE status concerns

14. Action 7 of the BEPS Action Plan, concerning preventing artificial avoidance of PE status, specifically referred to artificial avoidance of PE status in respect of dependent agents and the specific exemption activities. Permanent establishment avoidance issues directly related to the digital economy are expected to be raised under Action 1 (Address the Challenges of the Digital Economy). This meeting presents an opportunity for participants to raise other artificial avoidance of PE status concerns.

15. It is not surprising that over the years problems relating to the application of Article 5 have been identified. Reponses have emerged, some of which are largely compatible with the primary objective of the Article 5 taxation threshold. Clarifications have been added to the Commentary on Article 5 that set out the intended application and agreed practices. Alternative PE provisions have also been added to the Commentary, which provide solutions to some PE avoidance concerns. For example, the services provision in paragraph 42.23 and the anti-contract splitting provision in paragraph 42.45. Other responses to PE avoidance concerns are found in the UN Model and bilateral treaties. For example, reduced time thresholds and activity and duration based thresholds that do not require a fixed place of business. Most of these alternatives are well known to treaty negotiators.

Issue for Discussion: Are there other artificial avoidance of PE status concerns or solutions that participants wish to raise?

ANNEX

EXCERPTS FROM THE DISCUSSION DOCUMENT "INTERPRETATION AND APPLICATION OF ARTICLE 5 (PERMANENT ESTABLISHMENT) OF THE OECD MODEL TAX CONVENTION (OCTOBER 2012)

ITEMS 12 TO 21 CONCERNING ARTICLE 5(4) AND 5(5) ISSUES

12. Must the activities referred to in paragraph 4 be of a preparatory or auxiliary nature? (paragraphs 21 and 23 of the Commentary)

Description of the issue

70. The question was raised as to whether the activities that are mentioned in subparagraphs *a*) to *d*) of paragraph 4 are automatic exceptions or whether these exceptions are conditional on the activities being of a preparatory or auxiliary nature.

71. This issue was discussed in section 4.A.*d*) of the 2004 report of the Business Profits TAG "Are The Current Treaty Rules For Taxing Business Profits Appropriate For E-Commerce?":

> The alternative option to subject the activities covered by the exception to the overall limitation that they be of a preparatory or auxiliary nature is based on the same rationale but is arguably better targeted as it implicitly restricts the exceptions to activities that contribute only marginally to the profits of the enterprise. It could also be argued that this alternative option is fully in line with the purpose of paragraph 4, which is described as follows in paragraph 21 of the Commentary:
>
> > "The common feature of these activities is that they are, in general, preparatory or auxiliary activities" […] "Thus the provisions of paragraph 4 are designed to prevent an enterprise of one State from being taxed in the other State, if it carries on in that other State, activities of a purely preparatory or auxiliary character."
>
> …The alternative option to make all the exceptions subject to the "preparatory or auxiliary" condition would reduce certainty by subjecting the existing exceptions that currently apply automatically and therefore provide a bright line test to a condition that is inherently more subjective. The change would therefore increase the potential for disputes between taxpayers and tax authorities. In light of paragraph 21 of the Commentary on Article 5, it could be argued, however, that there is already some uncertainty as to whether or not all the existing exceptions are implicitly subject to this condition.

72. The issue was also discussed by the Joint Working Group on Business Restructurings.

Recommendation of the Working Party

73. The Working Party recommends that the following changes be made to the Commentary on Article 5 in order to address this issue:

> *Replace paragraph 21 of the Commentary on Article 5 by the following:*
>
> > 21. This paragraph lists a number of business activities which are treated as exceptions to the general definition laid down in paragraph 1 and which are not permanent establishments, even if the activity is carried on through a fixed place of business. ***Where the only activities carried on at a fixed place of business are activities to which one of subparagraphs a) to d) apply,*** ~~***Where each of the activities listed in subparagraphs a) to d) is the only activity carried on at a fixed place of business***~~***, the place is deemed not to constitute a permanent establishment.*** The common feature of these

activities is that they are, in general, preparatory or auxiliary activities. ***Since subparagraph e) deals with other unspecified activities, however, the requirement that the activity must have a preparatory or auxiliary character has been*** ~~This is~~ laid down explicitly in the case of the exception mentioned in ***that*** subparagraph ~~*e)*~~, which actually amounts to a general restriction of the scope of the definition contained in paragraph 1. Moreover subparagraph *f*) provides that combinations of activities mentioned in subparagraphs *a*) to *e*) in the same fixed place of business shall be deemed not to be a permanent establishment, provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character. Thus the provisions of paragraph 4 are designed to prevent an enterprise of one State from being taxed in the other State, if it carries on in that other State, activities of a purely preparatory or auxiliary character.

Replace paragraph 23 of the Commentary on Article 5 by the following:

23. Subparagraph *e*) provides that a fixed place of business through which the enterprise exercises solely an activity which has for the enterprise a preparatory or auxiliary character~~,~~ is deemed not to be a permanent establishment. The wording of this subparagraph makes it unnecessary to produce an exhaustive list of exceptions. Furthermore, this subparagraph provides a generalised exception to the general definition in paragraph 1 and, when read with that paragraph, provides a more selective test, by which to determine what constitutes a permanent establishment. To a considerable degree it limits that definition and excludes from its rather wide scope a number of forms of business organisations which, although they are carried on through a fixed place of business~~,~~ ***and may well contribute to the productivity of the enterprise, involve activities which are so remote from the actual realisation of profits by the enterprise that they*** should not be treated as permanent establishments. ~~It is recognised that such a place of business may well contribute to the productivity of the enterprise, but the services it performs are so remote from the actual realisation of profits that it is difficult to allocate any profit to the fixed place of business in question.~~ Examples are fixed places of business solely for the purpose of advertising or for the supply of information or for scientific research or for the servicing of a patent or a know-how contract, if such activities have a preparatory or auxiliary character.

Replace paragraphs 42.7 and 42.9 of the Commentary on Article 5 by the following:

42.7 Another issue relates to the fact that no permanent establishment may be considered to exist where the electronic commerce operations carried on through computer equipment at a given location in a country are restricted to the ~~preparatory or auxiliary~~ activities covered by paragraph 4. The question of whether particular activities performed at such a location fall within paragraph 4 needs to be examined on a case-by-case basis having regard to the various functions performed by the enterprise through that equipment. Examples of activities which would generally be regarded as ~~preparatory or auxiliary~~***covered by paragraph 4*** include:

– providing a communications link — much like a telephone line — between suppliers and customers;
– advertising of goods or services;
– relaying information through a mirror server for security and efficiency purposes;
– gathering market data for the enterprise;
– supplying information.

42.9 What constitutes core functions for a particular enterprise clearly depends on the nature of the business carried on by that enterprise. For instance, some ISPs are in the business of operating their own servers for the purpose of hosting web sites or other applications for other enterprises. For these ISPs, the operation of their servers in order to provide services to customers is an essential part of their commercial activity and cannot be considered preparatory or auxiliary ***within the meaning of subparagraphs 4 e) and f) or otherwise covered by paragraph 4***. A different example is that of an enterprise (sometimes referred to as an "e-tailer") that carries on the business of selling products through the Internet. In that case, the enterprise is not in the business of operating servers and the

mere fact that it may do so at a given location is not enough to conclude that activities performed at that location are more than preparatory and auxiliary ***or not otherwise covered by paragraph 4***. What needs to be done in such a case is to examine the nature of the activities performed at that location in light of the business carried on by the enterprise. If these activities are merely preparatory or auxiliary to the business of selling products on the Internet ***or are otherwise covered by paragraph 4*** (for example, the location is used to operate a server that hosts a web site which, as is often the case, is used exclusively for advertising, displaying a catalogue of products or providing information to potential customers), paragraph 4 will apply and the location will not constitute a permanent establishment. If, however, the typical functions related to a sale are performed at that location (for example, the conclusion of the contract with the customer, the processing of the payment and the delivery of the products are performed automatically through the equipment located there), these activities cannot be considered to be ~~merely preparatory or auxiliary~~ ***covered by paragraph 4***.

74. As explained below, however, the Working Party notes that whilst the last sentence of paragraph 23 is technically correct, it should not be misinterpreted as suggesting that research and development is, as a general rule, a preparatory or auxiliary activity.

Background

75. The Working Party agreed that the wording of subparagraphs *a*) to *d*) did not support the view that the application of these subparagraphs was subject to the additional condition that the relevant activity be of a preparatory or auxiliary character, which was a condition that was expressly included in subparagraphs *e*) and *f*). It therefore agreed that the Commentary should be amended to clarify that subparagraphs *a*) to *d*) were not subject to the extra condition that the activities referred to therein be of a preparatory or auxiliary nature and that a similar clarification should be made in paragraphs 42.7 and 42.9 of the Commentary.

76. During its discussion of the issue, the Working Party also discussed the last sentence of paragraph 23 of the Commentary, which provides that "[e]xamples are fixed places of business solely for the purpose of advertising or for the supply of information or for scientific research or for the servicing of a patent or a know-how contract, if such activities have a preparatory or auxiliary character." It was concluded that whilst the sentence was technically correct, it could be misinterpreted as suggesting that research and development was, as a general rule, a preparatory or auxiliary activity. After discussion, the Working Party decided that no changes should be made to the paragraph with respect to this issue but that the Working Party's report should include that warning.

77. The Working Party agreed, however, to redraft the penultimate sentence of paragraph 23 in order to remove any suggestion that there could be a link between the attribution of profits and the existence of a permanent establishment.

13. Relationship between delivery and the sale of goods in subparagraph 4 *a*) (paragraphs 22 and 27.1 of the Commentary)

Description of the issue

78. Does the exception in subparagraph 4 *a*) apply to goods or merchandise to be sold from abroad?

79. This question was raised in the context of the work of the Joint Working Group on Business Restructurings, which noted that the exception of subparagraph 4 *a*) does not apply to the situation in which a fixed place of business maintained for the delivery of goods is also engaged in the sale of goods.

Recommendation of the Working Party

80. The Working Party recommends that the following changes be made to the Commentary on Article 5 in order to address this issue:

Replace paragraph 22 of the Commentary on Article 5 by the following [other changes to paragraph 22 resulting from the recommendations in sections 14 and 16 would also be made to the paragraph]:

22. Subparagraph *a*) relates only to the case in which an enterprise acquires the use of facilities for storing, displaying or delivering its own goods or merchandise. Subparagraph *b*) relates to the stock of merchandise itself and provides that the stock, as such, shall not be treated as a permanent establishment if it is maintained for the purpose of storage, display or delivery. ***Subparagraphs a) and b) apply regardless of whether the storage or delivery takes place before or after a contract for the sale of the goods or merchandise has been concluded provided that the goods or merchandise belong to the enterprise whilst they are at the relevant location (e.g. the subparagraphs would remain applicable if contracts for the sale of some of the goods that are stored at a location have already been concluded but the property title to these goods only passes to the customer after their delivery)…*** [*changes resulting from the recommendations in sections 14 and 16 will be inserted here; the rest of existing paragraph 22 is moved to new paragraph 22.1*]

22.1 Subparagraph *c*) covers the case in which a stock of goods or merchandise belonging to one enterprise is processed by a second enterprise, on behalf of, or for the account of, the first-mentioned enterprise. The reference to the collection of information in subparagraph *d*) is intended to include the case of the newspaper bureau which has no purpose other than to act as one of many "tentacles" of the parent body; to exempt such a bureau is to do no more than to extend the concept of "mere purchase".

Replace paragraph 27.1 of the Commentary on Article 5 by the following:

27.1 Subparagraph *f*) is of no ***relevance*** ~~importance~~ in a case where an enterprise maintains several fixed places of business ~~within the meaning of~~***to which*** subparagraphs *a*) to *e*) ***apply*** provided that they are separated from each other locally and organisationally, as in such a case each place of business has to be viewed separately and in isolation for deciding whether a permanent establishment exists. Places of business are not "separated organisationally" where they each perform in a Contracting State complementary functions such as receiving and storing goods in one place, distributing those goods through another etc. An enterprise cannot fragment a cohesive operating business into several small operations in order to argue that each is merely engaged in a preparatory or auxiliary activity. ~~***The same approach applies***~~***A similar issue arises where an enterprise that maintains in a Contracting State one or more fixed places of business*** ~~***within the meaning of***~~ ***to which subparagraphs a) to e) apply is also deemed, through the application of paragraph 5, to have a permanent establishment in the same State; in that case, if the activities that resulted in that deemed permanent establishment are not separated organisationally from these fixed places of business, it could not be argued that the enterprise is solely engaged in a preparatory or auxiliary activity at these places.***

Background

81. Based on the wording of subparagraphs 4 *a)* and *b)*, which refer to the use of facilities or maintenance of a stock of goods or merchandise "***solely***" for the purpose of storage, display or delivery, there was general agreement with a member's conclusion that a place used for display or delivery that was also used for making sales would not be covered by these subparagraphs. The Working Party also agreed, however, that the wording of subparagraph 4 *a*) did not support the suggestion that the application of that subparagraph would depend on whether or not the goods or merchandise stored, displayed or delivered had already been sold and it was agreed that this should be clarified in the Commentary.

82. During the discussion, a member of the Working Party described a situation where an agent would sell goods stored by the foreign enterprise at a particular location so that the sales activities would constitute a permanent establishment under Article 5(5); in that case, he did not consider that the exception of subparagraph 4 *a*) should be applicable to the location where the goods were stored. It was agreed that paragraph 27.1 of the Commentary should be clarified to indicate that an agency permanent establishment

resulting from Article 5(5) should be treated in the same way as a fixed place of business for the purposes of the application of the non-fragmentation approach described in that paragraph.

14. Does a development property constitute a PE? (paragraph 22 of the Commentary)

Description of the issue

83. The question has been asked whether, in a situation where a developer develops and sells immovable property, the property would constitute a permanent establishment notwithstanding the fact that the business of the developer is to sell that property.

Recommendation of the Working Party

84. The Working Party recommends that the following changes be made to the Commentary on Article 5 in order to address this issue:

> *Replace paragraph 22 of the Commentary on Article 5 by the following [other changes to paragraph 22 resulting from the recommendations in sections 13 and 16 would also be made to the paragraph]:*
>
> > 22. Subparagraph *a*) relates only to the case in which an enterprise acquires the use of facilities for storing, displaying or delivering its own goods or merchandise. Subparagraph *b*) relates to the stock of merchandise itself and provides that the stock, as such, shall not be treated as a permanent establishment if it is maintained for the purpose of storage, display or delivery. *[the changes resulting from the recommendations in sections 13 and 16 will be inserted here]* ***In the context of these subparagraphs, the words "goods" and "merchandise" refer to tangible property that can be stored, displayed and delivered and would not cover, for example, immovable property and data (although the subparagraphs would cover tangible products that include data such as CDs and DVDs****). [the rest of paragraph 22 is moved to new paragraph 22.1 – see section 13]*

Background

85. One member of the Working Party described the situation of a non-resident developer who sells land situated in a country without having a sales office or other similar permanent establishment in that country and who argues that Article 7 prevents that country from taxing the profits from these sales (in that case the country would not tax these profits as capital gains). The Working Party concluded that the last part of paragraph 4 of the Commentary on Article 13[1] already clarifies that the Convention allowed the country to tax these profits and that it was purely a question of domestic law how the country decided to tax them (*i.e.* as business profits or as capital gains).

86. This led to the discussion of another example in which a non-resident developer would hold a stock of recently-built houses for sale without having another form of physical presence in the country. In that case, the issue would be whether it could be argued that the developer does not have a permanent establishment on the basis that the houses constitute "a stock of goods or merchandise" for the purposes of subparagraph 4 *b*).

87. It was concluded that whilst this would not affect the State of source's right to tax the gains from the sales (since this right is granted by paragraph 1 of Article 13 regardless of whether or not there is a PE), the issue could be relevant for the application of provisions such as paragraph 5 of Article 11. It was therefore agreed that the Commentary on subparagraphs *a*) and *b*) should clarify that these subparagraphs do not cover property such as real estate and data, although they would cover tangible products that included data, such as CDs and DVDs.

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[1]. "…Accordingly, no distinction between capital gains and commercial profits is made nor is it necessary to have special provisions as to whether the Article on capital gains or Article 7 on the taxation of business profits should apply. It is however left to the domestic law of the taxing State to decide whether a tax on capital gains or on ordinary income must be levied. The Convention does not prejudge this question."

15. Do "goods or merchandise" cover digital products or data? (paragraph 22 of the Commentary)

Description of the issue

88. Does the reference to "goods or merchandise" in subparagraphs 4 *a*), *b*) and *c*) apply to digital products or, more generally, data?

89. This issue was discussed in the Business Profits TAG's report "Are The Current Treaty Rules For Taxing Business Profits Appropriate For E-Commerce?" (section 4.A.*d*)):

> For instance, it is not clear to what extent the reference to "goods or merchandise" in subparagraphs *a*), *b*) and c) can apply to digital products or, more generally, data. It is also not clear to what extent the words "storage" and "delivery" can apply to digital products downloaded from servers through computer networks … Regardless of the views expressed on the option to eliminate these exceptions, the TAG agreed that it would be useful if these questions were dealt with in the Commentary in order to provide greater certainty to taxpayers and tax administrations as to the exact scope of the current exceptions included in paragraph 4.

Recommendation of the Working Party

90. The recommendation included in section 14 above addresses this issue.

Background

91. The Working Party concluded that since the storage of digital products would be done on servers, this issue appeared to have already been addressed through the explanations included in paragraphs 42.7 to 42.9 of the Commentary, which deal with the issue of whether activities carried on through servers are covered by the exceptions of Article 5(4). After the discussion of the issue in section 14 above, however, the Working Party concluded that the issue of the application of subparagraphs *a*), *b*) and *c*) to digital products and data could be easily addressed in combination with that other issue.

16. Carrying on various activities listed alternatively in subparagraphs 4 *a*) and *b*) (paragraph 22 of the Commentary)

Description of the issue

92. To what extent do the specific exceptions in subparagraphs 4 *a*) and *b*) apply if various activities listed alternatively in these subparagraphs are carried out at the same location and if these activities, taken together, go beyond the preparatory or auxiliary threshold so as to preclude the application of paragraph *f*)?

93. This issue was discussed in the Business Profits TAG's report "Are The Current Treaty Rules For Taxing Business Profits Appropriate For E-Commerce?" (section 4.A.*e*)):

> The question was also discussed whether or not paragraph 4 would apply where various activities listed alternatively in subparagraph *a*) and *b*) are carried on at the same location and these activities go beyond the preparatory or auxiliary threshold so as to preclude the application of subparagraph *f*). Regardless of the views expressed on the option to eliminate these exceptions, the TAG agreed that it would be useful if these questions were dealt with in the Commentary in order to provide greater certainty to taxpayers and tax administrations as to the exact scope of the current exceptions included in paragraph 4.

94. The Joint Working Group on Business Restructurings raised one specific example of that issue when it discussed whether the exception of subparagraph *a*), which is applicable to "storage, display ***or*** delivery", would apply if two or all three of these activities were performed simultaneously at the same location.

Recommendation of the Working Party

95. The Working Party recommends that the following changes be made to the Commentary on Article 5 in order to address this issue:

Replace paragraph 22 of the Commentary on Article 5 by the following [other changes to paragraph 22 resulting from the recommendations in sections 13 and 14 would also be made to the paragraph]:

22. Subparagraph *a*) relates only to the case in which an enterprise acquires the use of facilities for storing, displaying or delivering its own goods or merchandise. Subparagraph *b*) relates to the stock of merchandise itself and provides that the stock, as such, shall not be treated as a permanent establishment if it is maintained for the purpose of storage, display or delivery. *[the changes resulting from the recommendation in section 13 will be inserted here]* ***These subparagraphs also cover situations where a facility is used, or a stock of goods or merchandise is maintained, for any combination of storage, display and delivery since facilities used for the delivery of goods will almost always be also used for the storage of these goods, at least for a short period***. *[the changes resulting from the recommendation in section 14 will be inserted here; the rest of existing paragraph 22 is moved to new paragraph 22.1 – see section 13]*

Background

96. The Working Party agreed that the issue, which relates to the fact that subparagraphs 4 *a*) and 4 *b*) refer alternatively to storage, display or delivery, was a relatively minor drafting issue; it concluded that the phrase "storage, display or delivery" in subparagraphs 4 *a*) and 4 *b*) should be interpreted as "storage, display and/or delivery" and that this should be made clear in the Commentary.

17. Negotiation of import contracts as an activity of a preparatory or auxiliary nature (paragraphs 24 and 25 of the Commentary)

Description of the issue

97. The question was asked whether the observation in paragraph 44 of the Commentary reflects a disagreement with the interpretation of the permanent establishment definition included in the Commentary or with the views of other countries.

98. This observation by the Czech Republic and the Slovak Republic reads as follows:

44. The *Czech Republic* and the *Slovak Republic* would add to paragraph 25 their view that when an enterprise has established an office (such as a commercial representation office) in a country, and the employees working at that office are substantially involved in the negotiation of contracts for the import of products or services into that country, the office will in most cases not fall within paragraph 4 of Article 5. Substantial involvement in the negotiations exists when the essential parts of the contract — the type, quality, and amount of goods, for example, and the time and terms of delivery — are determined by the office. These activities form a separate and indispensable part of the business activities of the foreign enterprise, and are not simply activities of an auxiliary or preparatory character.

