European Banking Federation

CHIEF EXECUTIVE

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Ms Marlies de RUITER
Head Tax Treaties, Transfer Pricing and Financial Transactions Division
Centre for Tax Policy and Administration
OECD

Email: taxtreaties@oecd.org

Subject: *EBF Comments on the OECD Discussion Draft on BEPS Action 6: Preventing Treaty Abuse*

Dear Mrs de Ruiter,

The European Banking Federation (EBF) welcomes the opportunity to comment on the OECD's current work on preventing treaty abuse as part of the Base Erosion and Profit Shifting (BEPS) project.

The EBF is committed to contributing constructively to the BEPS project, in the expectation that the final outcome will deliver fair, certain, sustainable and principled rules.

While the EBF is supportive of the efforts of the OECD to prevent treaty abuse, we are concerned that, when seen as a whole, the actions foreseen in the OECD's report on BEPS Action 6 (the Report) could possibly conflict with the EU Internal Market principles, enshrined in the EU treaties, which are binding for a large number of the member countries of the OECD. Our concern arises because a series of entities carrying out legitimate cross-border activities on behalf of their group within the EU, for example bank subsidiaries and branches, would be affected with burdensome, and sometimes subjective, qualifications in order to benefit from tax treaties if the current proposals within the Report are not clarified.

Unrestricted treaty benefits for bank subsidiaries and branches within the EU

Banks branches and subsidiaries in the EU are under strict regulation and supervision not only of domestic but also of European banking supervision authorities. We are therefore concerned that the current wording of the report would go beyond the objectives of the BEPS treaty abuse actions undertaken therein by denying full treaty benefits to bank subsidiaries or branches operating in the EU for legitimate commercial purposes. Moreover, we consider that denying, or limiting, treaty benefits to banks subsidiaries and branches within the EU would potentially conflict with EU law. In this context we evoke the European Court of Justice (ECJ) breakthrough judgment in the *Van Gend en Loos* case (C-26/62) which sets the acknowledgment of direct effect of EU Treaty articles, and the primacy of European law *vis-à-vis* national legal orders of EU Member States, which account for a significant portion of the OECD Member States.

From a technical point of view, we believe that the proposed LOB provision in the Report, when applied to entities by virtue of Article X(2)(c)(ii), potentially conflicts with the EU's freedom of establishment to the extent that it discriminates on the basis of ownership. In this respect, we note consistent ECJ case law declaring as unlawful discriminations affecting entities of the same group established in different EU/EEA Member States, be it a subsidiary based on the residence of its parent company (*Lankhorst-*

Hohorst, C-324/00), a subsidiary and a parent company based on the residence of an intermediate entity (*Papillon*, C-418/07), or a non-resident parent company of a resident subsidiary (*Denkavit*, C-170/05, see also: EFTA court in *Fokus Bank*, E-1/04). We further note that in the aforementioned *Denkavit* and *Fokus Bank* cases, the ECJ and the EFTA courts refused to take into account the existence of a tax treaty to justify the discriminatory measure under review.

We would therefore call for an amendment of the applicable ownership test set out in the aforementioned provision in order to avoid denying, on an automatic basis, full treaty benefits to non-listed entities with less than 50% of qualified shareholding. The latter scenario of minority shareholdings is not uncommon in the banking sector, whereby bank subsidiaries are seldom owned by entities resident in the same Contracting State so that there is a risk, in the current stand of the drafting, that such subsidiaries will be able to solely rely on partial treaty benefit by virtue of either Article X(3) or Article X(4). Failing an amendment of the ownership test at Article X(2)(c)(ii), specific carve outs, in the first instance for banks and similar institutions, should be considered.

<u>Other points of attention</u>

The 'derivative benefits' clause at Article X(4) is a welcome addition to the extent such clause would entitle to treaty benefits certain entities that would otherwise not be able to do so pursuant to Article X. We are nevertheless concerned that the ownership test set out at Article X(4)(a) would conflict with the EU's freedom of establishment for the same reasons as those explained earlier in the context of Article X(2)(c)(ii). Also, it should be considered whether or not in the case of entities owned by non-resident individuals, notably private investment entities, a comparable reasoning could apply in the context of the free movement of capital under EU treaties.

As for the discretionary relief at Article X(5), it should be reconsidered whether the shifting of the burden of proof to the taxpayer, whereby