Recommendation of the Working Party

99. The Working Party recommends that the following changes be made to the Commentary on Article 5 in order to address this issue:

Replace paragraph 24 of the Commentary on Article 5 by the following:

24. It is often difficult to distinguish between activities which have a preparatory or auxiliary character and those which have not. The decisive criterion is whether or not the activity of the fixed

place of business in itself forms an essential and significant part of the activity of the enterprise as a whole. Each individual case will have to be examined on its own merits. In any case, a fixed place of business whose general purpose is one which is identical to the general purpose of the whole enterprise~~,~~ does not exercise a preparatory or auxiliary activity. Where, for example, the servicing of patents and know-how is the purpose of an enterprise, a fixed place of business of such enterprise exercising such an activity cannot get the benefits of subparagraph *e*). *[the rest of paragraph 24 is moved to new paragraph 24.1]*

24.1 A fixed place of business which has the function of managing an enterprise or even only a part of an enterprise or of a group of the concern cannot be regarded as doing a preparatory or auxiliary activity, for such a managerial activity exceeds this level. If enterprises with international ramifications establish a so-called "management office" in States in which they maintain subsidiaries, permanent establishments, agents or licensees, such office having supervisory and co-ordinating functions for all departments of the enterprise located within the region concerned, a permanent establishment will normally be deemed to exist, because the management office may be regarded as an office within the meaning of paragraph 2. Where a big international concern has delegated all management functions to its regional management offices so that the functions of the head office of the concern are restricted to general supervision (so-called polycentric enterprises), the regional management offices even have to be regarded as a "place of management" within the meaning of subparagraph *a*) of paragraph 2. The function of managing an enterprise, even if it only covers a certain area of the operations of the concern, constitutes an essential part of the business operations of the enterprise and therefore can in no way be regarded as an activity which has a preparatory or auxiliary character within the meaning of subparagraph *e*) of paragraph 4.

24.2 Similarly, where an enterprise that sells goods worldwide establishes an office in one State, and the employees working at that office take an active part in the negotiation of important parts of contracts for the sale of goods to buyers in that State (e.g. by participating in decisions related to the type, quality or quantity of products covered by these contracts) even if they do not exercise an authority to conclude contracts in the name of their employer, such activities will usually constitute an essential part of the business operations of the enterprise and should not be regarded as having a preparatory or auxiliary character within the meaning of subparagraph e) of paragraph 4. If the conditions of paragraph 1 are met, such an office will therefore constitute a permanent establishment.

Delete the following paragraph 44 of the Commentary on Article 5:

~~44. The *Czech Republic* and the *Slovak Republic* would add to paragraph 25 their view that when an enterprise has established an office (such as a commercial representation office) in a country, and the employees working at that office are substantially involved in the negotiation of contracts for the import of products or services into that country, the office will in most cases not fall within paragraph 4 of Article 5. Substantial involvement in the negotiations exists when the essential parts of the contract — the type, quality, and amount of goods, for example, and the time and terms of delivery — are determined by the office. These activities form a separate and indispensable part of the business activities of the foreign enterprise, and are not simply activities of an auxiliary or preparatory character.~~

Background

100. The Delegate for the Czech Republic indicated that the observation in paragraph 44 of the Commentary was an additional clarification rather than a disagreement with an interpretation included in the Commentary and that the reference to contracts "for the import of products or services" was merely illustrative. The situation that was envisaged in that observation was that of an office situated in a State that would be involved in the negotiation of important parts of contracts for the sale of goods to buyers in that State without exercising an authority to conclude contracts in the name of the enterprise. The Working Party

agreed that a proposed clarification should be added to the Commentary to address the issue raised in that observation.

101. The Delegates for the Czech Republic and the Slovak Republic have both indicated that their countries~~y~~ would delete their ~~its~~ observations if the proposed change is included in the Commentary.

18. Fragmentation of activities (paragraph 27.1 of the Commentary)

Description of the issue

102. Paragraph 27.1 of the Commentary on Article 5 reads as follows:

> 27.1 Subparagraph *f*) is of no importance in a case where an enterprise maintains several fixed places of business within the meaning of subparagraphs *a*) to *e*) provided that they are separated from each other locally and organisationally, as in such a case each place of business has to be viewed separately and in isolation for deciding whether a permanent establishment exists. Places of business are not "separated organisationally" where they each perform in a Contracting State complementary functions such as receiving and storing goods in one place, distributing those goods through another etc. An enterprise cannot fragment a cohesive operating business into several small operations in order to argue that each is merely engaged in a preparatory or auxiliary activity.

103. In the context of the work on business restructurings, the question was asked whether and to what extent the language in paragraph 27.1 of the Commentary on Article 5 on the fragmentation of activities may be relevant in dealing with the situation in which a non-resident is doing through a converted ("stripped") local enterprise what was previously done as a full-fledged operation.

Recommendation of the Working Party

104. The Working Party concluded that no changes should be made to the Commentary with respect to this issue because paragraph 27.1 of the Commentary deals with the combination of activities carried on by a single enterprise at different locations in a given State and is therefore not relevant in the situation where a foreign enterprise maintains places of business covered by the exceptions of Article 5(4) and a converted ("stripped") local enterprise is also carrying on in that State activities that were previously carried on as a full-fledged operation. The Working Party also noted, however, that such situations could, depending on the circumstances, be addressed through the application of legislative or judicial anti-abuse rules (as was the case for the fragmentation of contracts referred to in paragraph 18 of the Commentary).

Background

105. The Working Party noted that paragraph 27.1 of the Commentary dealt with the fragmentation of an enterprise's activities between different places of business of that same enterprise and was therefore not relevant in the situation where a foreign enterprise maintained places of business covered by the exceptions of Article 5(4) and a converted ("stripped") local enterprise was also carrying on activities that were previously carried on as a full-fledged operation. It was also agreed, however, that whilst no changes should be made to the Commentary with respect to this issue, the report of the Working Party should recognise that such situations could, depending on the circumstances, be addressed through the application of legislative or judicial anti-abuse rules (as is the case for the fragmentation of contracts referred to in paragraph 18 of the Commentary). It was noted, however, that, in practice, a better approach will often be to examine whether the various local companies have received an arm's length consideration for their activities.

19. Meaning of "to conclude contracts in the name of the enterprise" (paragraph 32.1 of the Commentary)

Description of the issue

106. Does the phrase "to conclude contracts in the name of the enterprise" only refer to cases where the principal is legally bound vis-à-vis the third party, under agency law, by reason of the contract concluded by the agent, or is it sufficient that the foreign principal is economically bound by the contracts concluded by the person acting for it in order for a permanent establishment to exist (provided the other conditions are met)?

107. This issue was discussed by the Joint Working Group on Business Restructurings and is illustrated by the following example, which was developed in the course of the preparation of the branch reports and general report for the IFA 2009 Congress:

> ***Commissionnaire arrangements***
>
> PARENTCO, a company resident of State R, and SUBCO, a company resident of State S, are parts of the same multinational group.
>
> Until 2008, SUBCO is the distributor in State S of the products of PARENTCO, which it buys from its parent and resells in State S. In 2008, the distributorship arrangement is replaced by a contract of *commissionnaire*. Under that contract, SUBCO will act as an agent of PARENTCO to sell in State S products owned by PARENTCO. As such, SUBCO will accept orders, submit quotes and documents in tender offers and conclude sales contracts for PARENTCO's products and will be authorized to engage in price negotiations and to grant discounts or terms of payment with current or new customers without specific prior approval by PARENTCO.
>
> In jurisdictions where agency law recognizes indirect representation, the contract will provide that SUBCO is acting as a *commissionnaire*. In jurisdictions where this is not possible, each contract concluded by SUBCO with a customer will specifically provide that the contract is exclusively between the parties and does not bind any other party, including PARENTCO.
>
> In a separate agreement, PARENTCO has agreed to fully reimburse SUBCO for any amount that it may be required to pay customers under its contractual liability. PARENTCO will also control the types of products that will be sold through SUBCO.

108. A related issue that was discussed by the Joint Working Group on Business Restructurings in relation to such arrangements was whether a dependent agent permanent establishment could be deemed to exist if it were established that the arrangements entered into in a particular case did not make commercial sense and were primarily structured in such a way as to avoid the creation of a permanent establishment.

Recommendation of the Working Party

109. The Working Party recommends that the following changes be made to the Commentary on Article 5 in order to address this issue:

> *Replace paragraph 32.1 of the Commentary on Article 5 by the following:*
>
> 32.1 Also, the phrase "authority to conclude contracts in the name of the enterprise" does not confine the application of the paragraph to an agent who enters into contracts literally in the name of the enterprise; the paragraph applies equally to an agent who concludes contracts which are binding on the enterprise even if those contracts are not actually in the name of the enterprise. ***For example, in some countries an enterprise would be bound, in certain cases, by a contract concluded with a third party by a person acting on behalf of the enterprise even if the person did not formally disclose that it was acting for the enterprise and the name of the enterprise was not referred to in the contract.*** *[the rest of existing paragraph 32.1 is moved to new paragraph 32.2]*

> ***32.2*** Lack of active involvement by an enterprise in transactions may be indicative of a grant of authority to an agent. For example, an agent may be considered to possess actual authority to conclude contracts where he solicits and receives (but does not formally finalise) orders which are sent directly to a warehouse from which goods are delivered and where the foreign enterprise routinely approves the transactions.

Background

110. The Working Party had an extensive discussion of this issue based on recent court decisions on *commissionnaire* arrangements in France (*Zimmer Ltd.*) and Norway (*Dell DUF*).

111. A large part of the discussion focused on the meaning of the first sentence of paragraph 32.1 of the Commentary, the relevant part of which reads "paragraph [5] applies equally to an agent who concludes contracts which are binding on the enterprise even if those contracts are not actually in the name of the enterprise". Whilst there was also a reference to the second part of paragraph 32.1,[2] it was explained that this part of the paragraph did not deal with the issue of "in the name of" (*i.e.* whether or not the contract, once concluded, was binding on the foreign enterprise) but focussed instead on whether the activities of the agent were enough to consider that the agent had concluded the contract.

The Working Party agreed that whilst it was not possible to reach a common view on the situations dealt with in the court decisions, it would be helpful to add to paragraph 32.1 of the Commentary an example of a situation where a foreign principal would be bound by a contract even though the contract would not literally be concluded in his name.

112. The Working Party also examined comments received from BIAC on the phrase "concluding contracts in the name of". It was explained that these comments referred to three particular situations: (1) "when a multinational group's contracting policies require multiple personnel in an organization to approve contracts, not all of whom may be employees of the enterprise being bound"; (2) "when contracts are in a standard form for all customers (e.g., online contracts) so that no negotiation occurs when the contracts are formed"; and (3) "when sales are governed by a framework contract applicable to all group companies and there follows specific purchase orders in which various personnel are able to conclude contracts for specific entities within the framework agreement". It was suggested that in cases 2 and 3, as long as sales contracts were concluded in the name of a foreign enterprise, the extent to which the person concluding these contracts (*e.g.* by accepting an order) was using standard contracts or was constrained by a framework contract would not seem to matter. With reference to case 3, one delegate indicated that his administration had dealt with a similar situation and had concluded that the acceptance of the order was the conclusion of the contract. It was clarified that this was done when the final nature and quantity to be delivered under the framework agreement was determined under a specific purchase order. As regards case 1, it was suggested that Article 5(5) referred to the level of approval that was decisive for the contract to be legally concluded, subject to the comments in paragraphs 32.1 to 33.1 of the Commentary. The Working Party agreed that these three cases raised questions of fact and that the Commentary already provided enough guidance to deal with them.

20. Is paragraph 5 restricted to situations where sales are concluded? (paragraph 33 of the Commentary)

Description of the issue

113. One of the conditions for an agency permanent establishment to exist is that the agent must have an *authority to conclude contracts* in the name of the foreign enterprise. The question was raised whether this means that the possible application of paragraph 5 to business restructurings is restricted to situations in which

[2]. "Lack of active involvement by an enterprise in transactions may be indicative of a grant of authority to an agent. For example, an agent may be considered to possess actual authority to conclude contracts where he solicits and receives (but does not formally finalise) orders which are sent directly to a warehouse from which goods are delivered and where the foreign enterprise routinely approves the transactions".

a full-fledged distributor is converted into a *commissionnaire* or other sales agent (that has and habitually exercises an authority to conclude contracts). Where a local manufacturer is converted into a contract or toll manufacturer or where a full-fledged research operation is converted into contract research, the converted local entity will not, in general, have an authority to conclude contracts with third parties.

114. This issue was raised during the work of the Joint Working Group on Business Restructurings.

Recommendation of the Working Party

115. The Working Party recommends that the following changes be made to the Commentary on Article 5 in order to address this issue:

> *Replace paragraph 33 of the Commentary on Article 5 by the following (and renumber existing paragraph 33.1 as paragraph 33.2):*
>
> 33. ***The types of contracts referred to in paragraph 5 are not restricted***~~, however,~~ ***to contracts for the sale of goods: the paragraph would cover, for example, a situation where a person has and habitually exercises an authority to conclude leasing contracts or contracts for services.*** The authority to conclude contracts must***, however,*** cover contracts relating to operations which constitute the business proper of the enterprise. It would be irrelevant, for instance, if the person had authority to engage employees for the enterprise to assist that person's activity for the enterprise or if the person were authorised to conclude, in the name of the enterprise, similar contracts relating to internal operations only. ~~***The types of contracts referred to in paragraph 5 are not restricted, however, to contracts for the sale of goods: the paragraph would cover, for example, a situation where a person has and habitually exercises an authority to conclude leasing contracts or contracts for services.***~~ *[the rest of paragraph 33 is moved to new paragraph 33.1]*
>
> ***33.1*** Moreover the authority has to be habitually exercised in the other State; whether or not this is the case should be determined on the basis of the commercial realities of the situation. A person who is authorised to negotiate all elements and details of a contract in a way binding on the enterprise can be said to exercise this authority "in that State", even if the contract is signed by another person in the State in which the enterprise is situated or if the first person has not formally been given a power of representation. The mere fact, however, that a person has attended or even participated in negotiations in a State between an enterprise and a client will not be sufficient, by itself, to conclude that the person has exercised in that State an authority to conclude contracts in the name of the enterprise. The fact that a person has attended or even participated in such negotiations could, however, be a relevant factor in determining the exact functions performed by that person on behalf of the enterprise. Since, by virtue of paragraph 4, the maintenance of a fixed place of business solely for purposes listed in that paragraph is deemed not to constitute a permanent establishment, a person whose activities are restricted to such purposes does not create a permanent establishment either.

Background

116. The Working Party agreed that whilst paragraph 5 required the conclusion of contracts in the name of the foreign enterprise and could therefore not apply in the case of a local entity that did not have an authority to conclude contracts with third parties, the word "contracts" did not refer exclusively to contracts for the sale of goods and would include, for example, leasing contracts. It was agreed that this should be clarified in the Commentary.

21. Does paragraph 6 apply only to agents who do not conclude contracts in the name of their principal?

Description of the issue

117. Does paragraph 6 only apply to agents who do not conclude contracts in the name of their principal?

118. The issue was discussed, but not addressed, during the work that led to the adoption of the report on Issues Arising under Article 5 (Permanent Establishment) of the Model Tax Convention, which was adopted by the OECD Committee on Fiscal Affairs on 7 November 2002.[3]

Recommendation of the Working Party

119. The Working Party noted that the term "general commission agent" used in the English version of paragraph 6 of Article 5 does not appear to correspond to the term *commissionnaire* used in the French version. It also noted that the Commentary seemed to include conflicting statements concerning the scope of paragraph 6. For these reasons, the Working Party concluded that this issue could not be addressed merely through changes to the Commentary.

[3]. Reproduced at page R(19)-1 in volume II of the full version of the Model Tax Convention.

18th ANNUAL TAX TREATY MEETING

Paris, 26-27 September 2013

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PARALLEL SESSION B

NEUTRALISING THE EFFECTS OF HYBRID MISMATCH ARRANGEMENTS

Note: Not for publication or distribution beyond invited Delegations

NEUTRALISING THE EFFECTS OF HYBRID MISMATCH ARRANGEMENTS

PARALLEL SESSION B (Thursday, 26 September 14:30 – 17:30; Room CC 5)

Chair: Živilė KVEDYTĖ (Lithuania)

Speakers: Charles MAKOLA (South Africa
David VARLEY (United States of America)
Arnaud DE GRAAF (Netherlands)
Eamonn O'DEA (Ireland)
Jakob SCHOU (Denmark)
John PETERSON (OECD Secretariat)
Edward BARRET (OECD Secretariat)

I. INTRODUCTION

1. Hybrid mismatch arrangements exploit inconsistent tax treatment across two or more jurisdictions to shift profit from one country to another or to permanently erode a country's tax base. While there can be several layers of complexity, hybrid mismatch arrangements are often based on similar underlying elements. These include:

- **Hybrid entities**: Entities that are treated as transparent for tax purposes in one country and as non-transparent in another country.
- **Hybrid instruments**: Instruments which are treated differently for tax purposes in the countries involved, most prominently as debt in one country and as equity in another country.

2. The basic structures employed in hybrid mismatch arrangements are generally designed to produce a deductible expense in one country while avoiding a corresponding inclusion in the other or to produce duplicate deductions from the same expenditure that can be offset against income arising in two or more jurisdictions. These arrangements often form part of a broader transaction and it can be difficult to determine which country has in fact lost tax revenue under the arrangement.

Treaty Issues

3. While hybrid mismatch arrangements exploit differences in the domestic laws of different countries they also have implications under double tax treaties: for instance, where a taxpayer seeks to secure treaty benefits from the source country for expenditure incurred under a hybrid mismatch arrangement without a corresponding income inclusion in the residence country. The 1999 report "The Application of the OECD Model Tax Convention to Partnerships"[1] (the Partnership Report) contains an extensive analysis of the application of treaty provisions to partnerships, including in situations where there is a mismatch in the tax treatment of the partnership. Currently, Working Party No. 1 (WP1) is considering a number of possible amendments to the OECD Model Tax Convention (the OECD Model), including a treaty rule under which

1 . Reproduced in Volume II of the full-length version of the OECD Model Tax Convention at page R(15)-1.

income derived by or through an entity or arrangement that is treated as fiscally transparent under the laws of one of the treaty countries shall be considered to be income of a resident of a Contracting State only to the extent that the income is treated, for purposes of taxation by that State, as the income of a resident of that State. In addition, WP1 is examining a treaty provision that would address the issue of how to grant treaty benefits with respect to payments made *by* a hybrid entity.

Previous work on domestic hybrid mismatches

4. Hybrids were also the focus of a report published in 2012 on *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues* (OECD, 2012). This report described the common types of hybrid mismatch arrangements and the effects they aim to achieve as well as the policy issues raised by these arrangements. The report set out a number of options to address hybrid mismatch arrangements, with a focus on domestic law rules which denied their resulting tax benefits. The report recommended that countries introduce anti-hybrid "matching rules" that re-characterise the domestic tax treatment of an entity or instrument under a hybrid mismatch arrangement, or neutralise the tax consequences thereof by aligning the tax treatment under domestic law to the tax treatment in the foreign country. In conjunction with the report on hybrid mismatch arrangements the OECD organised a workshop in Montreal in 2012 where senior tax officials from 16 OECD countries met to discuss recent trends in this area and shared experiences on detection, deterrence and response strategies. The examples covered in this session are based on material covered in these workshops and reports. Panel members will discuss these examples and possible responses to them. The session material concludes with a brief outline of the possible direction of work to be taken in relation to Action Item No. 2.

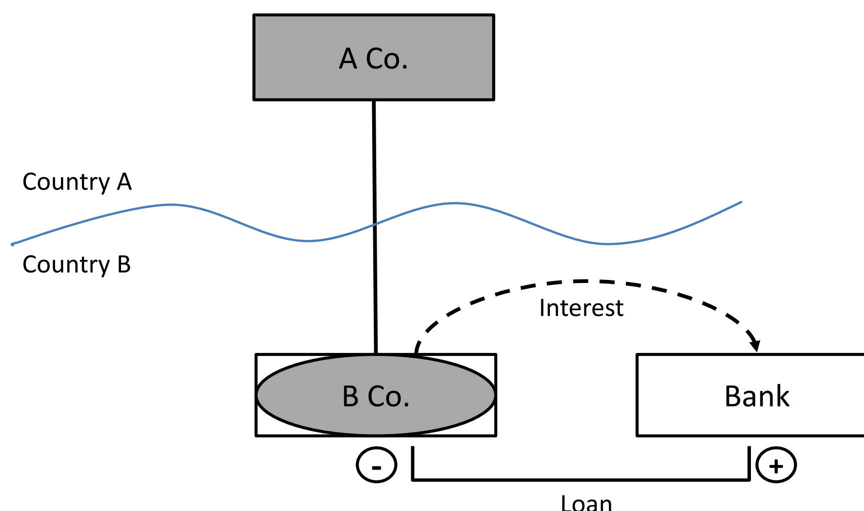
II. EXAMPLES OF HYBRID MISMATCH ARRANGEMENTS

5. While schemes involving hybrid mismatch arrangements may be complex, they generally rely on a number of basic techniques that exploit a difference in the characterisation of an entity or arrangement under the laws of two or more tax jurisdictions. Some of these techniques are illustrated and explained below.

Example 1 - Payments made by a hybrid entity giving rise to a double deduction

6. In this structure A Co holds all the shares of a foreign subsidiary (B Co). B Co is a hybrid entity that is disregarded as a separate entity for Country A tax purposes. B Co borrows from a bank and pays interest on the loan. Because B Co is disregarded for Country A tax purposes, Country A treats A Co as the borrower under the loan. The arrangement therefore gives rise to an interest deduction under the laws of both Country B and Country A.

Figure 1A



7. By itself, the double deduction (**DD**) may not be objectionable from a tax policy standpoint. Allowing a deduction in both jurisdictions is the orthodox response where Country A taxes the worldwide income of its residents, including the income derived through the activities of a disregarded entity located in a foreign jurisdiction. In this case the deductible interest expense must be recognised in both jurisdictions in order to offset the double income inclusion (*i.e.* income which is taxable under the laws of both jurisdictions). This point can be illustrated in the simplified tax calculation set out below:

	Country B Tax			Country A Tax		
Income Calculation	Country B income	300		Country A income	300	
	Expense	(200)		Country B income	300	
				Expense	(200)	
	Net income	100			400	
Tax at 30%			(30)			(120)
Tax credit						30
Net tax payable			(30)			(90)

In this example, assume the structure is that set out in Figure 1A and that A Co has $300 of business income sourced in Country A and B Co has $300 of business income sourced in Country B. The interest expense incurred by B Co is $200. The tax rate in both countries is 30%. Both countries relieve tax on foreign income by providing a credit for such taxes in their own jurisdiction.

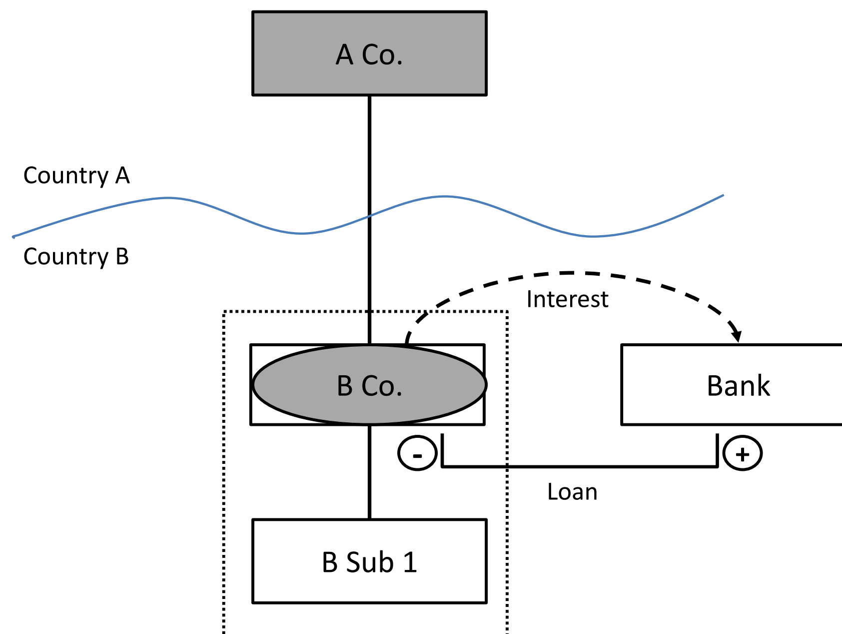
8. The interest expense incurred by B Co is taken into account in calculating the net income of both A Co and B Co. This results in net income subject to worldwide taxation in Country A of $400 producing a $120 tax liability, offset by a credit for foreign taxes, resulting in a net Country A tax payable of $90. The overall effect of the double-deduction is therefore neutral because in each case the deduction is set-off against income that is taxable in both jurisdictions.

9. The double-deduction raises base erosion issues when it is eligible to be set-off against income that is not subject to tax in the other jurisdiction. This effect can be demonstrated by assuming, in the above example, that B Co derives no income. In such a case the interest expense that is deemed to arise in Country A would be set-off against A Co's other income reducing the net tax payable under Country A law to $30.

10. In certain circumstances the reduction in Country A's tax base may only be temporary (*i.e.* it will be reversed out in a subsequent taxable period). This will be the case if B Co derives further double inclusion income in a subsequent period in circumstances where the Country B tax on such income is reduced through, for example, a loss carry-forward or other deduction that reduces the net income subject to tax under the laws of Country B only. This would be the case, under the example illustrated above, if B Co had a net loss in the first taxable period as a consequence of the interest expense and was permitted (or required) to carry forward that loss into the subsequent period to offset B Co's future income. The effect of the loss carry-forward would then be to reduce the amount of Country B tax in the future period, thereby reducing the tax credits available to shelter A Co's Country A tax liability.

In typical structures involving hybrids, however, the deduction is not simply *duplicated* but *separated* so that each piece is offset against income that is not subject to tax under the laws of the other jurisdiction. The following example, taken from the Hybrid Mismatch Report,[2] illustrates a hybrid structure designed to achieve this outcome:

Figure 1B



11. This structure is the same as Figure 1A save that B Co has a subsidiary (B Sub 1) which is the operating entity of the B Group and derives all the Country B income. Because Country B income is now derived through a separate operating subsidiary:

- A Co no longer derives any Country B income and the deduction is therefore automatically set off against Country A income; and

- B Co's deduction can be set off against income that is subject to tax only in Country B through the operation of a tax consolidation regime under Country B law.

12. This structure results in the same overall reduction in Country A taxes but this time the reduction is permanent. This is because the deduction generated under Country B law has been permanently set-off against unrelated Country B income through the tax consolidation regime and will no longer be available to reduce any dual-inclusion income that may be derived by B Co in this or any subsequent period . Any dual-inclusion income derived by B Co in a subsequent period will be subject to tax under Country B law at the full rate and such tax will be fully creditable under Country A law.

13. One policy response to structures that produce double deduction outcomes would be for each jurisdiction to ring-fence the deduction so that it can only be offset against income that is taxable in all the jurisdictions where the deduction is claimed. In order for such ring-fencing to be fully effective, however, this limitation would need to be applied by both jurisdictions. If this is not the case, then there is still scope for the group to manipulate the income subject to tax in the other jurisdiction in order to arbitrage differences in tax rates between jurisdictions and maximise the available tax shelter under the foreign tax credit regime applicable to the parent company. For example, taking the example in Figure 1B above, if Country B (a low

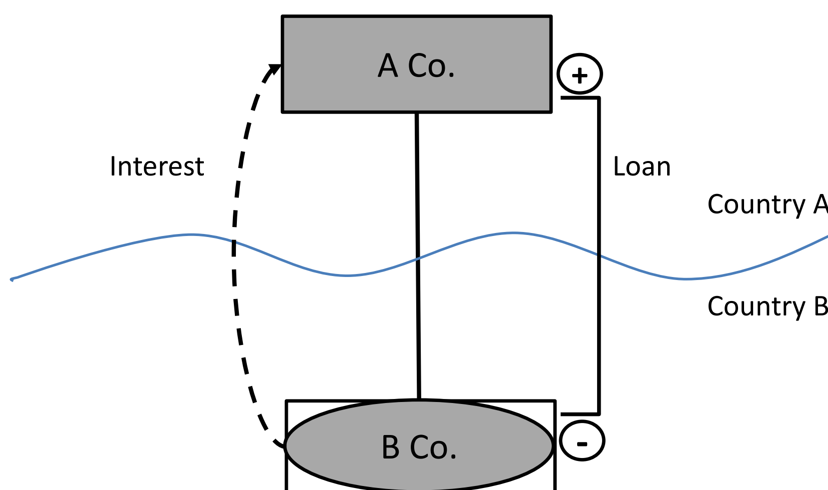
2 Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues (OECD, 2012).

tax country) permits the surrender of the loss from B Co to B Sub 1, while Country A (a high tax country) requires the B Co loss to be carried forward to a subsequent period under a ring-fencing rule, then that leaves scope for B Co to earn dual-inclusion income in a subsequent period that would be subject to a higher effective tax rate under the laws of Country B generating additional foreign tax credits within the limitation threshold set by Country A.

Example 2 - Disregarded payments made by a hybrid entity to a related party

14. This arrangement incorporates a deductible payment made by a hybrid entity to a related party with the result that the payment triggers a tax deduction for the payer with no inclusion for the payee. The most basic structure employing this kind of technique is set out below.

Figure 2



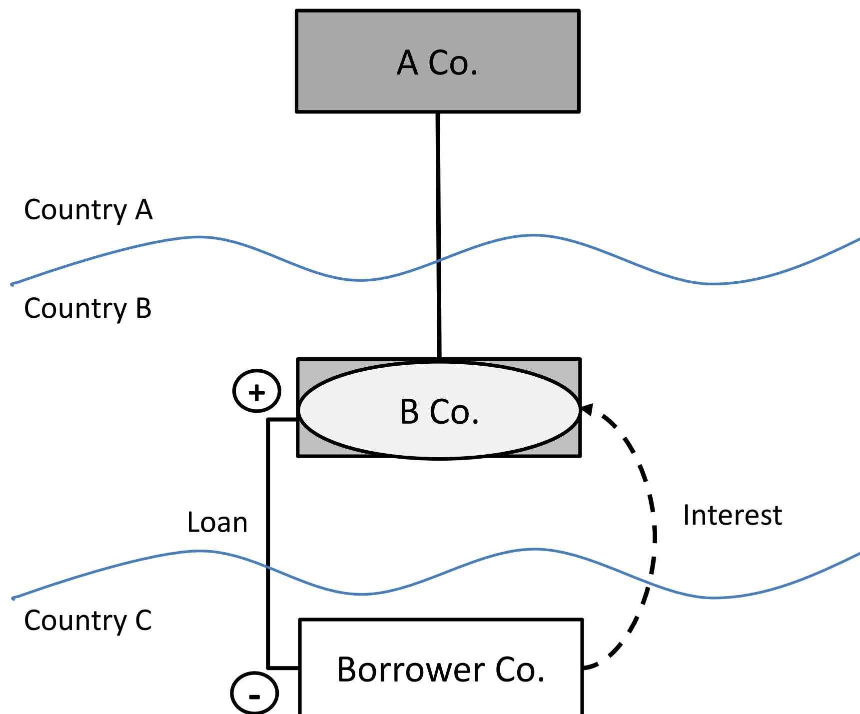
15. Under this structure B Co is a wholly-owned subsidiary of A Co. A Co lends money to B Co. B Co is treated as fiscally transparent under the laws of Country A and (because A Co is the only shareholder in B Co) Country A simply disregards the separate existence of B Co for tax purposes. Disregarding B Co means that the loan (and by extension the interest on the loan) between A Co and B Co is ignored under the laws of Country A. The arrangement therefore gives rise to a deduction, no inclusion (**D/NI**) outcome in that B Co is entitled to an interest deduction under the laws of Country B but there is no corresponding inclusion of that interest income for A Co under the laws of Country A.

16. This technique applies to a relatively narrow category of arrangements because it relies on a payment being made to a related party in the same ownership chain resident in a jurisdiction that treats the payer as transparent for tax purposes. At first glance it may appear that the hybrid element to the structure is the interest payment or loan (which is respected under the laws of Country B and disregarded under the laws of Country A) but, more fundamentally, it is the hybrid nature of the payer that produces the conflict in characterisation under the laws of the two jurisdictions rather than any particular feature of the loan or the interest payment. The arrangement can be thought of substantially similar to the first example set out above, the key difference being that the mechanic achieves a D/NI rather than a DD outcome. From the source countries perspective (Country B in the above example) the overall net outcome is not dis-similar to the payment of a deductible interest to a related party that is not resident in a jurisdiction that imposes income tax on corporations.

Example 3 - Payments made to a reverse hybrid

17. A third basic technique involving the use of hybrid entities is to produce a D/NI outcome by making a payment to a reverse hybrid. The diagram below illustrates a basic structure using this technique.

Figure 3



18. In this structure A Co. establishes a foreign subsidiary (B Co) under the laws of Country B. B Co is treated as transparent for tax purposes under the laws of Country B (*i.e.* the country where it is established) but is treated as a separate taxable entity under the laws of Country A. Such an entity can be described as a "reverse hybrid" from the perspective of Country A. Borrower Co borrows money from B Co. Interest payable under the loan is deductible under the laws of Borrower Co's jurisdiction but is not included in income under Country A or Country B law because neither country treats the payment as income of a resident (or, more specifically, each country treats the income as being derived by a resident of the other state). Under Country B law, B Co is treated as transparent – *i.e.* from Country B's perspective the interest income is considered to be derived by A Co. Under Country A law, B Co is treated as opaque for tax purposes and accordingly the interest income is considered to be derived by B Co.

19. While it produces a similar D/NI outcome, this technique can be applied to a much broader range of structures than those described in Example 2. In particular, the technique does not rely on the payment being made to a related party. The arrangement may also be more difficult for a revenue authority to identify as there may be nothing about the arrangement that provides any evidence of a hybrid element from the borrower's perspective. The effectiveness of this hybrid technique depends on whether Country A has a controlled foreign company or similar anti-deferral rules that would tax the interest payment (*i.e.* B Co's income) in any event.

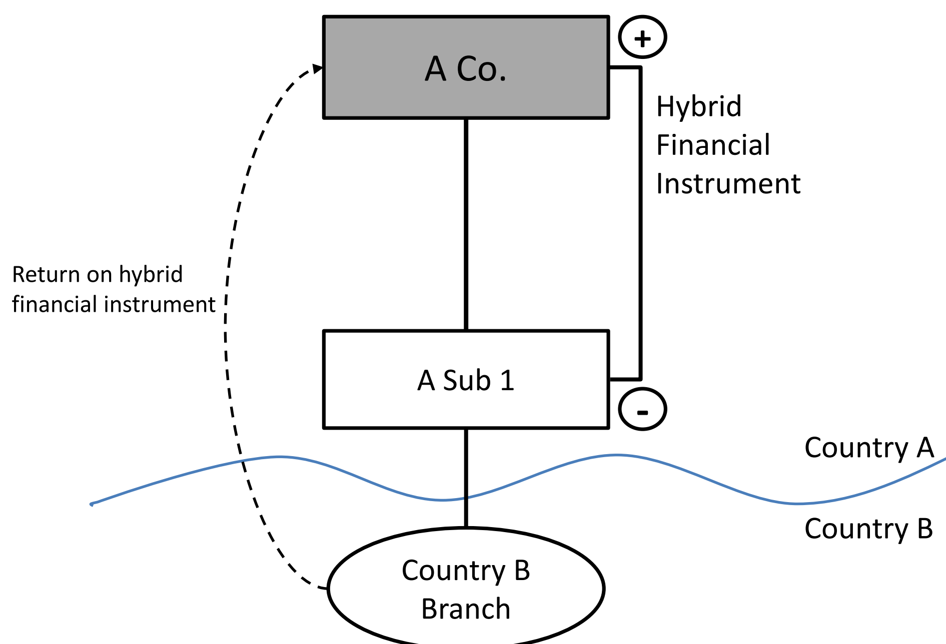
20. Under the principles of the Partnership Report (see particularly Example 7 at paragraphs 69-70), the payment by Borrower Co would not be eligible for relief from Country C withholding tax under a double tax treaty with Country C as the payment is not treated as the income of a resident of Country B (by Country B) or

as the income of a resident of Country A (by Country A). See paragraph 6.3 of the Commentary on Article 1 of the OECD Model.

Example 4 - Payments made by under a hybrid financing instrument that produce DNI outcomes

21. A fourth hybrid technique involves the use of hybrid financing instruments (HFIs). HFIs are instruments that are subject to a different characterisation for tax purposes under the law of to or more jurisdictions (most commonly, as debt from the perspective of the payer and equity from the perspective of the payee). This hybrid treatment results in payments under the HFI being deductible under the laws of the payer's jurisdiction and exempt from tax under the laws of the payee's jurisdiction (or eligible for some other tax relief). A recognised technique incorporating a HFI can be illustrated as follows.

Figure 4



22. A Sub 1, a Country A company, issues a financial instrument to A Co., a related Country A company. For purposes of Country A domestic tax law, the financial instrument is considered to have the nature of an equity investment and gives rise to a return that is characterised as a dividend.

23. A Sub 1 does business in Country B through a branch (permanent establishment). A Sub 1 uses the funds from the issuance of the financial instrument to finance its Country B operations. For purposes of Country B domestic tax law, the financial instrument is considered a debt-claim – *i.e.* to give rise to a return that is characterised as interest. Such interest is a deductible business expense. Country B considers the interest to have its source in Country B because the funds from the issuance of the financial instrument are used to finance a Country B business. Country B applies a withholding tax to interest paid to non-residents, subject to the limitations contained in any applicable tax treaty.

24. HFIs produce outcomes that are similar, in many respects, to the D/NI outcomes discussed in Example 3 above. HFIs are more likely to arise in the context of arrangements between related parties but, at least from the payee's perspective, there is no requirement for the payment under the HFI to be made to a related party. HFIs have a number of key features, however, that distinguish them from the other hybrids described above.

- The DNI outcome is not a consequence of the hybrid nature of the payer or the payee but of the instrument itself;

- Rather than the payment being disregarded or excluded under the laws of the recipient jurisdiction, the payment is subject to a special tax treatment in the recipient jurisdiction;

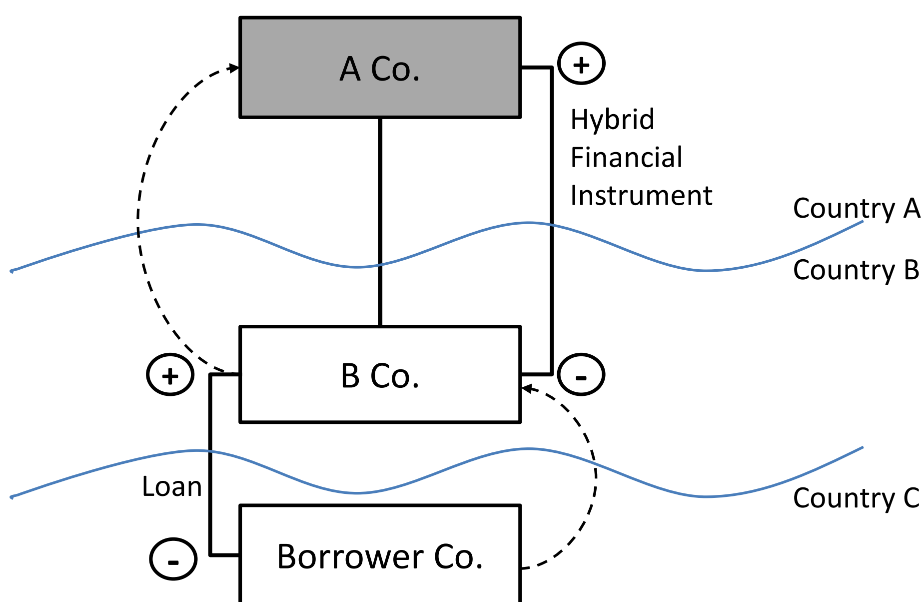
- The payment is more likely to be subject to treaty relief.

25. Under a tax treaty based on the OECD Model, Country B would generally tax the return on the financial instrument in a manner consistent with its characterisation under Country B domestic law (*i.e.* applying its domestic withholding tax, as limited by the interest article of the relevant treaty). Certain modifications to the OECD Model definitions of "dividends" and "interest", however, may permit taxpayers such as A Sub 1 to argue that the return should be characterised as a dividend for treaty purposes and, accordingly, that Country B is precluded from taxing the return under paragraph 5 of Article 10.[3]

Example 5 - Combining techniques to produce more complex structures

26. In practice the hybrid mismatch arrangements identified by countries combine a number of techniques or incorporate the technique into a wider arrangement in order to produce the desired tax effect. Thus, while the techniques described above can be thought of as generating basic D/NI or DD outcomes, these techniques often form part of more elaborate structures where the tax outcomes are more ambiguous. This can make it difficult, in the context of any hybrid mismatch arrangement, to determine which country's tax regime is being exploited by the arrangement. Example 5 provides an illustration of a more complex structure incorporating a hybrid mismatch arrangement.

Figure 5



27. Under this structure, B Co is a wholly-owned subsidiary of A Co. A Co lends money to B Co using a HFI. The payments under the HFI will be exempt from tax under the laws of Country A while being

3. Paragraph 5 of Article 10 of the OECD Model provides as follows:

Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except insofar as such dividends are paid to a resident of that other State or insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment situated in that other State, nor subject the company's undistributed profits to a tax on the company's undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State.

deductible under the laws of Country B. In addition, Borrower Co borrows money from B Co. Interest payable under the loan is deductible under the laws of Borrower Co's jurisdiction (Country C) and included in income by B Co under Country B law. B Co will only be taxed on the spread between the interest income received from Borrower Co and the interest paid to A Co. The result of this structure is a D/NI outcome between Countries A and C. Country B's tax revenue is not affected as interest income and interest deductions offset each other.

28. The D/NI outcome arising under the HFI is effectively shifted into Country C. This is achieved without there being a direct mismatch between the tax outcomes in Country C and Country A. Leaving aside the issues of detection and enforcement, the tax policy outcomes in this example are more ambiguous because there is no hybrid element being exploited in Country C.

III. RESPONDING TO HYBRID MISMATCH ARRANGEMENTS

General Responses

29. There are a number of potential responses to the kinds hybrid mismatch arrangements incorporating the techniques described in the section above. These include, but are not limited to:

- Limitations on deductibility of expenditure (particularly thin-capitalisation rules);
- Domestic withholding taxes on payments made to non-residents;
- Controlled foreign company rules in the parent jurisdiction; and
- General purpose anti-avoidance rules.

30. All these methods, however, may only be partially effective in neutralising the effect of hybrid mismatch arrangements.

Limitations on deductibility of expenditure

31. One of the most basic response strategies for tackling some of the tax planning techniques described in the section above would be to restrict the ability of a resident payer to claim a deduction for payments made to related parties. The most basic form of restriction is on related-party interest.

32. Interest deductibility on lending to related parties raises policy issues from both an inbound and outbound perspective. From an inbound perspective, the tax benefit of an interest deduction in the source state may exceed the recipient's effective rate of tax on the corresponding interest receipt. This difference in effective tax rates could be due to a number of factors, including the fact that the payment has been made under a hybrid mismatch arrangement. From an outbound perspective, a parent company may debt-fund an investment in (for example) a hybrid financing instrument that will produce exempt or deferred income, resulting in base erosion for the parent jurisdiction.

33. The fluidity and fungibility of money makes it a relatively simple exercise to adjust the interest expense of a controlled entity. At the same time the separate entity / arm's length approach provided for under the international tax architecture generally means that tax jurisdictions start from the position under domestic law that the outcomes provided for by these funding structures are to be respected. The challenges posed by interest deductibility, particularly in the related party and cross-border context, have led an increasing number of countries to introduce targeted or general limitations on interest deductibility. While these thin capitalisation and other interest restrictions can be partially effective in addressing some hybrid mismatch techniques, they are not a complete answer for most countries for the following reasons:

- Interest deductibility restrictions such as thin capitalization regimes are not, as a policy matter, designed to distinguish between interest arising under a hybrid mismatch arrangement and other kinds of interest. In particular they fail to address the base erosion issues presented by the double-deduction outcomes identified in Example 2.

- They apply only to interest payments and do not affect other deductible outbound payments (such as rents, royalties etc.).

- Control is not a pre-requisite for the use of certain hybrid mismatch techniques. Interest deductibility restrictions, however, typically only apply to interest payments made by controlled entities.

- In many countries, interest limitation rules apply only to debt funding between related parties while hybrid mismatch arrangements can be entered into between unrelated parties (see Examples 3, 4 and 5).

For these reasons interest limitation rules are not thought to be a comprehensive or precise answer to the issues posed by hybrid mismatch arrangements.

Domestic Withholding Taxes

34. Source countries may be less concerned by the tax revenue leakage from hybrid mismatch arrangements in circumstances where a withholding tax is imposed on the outgoing payment. As noted above, in relation to Example 2, the D/NI outcome achieved through a hybrid mismatch may be similar to the result that would be achieved if the payment had been made to an entity resident in a jurisdiction with no corporate income taxes. As such, some source countries may approach certain hybrid mismatch arrangements as primarily an issue of withholding taxes (i.e. does the arrangement result in a lower rate of withholding tax than would otherwise have applied in the absence of the arrangement).

35. Making changes to a country's withholding tax policy in order to tackle hybrid mismatch arrangements is *prima facie* unattractive from a policy standpoint because of the broad economic impact of withholding taxes (such as their impact on residents' after-tax cost of capital). It is therefore unlikely that many countries will consider it attractive to use withholding taxes to address hybrid mismatch arrangements. In addition there are a number of technical issues in using withholding taxes as a solution to hybrid mismatch arrangements. These include:

- A significant number of withholding taxes are subject to the operation of treaties and other international obligations and it may be difficult for a country to adjust these unilaterally;

- Adjustments to withholding taxes would not necessarily address base erosion in the payee jurisdiction or the kinds of double-deduction structures described in Example 1;

- Some mismatch arrangements (such as those involving hybrid financing instruments) will involve a conflict in characterisation of the instrument itself which may, in turn, affect whether payments made under that instrument are subject to withholding.

Controlled Foreign Company Rules

36. In general terms, controlled foreign company (CFC) rules can be thought of as a species of anti-avoidance rule, or an extension to the tax base of a residence jurisdiction, that taxes shareholders on the income derived by foreign companies in circumstances where, in the absence of such rules, that income would otherwise have been exempt from taxation (under an exemption regime) or only taxed on repatriation (under a credit regime).

37. Because CFC rules are an exception to the general principles for taxing shareholders in foreign entities, their operation is typically confined to taxing certain kinds of income derived by certain kinds of

entities and only in certain circumstances. The detail of CFC rules is often complex and there is considerable variation in CFC rules amongst those countries that have them. Although CFC rules require the income of the foreign company to be included in the income of the resident shareholder, they may have the indirect effect of protecting the tax base of source countries by discouraging the kind of inbound investment that erodes their tax base or that is designed to shift group profit from high to low tax jurisdictions.

38. While there is significant complexity in, and variation between, individual country rules, CFC rules typically contain a number of basic requirements including: control of a foreign entity by a resident taxpayer or taxpayers and "CFC income" of that foreign entity identified as caught by the regime. The CFC income could be income that is of a certain type or nature; that is derived from a certain listed (or unlisted) jurisdiction and / or subject to a lower rate of tax than that in the shareholder's country of residence. While some hybrid mismatch arrangements may already be caught by CFC rules (such as those identified in Example 3), in most cases taxing these arrangements under the CFC rules would require changes to the CFC rules of parent company jurisdictions to include income from hybrid mismatch arrangements within the definition of CFC income. Source countries would then be reliant on the rules being implemented and enforced by the parent company jurisdiction. Other issues include the fact that CFC rules typically only apply to entities that are under the control of residents of another jurisdiction – they would not capture, for example, domestically controlled or widely held companies. On the other hand, some arrangements (such as that identified in Example 5) may be difficult to address without making changes to CFC rules.

Anti-avoidance rules

39. As discussed in the Hybrid Mismatch report,[4] general anti-avoidance rules (including judicial doctrines such as "abuse of law", "economic substance", "fiscal nullity", "business purpose" or "step transactions") can be an effective tool in addressing some hybrid mismatch arrangements, in particular those with circular flows, contrivance or other artificial features. However, the terms of general anti-avoidance rules and the frequent need to show a direct link between the transactions and the avoidance of that particular jurisdiction's tax tend to make it difficult to apply general anti-avoidance rules to hybrid mismatch arrangements. Furthermore, such rules can be cumbersome to administer and more uneven in their application than specific anti-hybrid rules. General anti-avoidance rules are heavily reliant on tax administrations to administer and enforce and do not engender the certainty of outcomes often required in the cross-border context. As a consequence, although some countries have found general anti-avoidance rules to be an effective tool, such rules may not always provide a complete answer to cases of unintended double non-taxation through the use of hybrid mismatch arrangements.

40. A number of countries have introduced anti-avoidance rules aimed at specific transactions or taxpayers which may directly or indirectly have an impact on hybrid mismatch arrangements. For example, countries such as the Netherlands have introduced rules that in certain cases deny a deduction with respect to payments that are not subject to a minimum level of taxation in the country of the recipient. Other countries such as the United Kingdom deny companies a deduction for a finance expense where a main purpose of the lending transaction was to gain a domestic tax advantage.

Anti-hybrid rules

41. Anti-hybrid rules have been introduced by a number of countries. These rules re-characterise hybrid entities and/or instruments, or neutralise the tax consequences thereof (*e.g.* multiple deductions, deduction/no inclusion), by linking their tax treatment under domestic law to the tax treatment in the foreign country, thus eliminating the possibility for mismatches. For example:

- Denmark, Germany, New Zealand, the United Kingdom and the United States have rules which in certain circumstances deny the deduction of expenses which are also deductible in another country.

[4] Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues (OECD, 2012) p 13.

- Denmark and the United Kingdom have rules which in certain cases deny the deductibility of payments that are not taxable at the level of the recipient due to a mismatch in treatment, while Austria, Denmark, Germany (in certain cases), Italy, New Zealand and the United Kingdom have introduced rules that deny an exemption with respect to an item of income which is deductible in another (*i.e.* payor) country (this latter approach has also been agreed upon by the EU Code of Conduct Group (Business Taxation) in relation to hybrid instruments).

42. The experience of countries that have introduced anti-hybrid rules has overall been positive. In general, countries have found that these rules are effective in addressing mismatches in the tax treatment of instruments and entities across different countries. Countries have also noticed that the introduction of these rules may act not only as a deterrent for taxpayers but also eliminates the uncertainty that would otherwise arise regarding the tax treatment of these arrangements.

IV. DIRECTION OF WORK

43. The BEPS report calls for the development of "instruments to put an end to or neutralise the effects of hybrid mismatch arrangements and arbitrage." Some of the issues that need to be considered in the design of anti-hybrid rules include:

- **Scope**: What arrangements should the rules cover (*e.g.* what kinds of hybrid instruments should be caught by the rules) and which jurisdictions should the rules cover (should they apply to the payee or the payer jurisdiction)?

- **Definition**: Should the rules focus on the tools or techniques used in the hybrid mismatch arrangement (*i.e.* a focus on instruments or entities) or should they focus on their intended effect (*i.e.* multiple deductions, deduction with no corresponding inclusion of income or a combination thereof)?

- **Mechanics**: Should the rules apply automatically or only after a notice is issued by the relevant tax administration? Should they operate to re-characterise the arrangement or entity or simply eliminate the anomalous tax outcome?

- **Co-ordination Features**, *e.g.* in cases where two jurisdictions' anti-hybrid rules would apply, which jurisdiction's rules should take priority? In which cases? How should this mechanic work?

44. The work on the design of model anti-hybrid rules will begin by defining what hybrid mismatch arrangements are within their scope and then agree on the best mechanism for neutralising their effects. The model rules will be drafted in a way that seeks to minimise their potential impact on other domestic rules and reduces the potential for conflicts with controlled foreign company rules and the domestic anti-hybrid rules of other countries.

18th ANNUAL TAX TREATY MEETING

Paris, 26-27 September 2013

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PARALLEL SESSION C

PREVENTING TREATY ABUSE

Note: Not for publication or distribution beyond invited Delegations

PREVENTING TREATY ABUSE

PARALLEL SESSION C (Thursday, 26 September 14:30 – 17:30; Room CC 1)

Chair: Natalia ARISTIZABAL MORA (Colombia)

Speakers: Sophie CHATEL (Canada)
Henry LOUIE (United States)
Jacques SASSEVILLE (OECD Secretariat)

The BEPS Action Plan that was made public in July 2013 included the following description of the work to be undertaken in relation to treaty abuse:

> ***Treaty abuse is one of the most important sources of BEPS concerns.*** The Commentary on Article 1 of the OECD Model Tax treaty already includes a number of examples of provisions that could be used to address treaty-shopping situations as well as other cases of treaty abuse, which may give rise to double non-taxation. Tight treaty anti-abuse clauses, coupled with the exercise of taxing rights under domestic laws will contribute to restore source taxation in a number of cases.
>
> > *ACTION 6 –* ***Prevent Treaty Abuse***
> >
> > *Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. Work will also be done to clarify that tax treaties are not intended to be used to generate double non-taxation and to identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country. The work will be coordinated with the work on hybrids.*

In accordance with this description, the following three topics will be examined during this session

A. Options for treaty provisions and/or domestic rules to be examined as part of the work on preventing treaty abuse.

B. Options to clarify that tax treaties are not intended to be used to generate double non-taxation.

C. Tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country

A. Options for treaty provisions and/or domestic rules to be examined as part of the work on preventing treaty abuse

The Commentary on Article 1 of the OECD Model Tax treaty includes a variety of suggested provisions that may be used by countries concerned by different forms of treaty abuses and, primarily treaty shopping.

The speakers will discuss their countries' preferred approach(es) to treaty abuses. They will also discuss how these approaches would address the following simplified treaty abuse scenarios:

Example 1: Assignment of income

1. State T does not have a treaty with State S.

2. Under the State R-State S tax treaty, there is no withholding tax on dividends paid by a company resident of one Contracting State and beneficially owned by a company resident of the other State.

3. TCo, a company resident of State T which owns shares of company SCo, a company listed on the stock exchange of State S, enters into an agreement with RCo, an independent financial institution resident in State R, pursuant to which TCo assigns to RCo the right to the payment of dividends that have been declared but have not yet been paid by SCo.

Example 2: Acquisition of usufruct

1. Under the State T-State S tax treaty, the applicable rate of withholding tax on portfolio dividends is 15%. Under the State R-State S tax treaty, however, the applicable rate of withholding tax on dividends paid by a State S company to a State R resident is 5%.

2. TCo, a company resident in State T, enters into an agreement with RCo, a financial institution resident in State R, pursuant to which RCo acquires the usufruct of the preference shares of SCo, the State S subsidiary of TCo, for a period of three years, giving RCo the right to receive the dividends attached to these preferential shares. TCo retains 100% of the ordinary shares and the voting rights in ZCo.

Example 3: Dividend stripping using Art. 13

1. The State R-State S tax treaty is identical to the OECD Model Tax Convention.

2. RCo, a company resident in State R, owns all the shares of SCo, a company resident of State S. SCo has terminated its business operations and its only asset is 10 000 000 in cash. RCo sells all the shares of SCo to NEWCo, a recently established company resident of State S owned by independent tax advisers, for 10 000 000, an acquisition that is financed through a short-term bank loan guaranteed by RCo. The capital gain is exempt from tax in State R under that country's participation exemption and is exempt from tax in State S under Art. 13(5). SCo then pays a dividend of 10 000 000 to NEWCo (which is exempt from tax under the participation exemption of State S), which uses that money to reimburse the bank loan.

Example 4: Special purpose vehicle financing structure

1. Under most of the tax treaties concluded by State S, the applicable rate of withholding tax on interest is 10%. Under the State R-State S tax treaty, however, interest paid by a resident of a Contracting State and beneficially owned by a resident of the other State are exempt from source taxation. RCo does not tax at source interest paid to non-residents.

2. SCo, a company resident in State S, wishes to raise capital by issuing loan notes on the international market. In order to reduce the source withholding tax that it would otherwise have to deduct from interest paid to non-resident note holders, SCo establishes a wholly owned subsidiary, RCo, in State R. RCo issues loan notes on the international market that are unconditionally and irrevocably guaranteed by SCo. RCo then loans the capital raised to SCo on substantially the same terms.

Example 5: Total Return Swap

3. Under the State T-State S tax treaty and under almost all tax treaties concluded by State S, the applicable rate of withholding tax on portfolio dividends is 15%. Under the State R-State S tax treaty, however, dividends paid by a company resident of a Contracting State that are beneficially owned by a company resident of the other State are exempt from source taxation.

2. TCo, a resident of State T, enters into a Total Return Swap (TRS) contract with RBank, a bank resident of State R, with respect to 10 000 shares of SCo, a publicly listed company resident of State S. The contract provides for a net payment to be made to either TCo or RBank on the basis of the positive or negative return that the owner of 10 000 shares of SCo would realise during the period covered by the contract, taking into account a commission payable to RBank that is roughly equivalent to the interest for that period on an amount corresponding to the market value of 10 000 shares of SCo at the time that the contract is entered into.

After the discussion of these examples by the speakers, participants will be invited to address the following questions:

Questions to be discussed by the participants to the session:

1. What is your country preferred approach to addressing the problem of treaty abuses?

2. Among the various approaches discussed in the Commentary on Article 1, which are the approaches that you would personally agree to include in all of your country's tax treaties?

B. Options to clarify that tax treaties are not intended to be used to generate double non-taxation

Under this second part of the session, the speakers will first be invited to discuss whether and how to clarify that tax treaties are not intended to general double non-taxation. Participants will then be invited to address the following questions

Questions to be discussed by the participants to the session:

3. Would you support a general statement that tax treaties are not intended to be used to generate double non-taxation?

4. Should that statement be qualified in order to deal with certain situations of double non-taxation (e.g. income that the source country decides not to tax by reason of a tax incentive; dividends and capital gains covered by a participation exemption and income derived by pension funds, charitable organisations and some sovereign wealth funds)?

5. What form should that statement take?
   - Changes to the preamble of bilateral tax treaties?
   - Changes to the Commentary?
   - Multilateral declaration?
   - Other?

C. Tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country

Under this last part of the session, the speakers will be invited to discuss the tax policy considerations that their countries take into account when deciding whether or not they should enter into tax treaty negotiations with another country.

Based on these replies, participants will then be invited to discuss the following question:

Questions to be discussed by the participants to the session:

6. Would it be useful to formulate general guidance on the tax policy considerations that should be relevant to the decision of whether or not to conclude a tax treaty with another country and, if yes, what should these tax policy considerations be?

18th ANNUAL TAX TREATY MEETING

Paris, 26-27 September 2013

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PLENARY SESSION 3
SUMMARY OF THE DISCUSSIONS IN THE PARALLEL SESSIONS

Note: Not for publication or distribution beyond invited Delegations

SUMMARY OF THE DISCUSSIONS IN THE PARALLEL SESSIONS

PLENARY SESSION 3 (Friday, 27 September 9:00 – 9:45; Room CC 1)

Chair: Andrew DAWSON (Chair of Working Party 1)

Rapporteurs: Mansor HASSAN (Malaysia)
Živilė KVEDYTĖ (Lithuania)
Natalia Aristizabal MORA (Colombia)

During this session, the rapporteurs will summarise the discussions in the three parallel sessions of the previous afternoon, i.e. session A "Preventing the artificial avoidance of permanent establishment status"; session B "Neutralising the effects of hybrid mismatch arrangements" and session C "Preventing treaty abuse".

18th ANNUAL TAX TREATY MEETING

Paris, 26-27 September 2013

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PLENARY SESSION 4

STRENGTHENING CONTROLLED FOREIGN COMPANY (CFC) RULES

Note: Not for publication or distribution beyond invited Delegations

STRENGTHENING CONTROLLED FOREIGN COMPANY (CFC) RULES

PLENARY SESSION 4

PLENARY SESSION 4 (Friday, 27 September 9:45 – 10:50; Room CC 1)

Chair: Carmel PETERS (New Zealand)

Speakers: Lizeng FENG (People's Republic of China)
Dieter EIMERMANN (Germany)
Sandy RADMANESH (OECD Secretariat)
John PETERSON (OECD Secretariat)

I. Introduction

1. In general terms, CFC rules can be thought of as a species of anti-avoidance rule, or an extension of the tax base of a residence jurisdiction, designed to tax shareholders on the income derived by foreign companies in circumstances where, in the absence of such rules, that income would otherwise have been exempt from taxation (under an exemption regime) or only taxed on repatriation (under a credit regime). The general effect of the CFC regime is to tax shareholders, on a current basis, on mobile income (e.g. capital gains, dividends, interest, royalties and other portfolio flows) derived by a foreign corporation that are subject to a lower rate of effective tax than would have been applied by the shareholder's country of residence. The primary function of CFC rules is to guard against such income being diverted to and accumulated in low tax jurisdictions. CFC rules are often seen as a backstop to transfer pricing in that they address the diversion of profits to low tax entities in circumstances that fall outside the scope of such rules.

2. Because CFC rules are an exception to the general principles for taxing shareholders in foreign entities, the rules must specify the particular kinds of income, entities and circumstances which the regime will apply. The detail of CFC rules is typically complex and there is considerable variation in CFC rules amongst those countries that have them. A number of influences, from a variety of sources, affect the design of CFC rules, including: the nature of the domestic economy and tax system; concerns about international competitiveness; the need to address compliance and administrative burdens and the limitations imposed by treaties and other international obligations. Because CFC rules can affect an investor's after-tax rate of return, they have an impact on the mix of domestic and outbound investment and the source of funds for inbound investment. This raises the risk of market distortions, including the risk that the sources of inbound direct investment will gravitate towards those countries with few (if any) CFC rules.

3. Although CFC rules require the income of the foreign company to be included in the income of the resident shareholder, they may have the indirect effect of protecting the tax base of the source country by discouraging the kind of inbound investment that erodes the tax base of source countries or that is designed to

shift profit from high to low tax jurisdictions. CFC rules can also be used as a mechanism to address certain harmful tax practices by taxing income earned through preferential tax regimes.

4. CFC rules do not operate in isolation. Their effectiveness depends on the application of a number of related rules. For example, a country's definition of tax residency has an important impact on the scope of its CFC rules by marking the boundary between domestic and foreign corporations and also in determining whether the foreign corporation is controlled by residents.

5. While there is significant complexity in, and variation between, individual country rules, CFC rules typically contain a number of basic elements:

- Control of a foreign entity by a resident taxpayer or taxpayers;
- Income of that foreign entity identified as caught by the CFC regime. This could be income that is of a certain type or nature, derived from a certain listed (or unlisted jurisdiction) and / or subject to a lower rate of tax than the shareholder's residence country;
- A method for the attribution of CFC income to the direct or indirect shareholder;
- Measures to avoid double taxation.

6. Recommendations regarding the design of CFC rules may address all these elements. The primary focus of model CFC rules in the context of the BEPS project, however, will be on the first and second items (the kind of controlled foreign entities and income caught by CFC regimes).

II. Work done to date

7. As noted in the BEPS Action Plan,[1] the OECD has not undertaken significant work in the area of CFCs in the past. In 1996 the OECD published a report[2] on the CFC rules of those 14 member countries that had them and made a comparison between different regimes in order to assist in the identification of those areas where simplifications or improvements could be made. That report identified two general approaches to the design of CFC legislation: a "transactional approach" which focussed on the nature of the income derived by the CFC and a "jurisdictional approach" which focussed on the tax residence of the foreign company. The report observed that, in practice, both approaches tended to reach similar results, due to the availability of exemptions for income of foreign companies operating in high tax jurisdictions and income of an active business. The net effect of these regimes, together with their exceptions, was to tax shareholders, on a current basis, on mobile forms of "passive" income derived by a CFC, while exempting income of an active business and income that was likely to be subject to an equivalent level of tax in the foreign jurisdiction. Most of the regimes reviewed in the 1996 report also taxed "base company income" (income derived from low value-added activities in the supply chain, such as selling property or rendering services).

8. CFC rules have become more widespread since the OECD published its report in 1996. A recent report to the International Fiscal Association[3] noted that 22 of the 38 reporting countries had CFC rules, and several more were considering introducing them. The general characteristics of CFC regimes identified in the 1996 report were still evident; most regimes focus on passive income (although some also target certain types of active income) and many regimes target income that is subject to a lower rate of taxation in the foreign state. While the number of CFC regimes around the world has grown, so too has the controversy around them. This growing debate has highlighted uncertainties around the policy goals of a CFC regime (i.e. what these rules are supposed to achieve) and the effectiveness of CFC regimes (whether they do what they are supposed

[1] OECD (2013), Action Plan on Base Erosion and Profit Shifting, OECD, Paris.

[2] OECD (1996), Controlled Foreign Company Legislation, OECD, Paris.

[3] International Fiscal Association, Copenhagen 2013, Volume 98a

to). Challenges to the legality of CFC rules in the international context (including such cases as the Cadbury Schweppes[4] decision) have further complicated the debate as to the appropriate scope of these rules.

III. Material covered in this session

9. Against this somewhat complex background, the BEPS Action plan calls for Working Party No. 11 ("WP 11") to assist the BEPS Project to "develop recommendations regarding the design of controlled foreign company rules". This brief description of the action required leaves a significant amount of detail to be filled in by the WP 11 itself. On 13 August 2013 the Secretariat invited WP 11 delegates to nominate experts from inside their own tax administrations to form a Focus Group to consider the scope and the nature of the work to be done under this Action Item. This Focus Group is not expected to produce an issues paper before November. It is, therefore, not possible, at this point, to predict the future direction of this work. These session materials therefore outline a few basic structures intended to illustrate some of the issues that may need to be considered in context of reviewing the design of CFC rules. Consistent with the overall focus of the BEPS Project, these examples will focus on issues of *control* and the definition of *CFC income.*

Control

10. As set out in paragraph 5, one of the defining features of a CFC regime is that it applies only to *controlled* foreign companies. The original justification for a control requirement was that current taxation of resident's share of a foreign subsidiary's accrued income was only appropriate if the resident shareholder had the power to compel the corporation to distribute that income.[5] Given the types of income taxed under a CFC regime, the control requirement may also be relevant to the question of whether the foreign company is likely to have been structured in such a way so as to reduce the effective tax rate on its significant shareholders. Because of the complexity of CFC rules, countries may also use a control test to limit the scope of these rules and the attendant compliance costs for minority investors. Investors with a minority stake in CFCs may otherwise find it difficult to obtain the information necessary to comply with the requirements of CFC regimes.

Control of what?

11. A number of regimes measure control through holding of shares (or, more particularly, voting rights). Measuring voting control can be complicated and, in certain cases, arbitrary. For this reason CFC regimes may alternatively determine control by reference to a resident's economic interest in the foreign company. Economic tests can focus on ownership of, or entitlement to, shares in a CFC or assets or income of the CFC. Control can also be measured using other tools, such as under UK legislation, which incorporates a test based on the rules for determining group consolidation for accounting purposes.

12. Another method of establishing control relies on de facto control which involves establishing whether, in any particular situation, a resident taxpayer exercises actual control over the affairs of the foreign corporation. Under Italian law, for example, de facto control can be established if an Italian resident maintains a contractual relationship with the foreign entity which empowers him to exercise a dominant influence over it. As this is a question of fact, it involves some degree of uncertainty and may be difficult to establish in any given case. Thus, de facto control may be used as a backstop to rules based on voting control or economic interest.

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[4] European Court of Justice, 12 September 2006 (C-196/04)

[5] OECD (1996), Controlled Foreign Company Legislation, OECD, Paris.

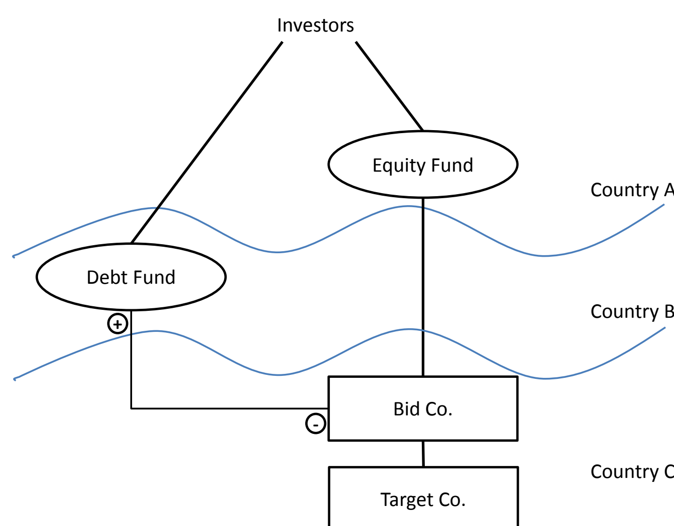
Held by whom?

13. Most CFC regimes capture foreign companies that are both directly and indirectly controlled by a resident. Moreover, countries also typically have constructive ownership or anti-avoidance rules which include interests held by related parties within the control test. In the absence of such rules, taxpayers could fragment share ownership among related parties to avoid the control requirement.

14. A number of regimes also treat a foreign company as a CFC even if the controlling interest is held by a group of unrelated persons. Concentrated ownership requirements such as those in Australia and New Zealand, for example, require control of a foreign entity to be held between a group of five or fewer residents. Concentrated ownership may add some complexity to the rules, and some countries may choose to take into account only resident shareholders with a minimum interest for purposes of the control test.

Example – Private Equity:

15. The following example of a private equity funding structure illustrates some of the challenges in applying a control test.



16. In the example illustrated above, Equity Fund is a fund established in Country A. Investors in the Equity Fund may also invest in an offshore Debt Fund established in Country B. Usually both funds will be managed by the same investment management company. Equity Fund establishes Bid Co (a company incorporated and tax resident in Country C). Bid Co borrows money from Debt Fund and acquires all the shares of Target Co. The structure results in additional interest expense for the target group, which is 'diverted' through Country B. Typically, in these structures, Debt Fund is organised so as to be subject to a low effective rate of tax on such interest income. Issues relevant to the application of the control test under Country A law include:

(i) Transparent vehicles

17. The Equity Fund could be a tax transparent entity under Country A law. This would mean that, even though Fund A is the sole owner of Bid Co, the Equity Fund will not be tax resident in Country A and Country A law is likely to apply its control test to the investors in Fund A rather than to the fund itself. If the underlying investors in the fund do not, in aggregate, meet the control test, the target group may not be caught by the CFC regime of Country A.

(ii) Related but non-controlled entities

18. Fund B derives only interest, which is a classic type of CFC income. Fund B has a substantially similar group of investors and the same management company as Fund A, however Fund B does not appear to be controlled by a resident of Country A. The fact that this interest income may escape taxation under the CFC regime of Country A highlights the fact that CFC rules generally do not capture effectively interests in a foreign company held through different branches of the same corporate group.

(iii) De facto control

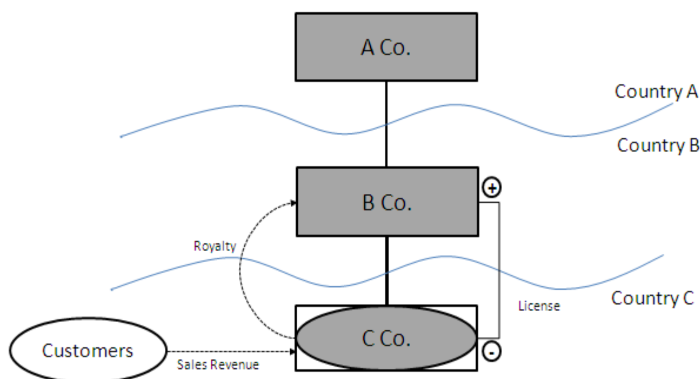
19. Fund A and Fund B are controlled by the same entity (the Management Company). This de facto control may bring the funds and / or the target group within the definition of a CFC under the control test, but this may only occur if Management Co is resident in Country A.

CFC income

20. There is no reason in principle why a CFC regime cannot bring into account all the income of a foreign company with a credit for underlying taxes paid in the foreign jurisdiction. The Brazilian CFC regime adopts this approach, as did the former New Zealand CFC regime up until a recent law change. Most countries, however, have adopted more limited definitions of CFC income that apply only to certain types of income and / or income from certain jurisdictions. The following two examples illustrate some of the challenges in defining CFC income:

Example – Intellectual property holding structures:

21. The example below illustrates a simplified structure used to hold intellectual property. A Co wholly owns B Co, a company resident in Country B. B Co wholly owns C Co, which is resident in Country C. B Co owns intellectual property which it licenses to C Co. C Co then pays royalties to B Co funded from sales of product or services to customers.



22. The arrangement is structured so that the royalty paid under C Co law is not recognised for the purposes of Country A's laws. In the example illustrated, this is achieved by having C Co treated as a disregarded entity under the laws of Country A (i.e. a branch of B Co) so that payments between C Co and B Co are ignored for the purposes of Country A's CFC rules. The structure results in active sales income being generated in C Co at a low effective rate of tax (due to the deductible royalty payments made by C Co to B Co). The royalty payments are, however, generally subject to a low effective rate of taxation in Country B and are invisible from the perspective of Country A's CFC laws (because, in this case, C Co is a disregarded entity). Issues for the treatment of CFC income under Country A's law include:

(i) Taxation of royalties

23. Royalty income is generally included in countries' definitions of CFC income, but there are multiple ways in which income can be generated from the exploitation of intellectual property without being subject to CFC rules. First, there are often exceptions based on the origin of the underlying intellectual property. If the intellectual property is considered to have originated outside the residence country then that may be enough to avoid the resulting royalty income being treated as CFC income.

24. Second, even if royalties are treated as CFC income this does not capture all the different ways that intellectual property can be exploited. A CFC income definition that only captured royalty income would not tax the value-added component of the intellectual property built into the product or services sold to countries. In the example above, Country A treats B Co as exploiting the intellectual property through sales to third party customers without deriving any royalty income.

(ii) Base company income

25. The sales income derived by C Co could be characterised as base company income. This may depend, however, on the nature of the products or services rendered and whether there are significant assets and operations in Country C or value added through the exploitation of underlying intellectual property. Another issue with respect to the sales income may be whether the CFC earns the income in Country A's domestic market without maintaining a permanent establishment there.

(iii) Low tax jurisdiction/ designated jurisdiction

26. CFC legislation typically targets income that is, or is likely to be, taxed at a lower rate than would apply in the residence country. In this example, this would require a comparison between the tax treatment of such income in Country A and in Countries B and C. A simple approach would be to base this comparison on the nominal tax rate in each country. In practice this is unlikely to provide an accurate picture of whether the income has been subject to a lower rate of tax in the foreign jurisdiction. For example, in an effort to attract direct investment and to foster knowledge based industries, a number of states offer tax incentives to locate intellectual property within their jurisdiction. These regimes may offer accelerated deductions for acquired intellectual property (affecting effective tax rates without affecting nominal tax rates).

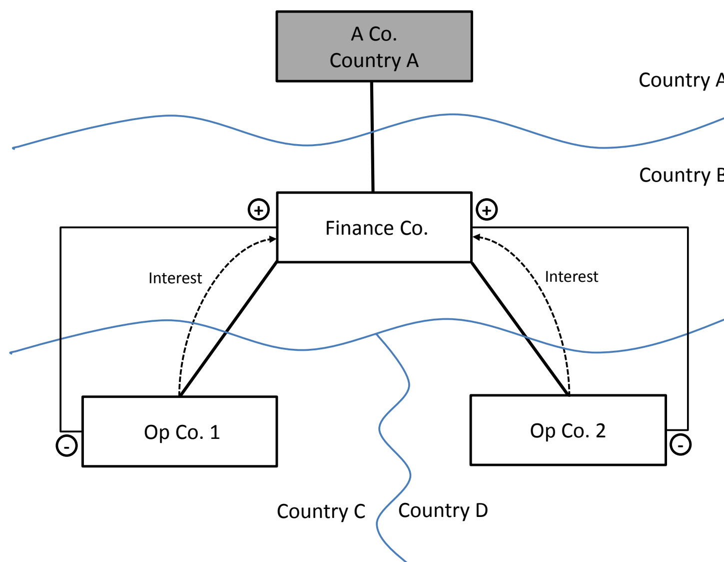
27. Alternatively, Country A could administer its CFC regime based on a list of countries with acceptable or unacceptable tax regimes. While such a list can be useful in minimising the administrative and compliance burden of CFC rules, it can also be distortionary in terms of investment outcomes and is prone to manipulation.

(iv) Characterisation and correcting the effect of mismatches

28. Most countries generally apply their own domestic rules in calculating a CFC's income. In this case, however, application of Country A law results in a mismatch in tax treatment because both Country B and C recognise the separate independent existence of C Co, whereas C Co is treated as a branch of B Co under Country A law. This mismatch results in a royalty lowering the overall effective tax rate of the international group, while avoiding additional tax under Country A's CFC rules.

Example – Financing Company

29. The example illustrated below considers a basic group financing structure. A Co, which is resident in the high-tax jurisdiction Country A, wholly owns Finance Co, resident in Country B (a low tax jurisdiction). Finance Co is holding company Op Co.1 and Op Co. 2 (operating entities resident in Country C and Country D respectively). Finance Co provides funding to Op Co 1 and Op Co 2 in the form of debt and equity.



30. The structure results in a reduction in the net income of the operating companies (due to the interest deductions) with these interest payments typically being subject to a low effective rate of taxation in Country B. Interest is one of the classic types of CFC income. While many countries permit foreign companies to earn a threshold level of interest income as part of an active business without running afoul of their CFC regime, in this case, Finance Co's main activity appears to be deriving interest and dividend income from its subsidiaries. Issues for the taxation of such interest income under Country A law may include:

(i) Active lending business

31. Under certain circumstances, interest income that would otherwise be considered CFC income may be excluded from the application of countries' CFC rules if it is the income of an active lending business. If Finance Co is, for example, part of a banking group, the interest income derived by it may not be subjected to CFC rules because monetary assets are considered intrinsic to the active business of the group or foreign company.[6] Some regimes do, however, impose limitations on the interest that can be received by a CFC from related-party lending.[7]

[6] For example, Germany Canada and U.S; in contrast, under Danish CFC rules interest may be captured even for financial institutions.

[7] For example, Japan and Korea.

(ii) Lending to an active business or entity in same jurisdiction

32. Some countries exempt certain forms of related-party interest from CFC income based on the nature and activities of the payor. Such exclusions include interest received by a CFC resident in the same country as the payer[8] or interest that is directly or indirectly funded from the income of an active business of the related borrower.[9] Under German rules, interest is not treated as CFC income if the CFC raises the capital outside of Germany and lends to either (i) German residents or permanent establishments of non-residents in Germany or (ii) non-residents or permanent establishments outside Germany that are engaged almost exclusively in an active business.

(iii) Characterisation and hybrid mismatch arrangements

33. As in the previous example on royalties, hybrid mismatch arrangements, in the form of hybrid entities and hybrid financial instruments, also raise policy issues that are relevant to the characterisation of CFC income. If the financing arrangements are subject to a hybrid mismatch arrangement which results in a lower overall global rate of tax paid by the group then some of the assumptions underpinning the exemptions from CFC income may not apply to justify the exemption. For example, if Op Co 1 is a transparent entity under Country A law, the interest income derived by Finance Co from Op Co 1 may be disregarded for the purposes of Country A's CFC regime and Finance Co would be treated, from Country A's perspective as conducting an active business in Country C (as a branch). The fact that Finance Co is now treated as the owner of an active business may mean that interest income paid by Op Co 2 to Finance Co falls below the minimum threshold set by Country A's CFC laws.

[8] For example, U.S.

[9] For example, Canada and Spain.

18th ANNUAL TAX TREATY MEETING

Paris, 26-27 September 2013

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PLENARY SESSION 5

LIMITING BASE EROSION VIA INTEREST DEDUCTIONS AND OTHER FINANCIAL PAYMENTS

Note: Not for publication or distribution beyond invited Delegations

LIMITING BASE EROSION VIA INTEREST DEDUCTIONS AND OTHER FINANCIAL PAYMENTS

PLENARY SESSION 5 (Friday, 27 September 11:20 – 12:30; Room CC 1)

Chair: Matias DE SAINTE LORETTE (*France)*

Speakers: Lyn REDMAN (Australia)
Serena FIORELLI (Italy)
Tebogo MATHOSA (South Africa)
Oliver PETZOLD (OECD Secretariat)
John PETERSON (OECD Secretariat)
Joe ANDRUS (OECD Secretariat)

Introduction

The use of interest (and in particular related party interest) is perhaps one of the most simple of the profit-shifting techniques available in international tax planning. The fluidity and fungibility of money makes it a relatively simple exercise to adjust the mix of debt and equity in a controlled entity. At the same time the separate entity / arm's length approach dictated by the international tax architecture requires tax jurisdictions to respect the outcomes provided for by these funding structures under domestic law.

Formulating recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense requires looking at the different areas where debt shifting can be used for tax planning purposes. An exploration of these issues can be made through the following three basic questions:

- To what extent is interest allocation only a related party issue?
- To what extent is interest allocation only an issue for domestic entities controlled from offshore?
- To what extent is interest allocation an issue about shifting debt into entities that can maximize the use of the interest deductions?

This session sets out some simplified examples intended to illustrate the significance of these questions. Each panel member will be asked to comment on these examples from the perspective of their own rules and provide comments on the issues each example raises.

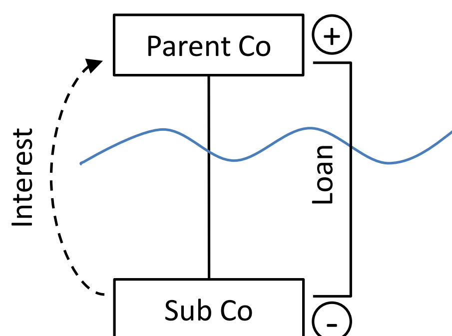
Q1: To what extent is interest allocation only a related party issue?

One of the key design questions of rules limiting interest deductibility is whether the limitation on the deductibility of interest expense should apply only to interest paid to a related party. Rules focused solely on related party financing have advantages from a compliance perspective and they might be considered to be better aligned with other limitations on deductibility (such as transfer pricing). An academic review of thin capitalisation rules, undertaken in 2005, shows that at that time thin capitalisation regimes with a fixed ratio

approach (under which interest expense is denied if a fixed debt-to-equity ratio is exceeded) typically restricted only interest payments to related parties.[1] While in practice related party debt is more prone to manipulation, interest limitation rules that fail to address third party debt are prone to abuse (through back to back financing arrangements for example) and do not address the general incentive to place deductible interest expense into entities located in high tax jurisdictions.

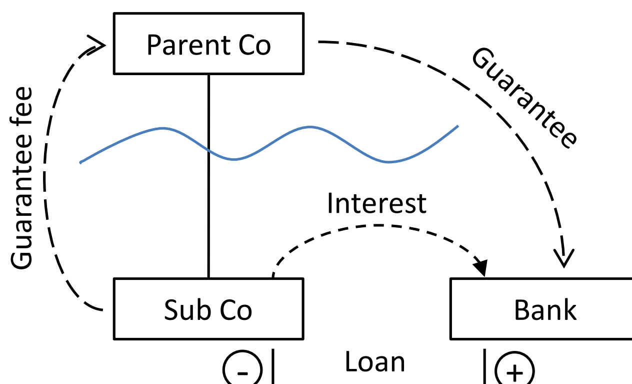
Figure 1 illustrates a related party debt situation where Parent Co provides a loan to Sub Co. Because Parent Co and Sub Co are related parties they typically have a significant degree of freedom in setting both the amount of debt and the interest rate. However, being related parties both lender and borrower operate within the confines of a transfer pricing framework which will prevent Parent Co from charging a non-arm's length interest rate and/or under-capitalising the subsidiary by introducing an excessive amount of debt.

Figure 1. Related party debt



To avoid the application of a transfer pricing thin capitalisation rule which applies to loans from related lenders only, some companies may structure their financing arrangements through third party intermediaries. This can be achieved through (i) a related party depositing an equivalent and corresponding sum with the lending institution (back-to-back arrangements) or (ii) by an affiliate providing a guarantee to the lending institution. Figure 2 illustrates such a situation: Sub Co enters into a loan arrangement with a third party (Bank). As it is a third party financing arrangement it could be assumed that it is at arm's length. However, Parent Co provides a guarantee for the loan to secure a larger loan or lower rate of interest for Sub Co.

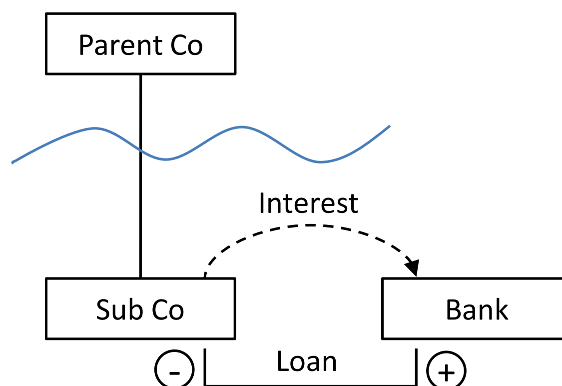
Figure 2. Third party debt with guarantee by controlling owner



1. Buettner et al., 'The impact of thin-capitalization rules on the capital structure of multinational firms' (2012) 96 Journal of Public Economics 930, 932.

Figure 3 illustrates a further situation which presents base erosion issues. In situations where a company is wholly controlled by another company business decisions about where and how much to borrow may be driven by an overall group strategy (which may include tax minimisation). In general terms there is an incentive for the group to locate third party debt at the level of Sub Co, if Sub Co is resident in a high tax jurisdiction, so called external debt shifting.

Figure 3. Wholly owned subsidiary with third party debt



The existence of international debt shifting has been established in a number of academic studies which show that multinational groups use more debt (both related party and third party) than comparable widely held or domestically owned businesses.[2] Studies show that groups leverage more debt on subsidiaries located in high tax countries and that additional debt is typically provided via intra-group loans. They also illustrate that, even though interest deduction limitation rules focusing solely on related party financing are effective in reducing intra-group debt, they lead to an increase of third party debt.[3] Thus, academic studies underline the importance of also focusing on third party debt in cases where there is a controlling owner.

Q2: To what extent is interest allocation an issue for domestic entities controlled from offshore?

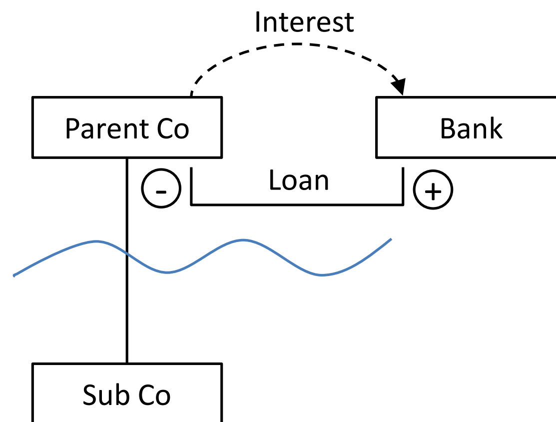
Interest allocation rules are also implicated from an outbound investment perspective. A company, for example may borrow domestically to fund an offshore investment that will produce exempt or deferred income. In such a case it may be more advantageous to borrow domestically particularly if the offshore investment is subject to tax at a lower effective rate than the parent.

Figure 4 illustrates an example where the external debt is located at the level of the parent company. Parent Co, resident in a high tax country, wholly owns Sub Co, resident in a low tax country. Parent Co uses its investment in Sub Co to support the increase in borrowing. Parent Co uses the interest deductions to offset taxable income arising in the parent jurisdiction.

2 . Møen et al., 'International Debt Shifting: Do Multinationals Shift Internal or External Debt?' (2011); Mintz and Weichenrieder, Taxation and the Financial Structure or German Outbound FDI' (2005).

3. Buettner et al., 'The impact of thin-capitalization rules on the capital structure of multinational firms' (2012) 96 Journal of Public Economics 930, 937.

Figure 4. Third party debt with underlying asset securing the loan



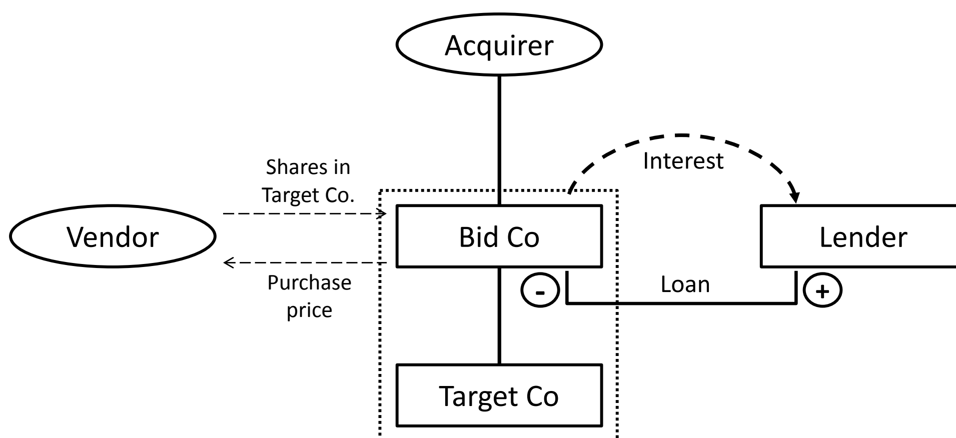
Q3: To what extent is interest allocation an issue about shifting debt into entities that can maximize the use of the interest deductions?

Figures 1 to 4 showed examples of base erosion in a cross-border context. However, the issue of base erosion through interest deductions may also arise in a domestic context. Indeed, more fundamentally, interest allocation issues arise in any situation an entity cannot utilise the deduction and enters into an arrangement to shift the debt to an entity on a higher effective tax rate.

This situation can arise for example in mergers and acquisitions where the acquiring party uses a so called debt-push down structure to set the interest payments against taxable income of the target company.

Figure 5 illustrates such a structure. Acquirer forms an acquisition vehicle (Bid Co) in Target Co's home jurisdiction. Bid Co borrows funds from Lender to acquire Target. The debt push-down can be achieved in a number of ways including (i) the interest on the acquisition debt can be set against Target Co's profits for tax purposes using a domestic group taxation regime or (ii) the acquisition debt is physically pushed into the target through a post-closing merger of Bid Co with Target Co, as a result of which there is one legal person that is both the borrower of the acquisition debt and the generator of profits against which the financing costs on the debt can be set.

Figure 5. Debt-push down structure



18th ANNUAL TAX TREATY MEETING

Paris, 26-27 September 2013

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PLENARY SESSION 6

TAX ISSUES RELATED TO THE DIGITAL ECONOMY

Note: Not for publication or distribution beyond invited Delegations

TAX ISSUES RELATED TO THE DIGITAL ECONOMY

PLENARY SESSION 6 (Friday, 27 September 14:00 – 16:00; Room CC 15)

Chair: Fergus HARRADENCE (United Kingdom)

Speakers: Jacques SASSEVILLE (OECD Secretariat)
Jesse EGGERT (OECD Secretariat)
Piet BATTIAU (OECD Secretariat)

The BEPS Action Plan that was made public in July 2013 included the following description of the work to be undertaken in relation to the digital economy:

> ***BEPS is a concern in the context of the digital economy. The actions will help address these concerns. However, there are specificities that need to be taken into consideration.*** This will require a thorough analysis of the different business models, the ever-changing business landscape and a better understanding of the generation of value in this sector. Moreover, indirect tax aspects should also be considered. Drawing on the other actions included in this plan, a dedicated task force on the digital economy will be established.
>
> > *ACTION 1* – ***Address the Tax Challenges of the Digital Economy***
> >
> > *Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation. Issues to be examined include, but are not limited to, the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation due to the lack of nexus under current international rules, the attribution of value created from the generation of marketable location-relevant data through the use of digital products and services, the characterisation of income derived from new business models, the application of related source rules, and how to ensure the effective collection of VAT/GST with respect to the cross-border supply of digital goods and services. Such work will require a thorough analysis of the various business models in this sector.*

This session will examine some of the main business models used in the digital economy and the difficulties that they raise for the application of existing international tax rules. While tax treaty rules will be the main focus of the discussion, the session will also deal with compliance issues and issues related to indirect taxes.

A key issue is whether it is possible to distinguish the digital economy from other sectors and how such a distinction should be made. One the one hand, the digital economy is often associated to the massive use of (personal) data and the capturing of economic value from information provided by the users of free products. On the other hand, there is a pervasive use of IT in all aspects of the economy, and the digital economy is increasingly permeating each sector, including (more) traditional sectors, like health care and agriculture.

One way to address this difficulty is to describe the digital economy in a narrow sense and to refer to the "digitalisation of the economy" to refer to the impact of IT developments on business in general. A breakdown of enterprises engaged in the digital economy in the narrow sense of the word can be gathered from the OECD Internet Economy Outlook 2012:

(1) *Enterprises that provide fundamental services needed to operate or use the Internet*: which includes firms that exploit fundamental infrastructure such as telecom companies (selling telecom pipes etc.), domain name registrars, data centre operators.

(2) Enterprises that perform online activities related to other IT industries: which includes software and operating systems firms providing software which (increasingly) relies on the Internet for most of its functionalities.

(3) Enterprises that act as Internet intermediaries: which include those that provide the Internet's basic infrastructure and platforms by enabling communication and transactions between third parties. Intermediaries can be commercial or non-commercial in nature, and include:

- Internet service providers (ISP's) – provide access to the Internet to households, business and government;
- data processing and web hosting providers – transform data, prepare data for dissemination, or store data or content on the Internet for others – this also includes cloud computing and related services such as grid computing;
- Internet search engines and portals – aid in navigation on the Internet;
- e-commerce intermediaries – enable online buying or selling of either digital or physical goods and services*;*
- payment intermediaries – process Internet payments; and
- participative networked platforms – aid in creating content and social networking.

(4) Enterprises that provide traditional offline services that are increasingly migrating online (including e-commerce): which includes online stores and other e-commerce platform firms, e-financing providers and internet banking, online travel agencies.

(5) Enterprises active in the "digital content sector": which includes business-to-business (B2B) licensing of content and technology, the selling of user data (e.g. to market research firms), computer and video games, film and video, music, news and online advertising.

Tax issues raised by the digital economy will be introduced by the Secretariat through a discussion of three case studies, which represent simplified descriptions of real-life cases. After the presentation of each of these case studies, the speakers will raise potential tax policy issues which the audience will then be asked to discuss. The discussion will be moderated by the Chair.

CASE 1 - Retail distribution through the Internet

Aco, a company resident of State R, is a worldwide on-line distributor of tangible goods (mostly books) and digital products such as e-books, music and software. It acquires non-exclusive distribution rights for e-books, music and software from copyright holders in several countries.

It sells products to consumers through its well-known web site, which displays the entire range of the products offered by Aco and allows visitors to acquire these products on-line.

Tangible products are delivered through independent courier services whereas digital products are downloaded from Aco's web site to the consumer's computer, once the credit card payment is confirmed.

Aco's mirror web sites are hosted on a number of servers located worldwide. In large markets, Aco's preferred approach is to use dedicated servers located in the country; such servers are located in server farms owned by independent companies. Changes/updates to the software and data stored on the servers are done from State R by Aco's employees.

Bco is a wholly-owned subsidiary of Aco that is resident of State S. It owns and operates a warehouse where the tangible products sold by Aco are stored and from which they are delivered by independent courier services. Bco does not interact with customers of Aco; it is remunerated on a cost-plus basis.

All e-mails and telephone requests to Aco (usually concerning technical problems with the web site or products sold) are handled through a call centre located in State R.

CASE 2 – Advertising through the Internet

Hco, a company resident of State S, operates a number of hardware stores in BigTown, the largest city in State S. In order to better target its advertising, Hco has concluded an agreement with GSco, a resident of a low-tax jurisdiction that is a subsidiary of GPco, a company resident of State T that is the publicly listed holding of a large multinational group that operates a widely-used internet search engine.

The very powerful search engine developed by that multinational group is offered free-of-charge to individuals and institutional users.

Based on the frequency of certain searches and the previous searches made by individual users, GSco is able to offer to companies such as Hco a very well-targeted advertising platform; in fact, the GPco group of companies derives 95% of its revenues from the selling of online advertising.

Through the standard agreement concluded through GSco's web portal, Hco has agreed to pay 0.10 on a "cost-per-click" basis for having its adds displayed on the result pages for a number of search phrases such as "buy tools in BigTown". Hco therefore agrees to pay that amount each time that an internet user clicks on one of its adds displayed as a result of a search

The auction system used by GSco determines where the adds will appear on the page displaying the results of a search (e.g. if 0.10 is the highest bid received by GSco for having an add displayed when someone searches "buy tools in BigTown", Hco's add will appear first).

In 2012, Hco paid 10 000 000 to GSco pursuant to that arrangement.

CASE 3 – Digital marketplace

X is a resident of the State R who is visiting State S. X is a subscriber of the mobile phone services offered by BU&U, a mobile phone operator resident and carrying on business in State R.

Before leaving State R, X downloads an app for restaurants in LargeCity, the capital of State S. He agrees to pay 1.99 for that app, a charge that will appear on the next monthly statement that BU&U will send to X.

That app was developed by Y, an independent developer resident of State T. Y is entitled to 70% of the revenues from the global sales of her app on the digital marketplace. BU&U acts as a marketing, sales and collection agent for Y, who remains the holder of the copyright in the app.

BU&U has a roaming agreement with Purple, a mobile phone operator resident and carrying on business in State S. During his visit to State S, X, using Purple's network, connects to the server of OS, a company resident of State W which has developed (and owns all the rights to) the operating system installed on X's mobile phone. X downloads from OS an app that displays interactive maps of the streets of LargeCity. X agrees to pay 2.99 for that app, an amount which he pays directly to OS with his credit card. OS has acquired all the rights in that that app from Y, who developed it and sold it to OS for a lump-sum amount of 1 000 and contingent payments equal to 50% of the sales revenues from the app.

18th ANNUAL TAX TREATY MEETING

Paris, 26-27 September 2013

******

PLENARY SESSION 7

CHANGING THE RULES

Note: Not for publication or distribution beyond invited Delegations

CHANGING THE RULES

PLENARY SESSION 7 (Friday, 27 September 16:00 – 16:45; Room CC 1)

Chair: Nicola BONUCCI (OECD Secretariat)

Speaker: René MONFROOIJ (OECD Secretariat)

SESSION OUTLINE:

The work that will follow the release of the Action Plan will likely result in recommendations regarding domestic law provisions, as well as in changes to the OECD Model Tax Convention and the Transfer Pricing Guidelines. Changes to the OECD Model Tax Convention do not automatically lead to the modification of bilateral tax treaties using it as a model; left to purely bilateral negotiations, such amendments can take a long time before entering into force. This panel will discuss possible ways that could be used to ensure that changes resulting from the BEPS work are implemented quickly.

A. Background

The delivery of the actions included in the Action Plan on BEPS will result in a number of outputs. Some actions will likely result in Recommendations regarding domestic law provisions, as well as in changes to the Commentary to the OECD Model Tax Convention and the Transfer Pricing Guidelines. Other actions will likely result in changes to the OECD Model Tax Convention.

It could notably lead to:

- the introduction of an anti-treaty abuse provision (action 6)
- changes to the definition of permanent establishment (action 7)
- the introduction of treaty provisions in relation to hybrid mismatch arrangements (action 2)

Changes to the OECD Model Tax Convention do not automatically lead to the amendment of the bilateral tax treaties using it as a model. Therefore, it is necessary for States to subsequently amend their bilateral treaties, notably through the conclusion of amending protocols between the two contracting States. If undertaken on a purely treaty-by-treaty basis, the sheer number of treaties in force would make such a process very lengthy, the more so where countries embark on comprehensive renegotiations of their bilateral tax treaties.

B. Developing a multilateral instrument

One option to overcome this constraint and swiftly implement the measures developed in the course of the BEPS work, in particular those that result in changes to the OECD Model Tax Convention, would be the conclusion of a multilateral instrument amending the bilateral treaties concerned.

At the same time, this option raises a number of tax and public international law issues that need to be analysed in detail before proceeding. If the feasibility study is conclusive, a high level conference could be convened to negotiate and adopt a multilateral instrument to implement the measures developed in the course of the work on BEPS.

Specifically, action 15 of the BEPS Action Plan reads as follows:

> ***Develop a Multilateral Instrument***
>
> *Analyse the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties. On the basis of this analysis, interested Parties will develop a multilateral instrument designed to provide an innovative approach to international tax matters, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution.*

C. ***An informal group of experts on the multilateral instruments***

The preparatory work that needs to be done to identify and analyse the issues that arise from the use of a multilateral instrument to swiftly implement the measures developed in the course of the BEPS work will be done by the OECD Secretariat (CTPA and LEG). This project will benefit from the input of eminent public international law and international tax law experts. An informal group of a limited number of experts in public international law has therefore been set up.

The objective is to deliver, by September 2014, a report on possible ways to swiftly implement, through a multilateral instrument, the measures developed in the course of the work on BEPS. The informal group of experts will work with the Secretariat. Consultation with Working Party no. 1 will also be held. The work will be coordinated by the OECD Legal Directorate together with CTPA.

D. Case study

Assume there are four countries (A, B, C and D) which have concluded bilateral tax treaties among themselves, in particular:

- A and B have treaties with all the other three countries;
- C and D do not have a treaty between them;
- Treaties concluded by A with C and D are identical to the OECD Model;
- Treaties concluded by B with C and D are identical to the UN Model;

A, B, C and D have agreed that their treaties should be amended to reflect changes to the wording of Art. 5(5) and Art. 5(6) of the OECD Model Tax Convention (dealing with the dependent agent PE). They are looking at ways to swiftly amend their treaties to incorporate these changes.

E. Request for input

Delegates are asked to:

- share their experience with multilateral treaties in the tax or other areas, and - if applicable - on how the changes made in the past to the MTC were reflected in the bilateral treaties previously concluded;

- provide their views on how to reflect in bilateral tax treaties the changes that will be made to the MTC as a result of the work on BEPS. The discussion should take into account the three following factors:

    - the time constraint and necessity to implement the measures developed in the course of the work on BEPS as soon as possible after their adoption;

    - the differences that exist from one bilateral treaty to another within the same country;

    - the importance of transparency towards tax payers and need to have accessible information on the changes made to the bilateral treaties.

ANNEX

ACTION PLAN ON
BASE EROSION AND PROFIT SHIFTING

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Acronyms and abbreviations

BEPS	Base erosion and profit shifting
BIAC	Business and Industry Advisory Committee to the OECD
CFA	Committee on Fiscal Affairs
CFC	Controlled foreign company
FDI	Foreign direct investment
FHTP	Forum on Harmful Tax Practices
GDP	Gross domestic product
MAP	Mutual agreement procedure
MNE	Multinational enterprise
OECD	Organisation for Economic Co-operation and Development
PE	Permanent establishment
TFTD	Task Force on Tax and Development
TUAC	Trade Union Advisory Committee to the OECD
UN	United Nations
VAT	Value added tax
VAT/GST	Value added tax/Goods and services tax

Chapter 1

Introduction

Globalisation has benefited our domestic economies. Globalisation is not new, but the pace of integration of national economies and markets has increased substantially in recent years. The free movement of capital and labour, the shift of manufacturing bases from high-cost to low-cost locations, the gradual removal of trade barriers, technological and telecommunication developments, and the ever-increasing importance of managing risks and of developing, protecting and exploiting intellectual property, have had an important impact on the way cross-border activities take place. Globalisation has boosted trade and increased foreign direct investments in many countries. Hence it supports growth, creates jobs, fosters innovation, and has lifted millions out of poverty.

Globalisation impacts countries' corporate income tax regimes. As long ago as the 1920s, the League of Nations recognised that the interaction of domestic tax systems can lead to double taxation with adverse effects on growth and global prosperity. Countries around the world agree on the need to eliminate double taxation and the need to achieve this on the basis of agreed international rules that are clear and predictable, giving certainty to both governments and businesses. International tax law is therefore a key pillar in supporting the growth of the global economy.

As the economy became more globally integrated, so did corporations. Multi-national enterprises (MNE) now represent a large proportion of global GDP. Also, intra-firm trade represents a growing proportion of overall trade. Globalisation has resulted in a shift from country-specific operating models to global models based on matrix management organisations and integrated supply chains that centralise several functions at a regional or global level. Moreover, the growing importance of the service component of the economy, and of digital products that often can be delivered over the Internet, has made it much easier for businesses to locate many productive activities in geographic locations that are distant from the physical location of their customers. These developments have been exacerbated by the increasing

sophistication of tax planners in identifying and exploiting the legal arbitrage opportunities and the boundaries of acceptable tax planning, thus providing MNEs with more confidence in taking aggressive tax positions.

These developments have opened up opportunities for MNEs to greatly minimise their tax burden. This has led to a tense situation in which citizens have become more sensitive to tax fairness issues. It has become a critical issue for all parties:

- *Governments are harmed.* Many governments have to cope with less revenue and a higher cost to ensure compliance. Moreover, Base Erosion and Profit Shifting (BEPS) undermines the integrity of the tax system, as the public, the media and some taxpayers deem reported low corporate taxes to be unfair. In developing countries, the lack of tax revenue leads to critical under-funding of public investment that could help promote economic growth. Overall resource allocation, affected by tax-motivated behaviour, is not optimal.
- *Individual taxpayers are harmed.* When tax rules permit businesses to reduce their tax burden by shifting their income away from jurisdictions where income producing activities are conducted, other taxpayers in that jurisdiction bear a greater share of the burden.
- *Businesses are harmed.* MNEs may face significant reputational risk if their effective tax rate is viewed as being too low. At the same time, different businesses may assess such risk differently, and failing to take advantage of legal opportunities to reduce an enterprise's tax burden can put it at a competitive disadvantage. Similarly, corporations that operate only in domestic markets, including family-owned businesses or new innovative companies, have difficulty competing with MNEs that have the ability to shift their profits across borders to avoid or reduce tax. Fair competition is harmed by the distortions induced by BEPS.

Chapter 2

Background

Taxation is at the core of countries' sovereignty, but the interaction of domestic tax rules in some cases leads to gaps and frictions. When designing their domestic tax rules, sovereign states may not sufficiently take into account the effect of other countries' rules. The interaction of independent sets of rules enforced by sovereign countries creates frictions, including potential double taxation for corporations operating in several countries. It also creates gaps, in cases where corporate income is not taxed at all, either by the country of source or the country of residence, or is only taxed at nominal rates. In the domestic context, coherence is usually achieved through a principle of matching – a payment that is deductible by the payer is generally taxable in the hands of the recipient, unless explicitly exempted. There is no similar principle of coherence at the international level, which leaves plenty of room for arbitrage by taxpayers, though sovereign states have co-operated to ensure coherence in a narrow field, namely to prevent double taxation.

The international standards have sought to address these frictions in a way that respects tax sovereignty, but gaps remain. Since at least the 1920s, it has been recognised that the interaction of domestic tax systems can lead to overlaps in the exercise of taxing rights that in turn can result in double taxation. Countries have long worked and are strongly committed to eliminate such double taxation in order to minimise trade distortions and impediments to sustainable economic growth, while affirming their sovereign right to establish their own tax rules. There are gaps and frictions among different countries' tax systems that were not taken in account in designing the existing standards and which are not dealt with by bilateral tax treaties. The global economy requires countries to collaborate on tax matters in order to be able to protect their tax sovereignty.

In many circumstances, the existing domestic law and treaty rules governing the taxation of cross-border profits produce the correct results and do not give rise to BEPS. International co-operation has resulted in

shared principles and a network of thousands of bilateral tax treaties that are based on common standards and that therefore generally result in the prevention of double taxation on profits from cross-border activities. Clarity and predictability are fundamental building blocks of economic growth. It is important to retain such clarity and predictability by building on this experience. At the same time, instances where the current rules give rise to results that generate concerns from a policy perspective should be tackled.

Over time, the current rules have also revealed weaknesses that create opportunities for BEPS. BEPS relates chiefly to instances where the interaction of different tax rules leads to double non-taxation or less than single taxation. It also relates to arrangements that achieve no or low taxation by shifting profits away from the jurisdictions where the activities creating those profits take place. No or low taxation is not *per se* a cause of concern, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it. In other words, what creates tax policy concerns is that, due to gaps in the interaction of different tax systems, and in some cases because of the application of bilateral tax treaties, income from cross-border activities may go untaxed anywhere, or be only unduly lowly taxed.

The spread of the digital economy also poses challenges for international taxation. The digital economy is characterised by an unparalleled reliance on intangible assets, the massive use of data (notably personal data), the widespread adoption of multi-sided business models capturing value from externalities generated by free products, and the difficulty of determining the jurisdiction in which value creation occurs. This raises fundamental questions as to how enterprises in the digital economy add value and make their profits, and how the digital economy relates to the concepts of source and residence or the characterisation of income for tax purposes. At the same time, the fact that new ways of doing business may result in a relocation of core business functions and, consequently, a different distribution of taxing rights which may lead to low taxation is not *per se* an indicator of defects in the existing system. It is important to examine closely how enterprises of the digital economy add value and make their profits in order to determine whether and to what extent it may be necessary to adapt the current rules in order to take into account the specific features of that industry and to prevent BEPS.

These weaknesses put the existing consensus-based framework at risk, and a bold move by policy makers is necessary to prevent worsening problems. Inaction in this area would likely result in some governments losing corporate tax revenue, the emergence of competing sets of international standards, and the replacement of the current consensus-based framework by unilateral measures, which could lead to global tax chaos marked by the

massive re-emergence of double taxation. In fact, if the Action Plan fails to develop effective solutions in a timely manner, some countries may be persuaded to take unilateral action for protecting their tax base, resulting in avoidable uncertainty and unrelieved double taxation. It is therefore critical that governments achieve consensus on actions that would deal with the above weaknesses. As the G20 Leaders pointed out, "Despite the challenges we all face domestically, we have agreed that multilateralism is of even greater importance in the current climate, and remains our best asset to resolve the global economy's difficulties" (G20, 2012).

In the changing international tax environment, a number of countries have expressed a concern about how international standards on which bilateral tax treaties are based allocate taxing rights between source and residence States. This Action Plan is focused on addressing BEPS. While actions to address BEPS will restore both source and residence taxation in a number of cases where cross-border income would otherwise go untaxed or would be taxed at very low rates, these actions are not directly aimed at changing the existing international standards on the allocation of taxing rights on cross-border income.

The G20 finance ministers called on the OECD to develop an action plan to address BEPS issues in a co-ordinated and comprehensive manner. Specifically, this Action Plan should provide countries with domestic and international instruments that will better align rights to tax with economic activity. As called for in the recent OECD report on BEPS, *Addressing Base Erosion and Profit Shifting* (OECD, 2013a), this Action Plan *(i)* identifies actions needed to address BEPS, *(ii)* sets deadlines to implement these actions and *(iii)* identifies the resources needed and the methodology to implement these actions.

Chapter 3

Action Plan

Fundamental changes are needed to effectively prevent double non-taxation, as well as cases of no or low taxation associated with practices that artificially segregate taxable income from the activities that generate it. A number of actions can be undertaken in order to address the weaknesses in the current rules in an effective and efficient manner. This Action Plan calls for fundamental changes to the current mechanisms and the adoption of new consensus-based approaches, including anti-abuse provisions, designed to prevent and counter base erosion and profit shifting:

New international standards must be designed to ensure the coherence of corporate income taxation at the international level. BEPS issues may arise directly from the existence of loopholes, as well as gaps, frictions or mismatches in the interaction of countries' domestic tax laws. These types of issues generally have not been dealt with by OECD standards or bilateral treaty provisions. There is a need to complement existing standards that are designed to prevent double taxation with instruments that prevent double non-taxation in areas previously not covered by international standards and that address cases of no or low taxation associated with practices that artificially segregate taxable income from the activities that generate it. Moreover, governments must continue to work together to tackle harmful tax practices and aggressive tax planning.

A realignment of taxation and relevant substance is needed to restore the intended effects and benefits of international standards, which may not have kept pace with changing business models and technological developments:

- Whilst bilateral tax treaties have been effective in preventing double taxation, there is a concern that they often fail to prevent double non-taxation that results from interactions among more than two countries. In particular, the involvement of third countries in the bilateral framework established by treaty partners puts a strain on the existing rules, in particular when done via shell companies that have little or no substance in terms of office space, tangible assets and employees.

- In the area of transfer pricing, the rules should be improved in order to put more emphasis on value creation in highly integrated groups, tackling the use of intangibles, risks, capital and other high-risk transactions to shift profits. At the same time, there is consensus among governments that moving to a system of formulary apportionment of profits is not a viable way forward; it is also unclear that the behavioural changes companies might adopt in response to the use of a formula would lead to investment decisions that are more efficient and tax-neutral than under a separate entity approach.

The actions implemented to counter BEPS cannot succeed without further transparency, nor without certainty and predictability for business. The availability of timely, targeted and comprehensive information is essential to enable governments to quickly identify risk areas. While audits remain a key source of relevant information, they suffer from a number of constraints and from a lack of relevant tools for the early detection of aggressive tax planning. As a result, timely, comprehensive and relevant information on tax planning strategies is often unavailable to tax administrations, and new mechanisms to obtain that information must be developed. At the same time, mechanisms should be implemented to provide businesses with the certainty and predictability they need to make investment decisions.

A. Actions

BEPS is a concern in the context of the digital economy. The actions will help address these concerns. However, there are specificities that need to be taken into consideration. This will require a thorough analysis of the different business models, the ever-changing business landscape and a better understanding of the generation of value in this sector. Moreover, indirect tax aspects should also be considered. Drawing on the other actions included in this plan, a dedicated task force on the digital economy will be established.

ACTION 1
Address the tax challenges of the digital economy

Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation. Issues to be examined include, but are not limited to, the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation due to the lack of nexus under current international rules, the attribution of value created from the generation of marketable location-relevant data through the use of digital

products and services, the characterisation of income derived from new business models, the application of related source rules, and how to ensure the effective collection of VAT/GST with respect to the cross-border supply of digital goods and services. Such work will require a thorough analysis of the various business models in this sector.

(i) Establishing international coherence of corporate income taxation

Globalisation means that domestic policies, including tax policy, cannot be designed in isolation. Tax policy is at the core of countries' sovereignty, and each country has the right to design its tax system in the way it considers most appropriate. At the same time, the increasing interconnectedness of domestic economies has highlighted the gaps that can be created by interactions between domestic tax laws. Therefore, there is a need to complement rules to prevent double taxation with a fundamentally new set of standards designed to establish international coherence in corporate income taxation.

Four main issues have been identified:

The BEPS report (OECD, 2013a) calls for the development of "instruments to put an end to or neutralise the effects of hybrid mismatch arrangements and arbitrage". Hybrid mismatch arrangements can be used to achieve unintended double non-taxation or long-term tax deferral by, for instance, creating two deductions for one borrowing, generating deductions without corresponding income inclusions, or misusing foreign tax credit and participation exemption regimes. Country rules that allow taxpayers to choose the tax treatment of certain domestic and foreign entities could facilitate hybrid mismatches. While it may be difficult to determine which country has in fact lost tax revenue, because the laws of each country involved have been followed, there is a reduction of the overall tax paid by all parties involved as a whole, which harms competition, economic efficiency, transparency and fairness.

ACTION 2
Neutralise the effects of hybrid mismatch arrangements

Develop model treaty provisions and recommendations regarding the design of domestic rules to neutralise the effect (e.g. double non-taxation, double deduction, long-term deferral) of hybrid instruments and entities. This may include: (i) changes to the OECD Model Tax Convention to ensure that hybrid instruments and entities (as well as dual resident entities) are not used to obtain the benefits of treaties unduly; (ii) domestic law provisions that prevent exemption or non-recognition for payments that are deductible by the payor; (iii) domestic law provisions that deny a deduction for a payment

that is not includible in income by the recipient (and is not subject to taxation under controlled foreign company (CFC) or similar rules); (iv) domestic law provisions that deny a deduction for a payment that is also deductible in another jurisdiction; and (v) where necessary, guidance on co-ordination or tie-breaker rules if more than one country seeks to apply such rules to a transaction or structure. Special attention should be given to the interaction between possible changes to domestic law and the provisions of the OECD Model Tax Convention. This work will be co-ordinated with the work on interest expense deduction limitations, the work on CFC rules, and the work on treaty shopping.

One area in which the OECD has not done significant work in the past is CFC rules. One of the sources of BEPS concerns is the possibility of creating affiliated non-resident taxpayers and routing income of a resident enterprise through the non-resident affiliate. CFC and other anti-deferral rules have been introduced in many countries to address this issue. However, the CFC rules of many countries do not always counter BEPS in a comprehensive manner. While CFC rules in principle lead to inclusions in the residence country of the ultimate parent, they also have positive spillover effects in *source countries* because taxpayers have no (or much less of an) incentive to shift profits into a third, low-tax jurisdiction.

ACTION 3
Strengthen CFC rules

Develop recommendations regarding the design of controlled foreign company rules. This work will be co-ordinated with other work as necessary.

Another issue raising BEPS concerns is excessive deductible payments such as interest and other financial payments. The deductibility of interest expense can give rise to double non-taxation in both the inbound and outbound investment scenarios. From an inbound perspective, the concern regarding interest expense deduction is primarily with lending from a related entity that benefits from a low-tax regime, to create excessive interest deductions for the issuer without a corresponding interest income inclusion by the holder. The result is that the interest payments are deducted against the taxable profits of the operating companies while the interest income is taxed favourably or not at all at the level of the recipient, and sometimes the group as a whole may have little or no external debt. From an outbound perspective, a company may use debt to finance the production of exempt or deferred income, thereby claiming a current deduction for interest expense while deferring or exempting the related income. Rules regarding the deductibility

of interest expense therefore should take into account that the related interest income may not be fully taxed or that the underlying debt may be used to inappropriately reduce the earnings base of the issuer or finance deferred or exempt income. Related concerns are raised by deductible payments for other financial transactions, such as financial and performance guarantees, derivatives, and captive and other insurance arrangements, particularly in the context of transfer pricing.

ACTION 4
Limit base erosion via interest deductions and other financial payments

Develop recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense, for example through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income, and other financial payments that are economically equivalent to interest payments. The work will evaluate the effectiveness of different types of limitations. In connection with and in support of the foregoing work, transfer pricing guidance will also be developed regarding the pricing of related party financial transactions, including financial and performance guarantees, derivatives (including internal derivatives used in intra-bank dealings), and captive and other insurance arrangements. The work will be co-ordinated with the work on hybrids and CFC rules.

Preferential regimes continue to be a key pressure area. In 1998, the OECD issued a report (OECD, 1998) on harmful tax practices in part based on the recognition that a "race to the bottom" would ultimately drive applicable tax rates on certain mobile sources of income to zero for all countries, whether or not this was the tax policy a country wished to pursue. Agreeing to a set of common rules may in fact help countries to make their sovereign tax policy choices. The underlying policy concerns expressed in the 1998 Report as regards the "race to the bottom" on the mobile income tax base are as relevant today as they were 15 years ago. However, the "race to the bottom" nowadays often takes less the form of traditional ring-fencing and more the form of across the board corporate tax rate reductions on particular types of income (such as income from financial activities or from the provision of intangibles). The BEPS report (OECD, 2013a) calls for proposals to develop "solutions to counter harmful regimes more effectively, taking into account factors such as transparency and substance." In furtherance of this goal, the work of the Forum on Harmful Tax Practices (FHTP) will be refocused to develop more effective solutions.

ACTION 5
Counter harmful tax practices more effectively, taking into account transparency and substance

Revamp the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for any preferential regime. It will take a holistic approach to evaluate preferential tax regimes in the BEPS context. It will engage with non-OECD members on the basis of the existing framework and consider revisions or additions to the existing framework.

(ii) Restoring the full effects and benefits of international standards

Current rules work well in many cases, but they need to be adapted to prevent BEPS that results from the interactions among more than two countries and to fully account for global value chains. The interposition of third countries in the bilateral framework established by treaty partners has led to the development of schemes such as low-taxed branches of a foreign company, conduit companies, and the artificial shifting of income through transfer pricing arrangements. FDI figures show the magnitude of the use of certain regimes to channel investments and intra-group financing from one country to another through conduit structures. In order to preserve the intended effects of bilateral relationships, the rules must be modified to address the use of multiple layers of legal entities inserted between the residence country and the source country.

Existing domestic and international tax rules should be modified in order to more closely align the allocation of income with the economic activity that generates that income:

Treaty abuse is one of the most important sources of BEPS concerns. The Commentary on Article 1 of the OECD Model Tax Convention already includes a number of examples of provisions that could be used to address treaty-shopping situations as well as other cases of treaty abuse, which may give rise to double non-taxation. Tight treaty anti-abuse clauses coupled with the exercise of taxing rights under domestic laws will contribute to restore source taxation in a number of cases.

ACTION 6
Prevent treaty abuse

Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. Work will also be done to clarify that tax treaties are not intended to be used to generate double non-taxation and to identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country. The work will be co-ordinated with the work on hybrids.

The definition of permanent establishment (PE) must be updated to prevent abuses. In many countries, the interpretation of the treaty rules on agency-PE allows contracts for the sale of goods belonging to a foreign enterprise to be negotiated and concluded in a country by the sales force of a local subsidiary of that foreign enterprise without the profits from these sales being taxable to the same extent as they would be if the sales were made by a distributor. In many cases, this has led enterprises to replace arrangements under which the local subsidiary traditionally acted as a distributor by "commissionnaire arrangements" with a resulting shift of profits out of the country where the sales take place without a substantive change in the functions performed in that country. Similarly, MNEs may artificially fragment their operations among multiple group entities to qualify for the exceptions to PE status for preparatory and ancillary activities.

ACTION 7
Prevent the artificial avoidance of PE status

Develop changes to the definition of PE to prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions. Work on these issues will also address related profit attribution issues.

A major issue is transfer pricing and the enforcement of the arm's length principle. Transfer pricing rules serve to allocate income earned by a multinational enterprise among those countries in which the company does business. In many instances, the existing transfer pricing rules, based on the arm's length principle, effectively and efficiently allocate the income of multinationals among taxing jurisdictions. In other instances, however, multinationals have been able to use and/or misapply those rules to separate income from the economic activities that produce that income and to shift it into low-tax environments. This most often results from transfers of intangibles and other mobile assets for less than full value, the

over-capitalisation of lowly taxed group companies and from contractual allocations of risk to low-tax environments in transactions that would be unlikely to occur between unrelated parties.

Alternative income allocation systems, including formula based systems, are sometimes suggested. However, the importance of concerted action and the practical difficulties associated with agreeing to and implementing the details of a new system consistently across all countries mean that, rather than seeking to replace the current transfer pricing system, the best course is to directly address the flaws in the current system, in particular with respect to returns related to intangible assets, risk and over-capitalisation. Nevertheless, special measures, either within or beyond the arm's length principle, may be required with respect to intangible assets, risk and over-capitalisation to address these flaws.

ACTIONS 8, 9, 10
Assure that transfer pricing outcomes are in line with value creation

Action 8 – Intangibles

Develop rules to prevent BEPS by moving intangibles among group members. This will involve: (i) adopting a broad and clearly delineated definition of intangibles; (ii) ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with (rather than divorced from) value creation; (iii) developing transfer pricing rules or special measures for transfers of hard-to-value intangibles; and (iv) updating the guidance on cost contribution arrangements.

Action 9 – Risks and capital

Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members. This will involve adopting transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. The rules to be developed will also require alignment of returns with value creation. This work will be co-ordinated with the work on interest expense deductions and other financial payments.

Action 10 – Other high-risk transactions

Develop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties. This will involve adopting transfer pricing rules or special measures to: (i) clarify the circumstances

in which transactions can be recharacterised; (ii) clarify the application of transfer pricing methods, in particular profit splits, in the context of global value chains; and (iii) provide protection against common types of base eroding payments, such as management fees and head office expenses.

(iii) Ensuring transparency while promoting increased certainty and predictability

Preventing BEPS implies transparency at different levels. Progress on transparency has been made by the Global Forum on Transparency and Exchange of Information for Tax Purposes, but the need for a more holistic approach has been revealed when it comes to preventing BEPS, which implies more transparency on different fronts. Data collection on BEPS should be improved. Taxpayers should disclose more targeted information about their tax planning strategies, and transfer pricing documentation requirements should be less burdensome and more targeted.

Improving the availability and analysis of data on BEPS is critical, including to monitor the implementation of the Action Plan. The BEPS report (OECD, 2013a) notes that there are several studies and data indicating that there is an increased disconnect between the location where value creating activities and investment take place and the location where profits are reported for tax purposes. The report noted that further work needs to be done to evaluate such studies, to develop measures of the scale and effects of BEPS behaviours, and to monitor the impact of measures taken under the Action Plan to address BEPS. This should include outcome-based techniques, which look at measures of the allocation of income across jurisdictions relative to measures of value creating activities, as well as techniques that can be used to monitor the specific issues identified in the Action Plan. Accordingly, it is important to identify the types of data that taxpayers should provide to tax administrators, as well as the methodologies that can be used to analyse these data and to assess the likely economic implications of BEPS behaviours and actions taken to address BEPS.

ACTION 11
Establish methodologies to collect and analyse data on BEPS and the actions to address it

Develop recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis. This will involve developing an economic analysis of the scale and impact of BEPS (including spillover effects across countries) and actions

to address it. The work will also involve assessing a range of existing data sources, identifying new types of data that should be collected, and developing methodologies based on both aggregate (e.g. FDI and balance of payments data) and micro-level data (e.g. from financial statements and tax returns), taking into consideration the need to respect taxpayer confidentiality and the administrative costs for tax administrations and businesses.

Transparency on certain tax planning/transactions is also needed. Comprehensive and relevant information on tax planning strategies is often unavailable to tax administrations. Yet the availability of timely, targeted and comprehensive information is essential to enable governments to quickly identify risk areas. While audits remain a key source of relevant information, they suffer from a number of constraints as tools for the early detection of aggressive tax planning techniques. Measures designed to improve information flow about tax risks to tax administrations and tax policy makers ("disclosure initiatives") may be useful in this regard. Other potentially useful measures include co-operative compliance programmes between taxpayers and tax administrations (see OECD, 2013b).

ACTION 12
Require taxpayers to disclose their aggressive tax planning arrangements

Develop recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures, taking into consideration the administrative costs for tax administrations and businesses and drawing on experiences of the increasing number of countries that have such rules. The work will use a modular design allowing for maximum consistency but allowing for country specific needs and risks. One focus will be international tax schemes, where the work will explore using a wide definition of "tax benefit" in order to capture such transactions. The work will be co-ordinated with the work on co-operative compliance. It will also involve designing and putting in place enhanced models of information sharing for international tax schemes between tax administrations.

Transparency also relates to transfer pricing and value-chain analyses. A key issue in the administration of transfer pricing rules is the asymmetry of information between taxpayers and tax administrations. This potentially undermines the administration of the arm's length principle and enhances opportunities for BEPS. In many countries, tax administrations have little capability of developing a "big picture" view of a taxpayer's global value chain. In addition, divergences between approaches to transfer pricing documentation

requirements leads to significant administrative costs for businesses. In this respect, it is important that adequate information about the relevant functions performed by other members of the MNE group in respect of intra-group services and other transactions is made available to the tax administration.

ACTION 13
Re-examine transfer pricing documentation

Develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business. The rules to be developed will include a requirement that MNE's provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template.

The actions to counter BEPS must be complemented with actions that ensure certainty and predictability for business. Work to improve the effectiveness of the mutual agreement procedure (MAP) will be an important complement to the work on BEPS issues. The interpretation and application of novel rules resulting from the work described above could introduce elements of uncertainty that should be minimised as much as possible. Work will therefore be undertaken in order to examine and address obstacles that prevent countries from solving treaty-related disputes under the MAP. Consideration will also be given to supplementing the existing MAP provisions in tax treaties with a mandatory and binding arbitration provision.

ACTION 14
Make dispute resolution mechanisms more effective

Develop solutions to address obstacles that prevent countries from solving treaty-related disputes under MAP, including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases.

(iv) From agreed policies to tax rules: the need for a swift implementation of the measures

There is a need to consider innovative ways to implement the measures resulting from the work on the BEPS Action Plan. The delivery of the actions included in the Action Plan on BEPS will result in a number of outputs. Some actions will likely result in recommendations regarding domestic law

provisions, as well as in changes to the Commentary to the OECD Model Tax Convention and the Transfer Pricing Guidelines. Other actions will likely result in changes to the OECD Model Tax Convention. This is for example the case for the introduction of an anti-treaty abuse provision, changes to the definition of permanent establishment, changes to transfer pricing provisions and the introduction of treaty provisions in relation to hybrid mismatch arrangements. Changes to the OECD Model Tax Convention are not directly effective without amendments to bilateral tax treaties. If undertaken on a purely treaty-by-treaty basis, the sheer number of treaties in effect may make such a process very lengthy, the more so where countries embark on comprehensive renegotiations of their bilateral tax treaties. A multilateral instrument to amend bilateral treaties is a promising way forward in this respect.

ACTION 15
Develop a multilateral instrument

Analyse the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties. On the basis of this analysis, interested Parties will develop a multilateral instrument designed to provide an innovative approach to international tax matters, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution.

B. Timing

Addressing BEPS is critical for most countries and must be done in a timely manner, not least to prevent the existing consensus-based framework from unravelling. The pace of the project must be rapid so that concrete actions can be delivered quickly. At the same time, governments also need time to complete the necessary technical work and achieve widespread consensus. Against this background, it is expected that the Action Plan will largely be completed in a two-year period, recognising that some actions will be addressed faster as work has already been advanced, while others might require longer-term work:

- Amongst the actions more likely to be delivered in *12-18 months* are those in the areas of hybrid mismatch arrangements, treaty abuse, the transfer pricing aspects of intangibles, documentation requirements for transfer pricing purposes, a report identifying the issues raised by the digital economy and possible actions to address them, as well as part of the work on harmful tax practices.

- Actions to be delivered *in two years* relate to CFC rules, interest deductibility, preventing the artificial avoidance of PE status, the transfer pricing aspects of intangibles, risks, capital and high-risk transactions, part of the work on harmful tax practices, data collection, mandatory disclosure rules, and dispute resolution.
- Actions that may require *more than two years* include the transfer pricing aspects of financial transactions, part of the work on harmful tax practices and the development of a multilateral instrument to swiftly implement changes to bilateral treaties. Although these actions are considered as key items of the Action Plan, it is recognised that this work will have to be developed in different stages, starting with a thorough analysis of the issues.

Annex A contains tables summarising the different actions and indicating the expected timeline for completing them.

C. Methodology

The BEPS project marks a turning point in the history of international co-operation on taxation. As the current consensus-based framework is at risk, it is critical that a proper methodology be adopted to make sure that the work is inclusive and effective, takes into account the perspective of developing countries and benefits from the input of business and the civil society at large.

(i) An inclusive and effective process: launching the OECD/G20 BEPS Project and involving developing countries

Accomplishing the actions set forth in this Action Plan requires an effective and comprehensive process that involves all relevant stakeholders. To this end, and in order to facilitate greater involvement of major non-OECD economies, the "BEPS Project" will be launched. In light of the strong interest and support expressed on several occasions by the G20, it is proposed that interested G20 countries that are not members of the OECD will be invited to be part of the project as Associates, i.e. on an equal footing with OECD members (including at the level of the subsidiary bodies involved in the work on BEPS), and will be expected to associate themselves with the outcome of the BEPS Project. Other non-members could be invited to participate as Invitees on an ad hoc basis.

Developing countries also face issues related to BEPS, though the issues may manifest differently given the specificities of their legal and administrative frameworks. The UN participates in the tax work of the OECD and will certainly provide useful insights regarding the particular

concerns of developing countries. The Task Force on Tax and Development (TFTD) and the OECD Global Relations Programme will provide a useful platform to discuss the specific BEPS concerns in the case of developing countries and explore possible solutions with all stakeholders. Finally, existing mechanisms such as the Global Fora on Tax Treaties, on Transfer Pricing, on VAT and on Transparency and Exchange of Information for Tax Purposes will all be used to involve all countries in the discussions regarding possible technical solutions.

(ii) Efficient process

Political expectations are very high in most countries and the results and impact of the BEPS work must be in line with these political expectations. The BEPS Project will draw on the expertise of the Committee on Fiscal Affairs (CFA) and of its subsidiary bodies. While the practices of these subsidiary bodies are well-adapted to developing consensus on routine work, they require some adaptation to deliver results within the expected timelines. There is thus a need to find ways to accomplish the work quickly while seeking consensus. Each subsidiary body will need to seek new ways to find consensus as quickly as possible. This may involve, for example, setting up focus groups for the actions for which it is responsible. Each focus group could be composed of a relatively small number of delegates, with one country taking the lead and acting as co-ordinator. The focus groups would work actively in between meetings of the relevant subsidiary body, using remote working methods and reducing physical meetings to a minimum, to prepare drafts which would be circulated to and approved by the subsidiary body.

(iii) Consulting with business and civil society

Consultation with non-governmental stakeholders is also key. Business and civil society representatives will be invited to comment on the different proposals developed in the course of the work. The OECD's core relationship with civil society is through the Business and Industry Advisory Committee (BIAC) and the Trade Union Advisory Committee (TUAC) to the OECD. Non-governmental organisations, think tanks, and academia will also be consulted. The OECD's work on the different items of the Action Plan will continue to include a transparent and inclusive consultation process, and a high-level policy dialogue with all interested parties will be organised on an annual basis.

References

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Annex A

Overview of the actions and timelines

This annex contains summary tables indicating the timeline for the actions included in the Action Plan.

Table A.1. **Summary of the BEPS Action Plan by action**

Action	Description	Expected output	Deadline
1 – Address the tax challenges of the digital economy	*Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation. Issues to be examined include, but are not limited to, the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation due to the lack of nexus under current international rules, the attribution of value created from the generation of marketable location-relevant data through the use of digital products and services, the characterisation of income derived from new business models, the application of related source rules, and how to ensure the effective collection of VAT/GST with respect to the cross-border supply of digital goods and services. Such work will require a thorough analysis of the various business models in this sector.*	Report identifying issues raised by the digital economy and possible actions to address them	September 2014

Table A.1. **Summary of the BEPS Action Plan by action** *(continued)*

Action	Description	Expected output	Deadline
2 – Neutralise the effects of hybrid mismatch arrangements	*Develop model treaty provisions and recommendations regarding the design of domestic rules to neutralise the effect (e.g. double non-taxation, double deduction, long-term deferral) of hybrid instruments and entities. This may include: (i) changes to the OECD Model Tax Convention to ensure that hybrid instruments and entities (as well as dual resident entities) are not used to obtain the benefits of treaties unduly; (ii) domestic law provisions that prevent exemption or non-recognition for payments that are deductible by the payor; (iii) domestic law provisions that deny a deduction for a payment that is not includible in income by the recipient (and is not subject to taxation under controlled foreign company (CFC) or similar rules); (iv) domestic law provisions that deny a deduction for a payment that is also deductible in another jurisdiction; and (v) where necessary, guidance on co-ordination or tie-breaker rules if more than one country seeks to apply such rules to a transaction or structure. Special attention should be given to the interaction between possible changes to domestic law and the provisions of the OECD Model Tax Convention. This work will be co-ordinated with the work on interest expense deduction limitations, the work on CFC rules, and the work on treaty shopping.*	Changes to the Model Tax Convention	September 2014
		Recommendations regarding the design of domestic rules	September 2014
3 – Strengthen CFC rules	*Develop recommendations regarding the design of controlled foreign company rules. This work will be co-ordinated with other work as necessary.*	Recommendations regarding the design of domestic rules	September 2015

Table A.1. **Summary of the BEPS Action Plan by action** *(continued)*

Action	Description	Expected output	Deadline
4 – Limit base erosion via interest deductions and other financial payments	*Develop recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense, for example through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income, and other financial payments that are economically equivalent to interest payments. The work will evaluate the effectiveness of different types of limitations. In connection with and in support of the foregoing work, transfer pricing guidance will also be developed regarding the pricing of related party financial transactions, including financial and performance guarantees, derivatives (including internal derivatives used in intra-bank dealings), and captive and other insurance arrangements. The work will be co-ordinated with the work on hybrids and CFC rules.*	Recommendations regarding the design of domestic rules	September 2015
		Changes to the Transfer Pricing Guidelines	December 2015
5 – Counter harmful tax practices more effectively, taking into account transparency and substance	*Revamp the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for any preferential regime. It will take a holistic approach to evaluate preferential tax regimes in the BEPS context. It will engage with non-OECD members on the basis of the existing framework and consider revisions or additions to the existing framework.*	Finalise review of member country regimes	September 2014
		Strategy to expand participation to non-OECD members	September 2015
		Revision of existing criteria	December 2015
6 – Prevent treaty abuse	*Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. Work will also be done to clarify that tax treaties are not intended to be used to generate double non-taxation and to identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country. The work will be co-ordinated with the work on hybrids.*	Changes to the Model Tax Convention	September 2014
		Recommendations regarding the design of domestic rules	September 2014

Table A.1. **Summary of the BEPS Action Plan by action** *(continued)*

Action	Description	Expected output	Deadline
7 – Prevent the artificial avoidance of PE status	*Develop changes to the definition of PE to prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions. Work on these issues will also address related profit attribution issues.*	Changes to the Model Tax Convention	September 2015
8 – Assure that transfer pricing outcomes are in line with value creation: intangibles	*Develop rules to prevent BEPS by moving intangibles among group members. This will involve: (i) adopting a broad and clearly delineated definition of intangibles; (ii) ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with (rather than divorced from) value creation; (iii) developing transfer pricing rules or special measures for transfers of hard-to-value intangibles; and (iv) updating the guidance on cost contribution arrangements.*	Changes to the Transfer Pricing Guidelines and possibly to the Model Tax Convention	September 2014
		Changes to the Transfer Pricing Guidelines and possibly to the Model Tax Convention	September 2015
9 – Assure that transfer pricing outcomes are in line with value creation: risks and capital	*Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members. This will involve adopting transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. The rules to be developed will also require alignment of returns with value creation. This work will be co-ordinated with the work on interest expense deductions and other financial payments.*	Changes to the Transfer Pricing Guidelines and possibly to the Model Tax Convention	September 2015
10 – Assure that transfer pricing outcomes are in line with value creation: other high-risk transactions	*Develop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties. This will involve adopting transfer pricing rules or special measures to: (i) clarify the circumstances in which transactions can be recharacterised; (ii) clarify the application of transfer pricing methods, in particular profit splits, in the context of global value chains; and (iii) provide protection against common types of base eroding payments, such as management fees and head office expenses.*	Changes to the Transfer Pricing Guidelines and possibly to the Model Tax Convention	September 2015

Table A.1. **Summary of the BEPS Action Plan by action** *(continued)*

Action	Description	Expected output	Deadline
11 – Establish methodologies to collect and analyse data on BEPS and the actions to address it	*Develop recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis. This will involve developing an economic analysis of the scale and impact of BEPS (including spillover effects across countries) and actions to address it. The work will also involve assessing a range of existing data sources, identifying new types of data that should be collected, and developing methodologies based on both aggregate (e.g. FDI and balance of payments data) and micro-level data (e.g. from financial statements and tax returns), taking into consideration the need to respect taxpayer confidentiality and the administrative costs for tax administrations and businesses.*	Recommendations regarding data to be collected and methodologies to analyse them	September 2015
12 – Require taxpayers to disclose their aggressive tax planning arrangements	*Develop recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures, taking into consideration the administrative costs for tax administrations and businesses and drawing on experiences of the increasing number of countries that have such rules. The work will use a modular design allowing for maximum consistency but allowing for country specific needs and risks. One focus will be international tax schemes, where the work will explore using a wide definition of "tax benefit" in order to capture such transactions. The work will be co-ordinated with the work on co-operative compliance. It will also involve designing and putting in place enhanced models of information sharing for international tax schemes between tax administrations.*	Recommendations regarding the design of domestic rules	September 2015

Table A.1. **Summary of the BEPS Action Plan by action** *(continued)*

Action	Description	Expected output	Deadline
13 – Re-examine transfer pricing documentation	*Develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business. The rules to be developed will include a requirement that MNE's provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template.*	Changes to Transfer Pricing Guidelines and Recommendations regarding the design of domestic rules	September 2014
14 – Make dispute resolution mechanisms more effective	*Develop solutions to address obstacles that prevent countries from solving treaty-related disputes under MAP, including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases.*	Changes to the Model Tax Convention	September 2015
15 – Develop a multilateral instrument	*Analyse the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties. On the basis of this analysis, interested Parties will develop a multilateral instrument designed to provide an innovative approach to international tax matters, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution.*	Report identifying relevant public international law and tax issues	September 2014
		Develop a multilateral instrument	December 2015

Table A.2. **Summary of the BEPS Action Plan by timeline**

BY SEPTEMBER 2014		
Action	Description	Expected Output
Address the tax challenges of the digital economy	*Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation. Issues to be examined include, but are not limited to, the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation due to the lack of nexus under current international rules, the attribution of value created from the generation of marketable location-relevant data through the use of digital products and services, the characterisation of income derived from new business models, the application of related source rules, and how to ensure the effective collection of VAT/GST with respect to the cross-border supply of digital goods and services. Such work will require a thorough analysis of the various business models in this sector.*	Report identifying issues raised by the digital economy and possible actions to address them
Neutralise the effects of hybrid mismatch arrangements	*Develop model treaty provisions and recommendations regarding the design of domestic rules to neutralise the effect (e.g. double non-taxation, double deduction, long-term deferral) of hybrid instruments and entities. This may include: (i) changes to the OECD Model Tax Convention to ensure that hybrid instruments and entities (as well as dual resident entities) are not used to obtain the benefits of treaties unduly; (ii) domestic law provisions that prevent exemption or non-recognition for payments that are deductible by the payor; (iii) domestic law provisions that deny a deduction for a payment that is not includible in income by the recipient (and is not subject to taxation under controlled foreign company (CFC) or similar rules); (iv) domestic law provisions that deny a deduction for a payment that is also deductible in another jurisdiction; and (v) where necessary, guidance on co-ordination or tie-breaker rules if more than one country seeks to apply such rules to a transaction or structure. Special attention should be given to the interaction between possible changes to domestic law and the provisions of the OECD Model Tax Convention. This work will be co-ordinated with the work on interest expense deduction limitations, the work on CFC rules, and the work on treaty shopping.*	Changes to the Model Tax Convention Recommendations regarding the design of domestic rules

Table A.2. **Summary of the BEPS Action Plan by timeline** *(continued)*

BY SEPTEMBER 2014		
Action	Description	Expected Output
Counter harmful tax practices more effectively, taking into account transparency and substance – *phase 1*	*Revamp the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for any preferential regime. It will take a holistic approach to evaluate preferential tax regimes in the BEPS context. It will engage with non-OECD members on the basis of the existing framework and consider revisions or additions to the existing framework.*	Finalise review of member country regimes
Prevent treaty abuse	*Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. Work will also be done to clarify that tax treaties are not intended to be used to generate double non-taxation and to identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country. The work will be co-ordinated with the work on hybrids.*	Changes to the Model Tax Convention Recommendations regarding the design of domestic rules
Assure that transfer pricing outcomes are in line with value creation: intangibles – *phase 1*	*Develop rules to prevent BEPS by moving intangibles among group members. This will involve: (i) adopting a broad and clearly delineated definition of intangibles; (ii) ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with (rather than divorced from) value creation; …*	Changes to the Transfer Pricing Guidelines and possibly to the Model Tax Convention
Re-examine transfer pricing documentation	*Develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business. The rules to be developed will include a requirement that MNE's provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template.*	Changes to Transfer Pricing Guidelines and Recommendations regarding the design of domestic rules

Table A.2. **Summary of the BEPS Action Plan by timeline** *(continued)*

BY SEPTEMBER 2014		
Action	Description	Expected Output
Develop a multilateral instrument *– phase 1*	*Analyse the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties. On the basis of this analysis, interested Parties will develop a multilateral instrument designed to provide an innovative approach to international tax matters, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution.*	Report identifying relevant public international law and tax issues

BY SEPTEMBER 2015		
Action	Description	Expected Output
Strengthen CFC rules	*Develop recommendations regarding the design of controlled foreign company rules. This work will be co-ordinated with other work as necessary.*	Recommendations regarding the design of domestic rules
Limit base erosion via interest deductions and other financial payments	*Develop recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense, for example through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income, and other financial payments that are economically equivalent to interest payments. The work will evaluate the effectiveness of different types of limitations. In connection with and in support of the foregoing work, transfer pricing guidance will also be developed regarding the pricing of related party financial transactions, including financial and performance guarantees, derivatives (including internal derivatives used in intra-bank dealings), and captive and other insurance arrangements. The work will be co-ordinated with the work on hybrids and CFC rules.*	Recommendations regarding the design of domestic rules

Table A.2. **Summary of the BEPS Action Plan by timeline** *(continued)*

BY SEPTEMBER 2015		
Action	Description	Expected Output
Counter harmful tax practices more effectively, taking into account transparency and substance – *phase 2*	*Revamp the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for any preferential regime. It will take a holistic approach to evaluate preferential tax regimes in the BEPS context. It will engage with non-OECD members on the basis of the existing framework and consider revisions or additions to the existing framework.*	Strategy to expand participation to non-OECD members
Prevent the artificial avoidance of PE status	*Develop changes to the definition of PE to prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions. Work on these issues will also address related profit attribution issues.*	Changes to the Model Tax Convention
Assure that transfer pricing outcomes are in line with value creation: intangibles – *phase 2*	*Develop rules to prevent BEPS by moving intangibles among group members. This will involve: … (iii) developing transfer pricing rules or special measures for transfers of hard-to-value intangibles; and (iv) updating the guidance on cost contribution arrangements.*	Changes to the Transfer Pricing Guidelines and possibly to the Model Tax Convention
Assure that transfer pricing outcomes are in line with value creation: risks and capital	*Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members. This will involve adopting transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. The rules to be developed will also require alignment of returns with value creation. This work will be co-ordinated with the work on interest expense deductions and other financial payments.*	Changes to the Transfer Pricing Guidelines and possibly to the Model Tax Convention
Assure that transfer pricing outcomes are in line with value creation/other high-risk transactions	*Develop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties. This will involve adopting transfer pricing rules or special measures to: (i) clarify the circumstances in which transactions can be recharacterised; (ii) clarify the application of transfer pricing methods, in particular profit splits, in the context of global value chains; and (iii) provide protection against common types of base eroding payments, such as management fees and head office expenses.*	Changes to the Transfer Pricing Guidelines and possibly to the Model Tax Convention

Table A.2. **Summary of the BEPS Action Plan by timeline** *(continued)*

BY SEPTEMBER 2015		
Action	Description	Expected Output
Establish methodologies to collect and analyse data on beps and the actions to address it	*Develop recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis. This will involve developing an economic analysis of the scale and impact of BEPS (including spillover effects across countries) and actions to address it. The work will also involve assessing a range of existing data sources, identifying new types of data that should be collected, and developing methodologies based on both aggregate (e.g. FDI and balance of payments data) and micro-level data (e.g. from financial statements and tax returns), taking into consideration the need to respect taxpayer confidentiality and the administrative costs for tax administrations and businesses.*	Recommendations regarding data to be collected and methodologies to analyse them
Require taxpayers to disclose their aggressive tax planning arrangements	*Develop recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures, taking into consideration the administrative costs for tax administrations and businesses and drawing on experiences of the increasing number of countries that have such rules. The work will use a modular design allowing for maximum consistency but allowing for country specific needs and risks. One focus will be international tax schemes, where the work will explore using a wide definition of "tax benefit" in order to capture such transactions. The work will be co-ordinated with the work on co-operative compliance. It will also involve designing and putting in place enhanced models of information sharing for international tax schemes between tax administrations.*	Recommendations regarding the design of domestic rules
Make dispute resolution mechanisms more effective	*Develop solutions to address obstacles that prevent countries from solving treaty-related disputes under MAP, including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases.*	Changes to the Model Tax Convention

Table A.2. **Summary of the BEPS Action Plan by timeline** *(continued)*

BY DECEMBER 2015		
Action	Description	Expected Output
Limit base erosion via interest deductions – *phase 2*	*Develop recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense, for example through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income, and other financial payments that are economically equivalent to interest payments. The work will evaluate the effectiveness of different types of limitations. In connection with and in support of the foregoing work, transfer pricing guidance will also be developed regarding the pricing of related party financial transactions, including financial and performance guarantees, derivatives (including internal derivatives used in intra-bank dealings), and captive and other insurance arrangements. The work will be co-ordinated with the work on hybrids and CFC rules.*	Changes to the Transfer Pricing Guidelines
Counter harmful tax practices more effectively, taking into account transparency and substance – *phase 3*	*Revamp the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for any preferential regime. It will take a holistic approach to evaluate preferential tax regimes in the BEPS context. It will engage with non-OECD members on the basis of the existing framework and consider revisions or additions to the existing framework.*	Revision of existing criteria to identify harmful tax practices
Develop a multilateral instrument – *phase 2*	*Analyse the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties. On the basis of this analysis, interested Parties will develop a multilateral instrument designed to provide an innovative approach to international tax matters, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution.*	Multilateral instrument

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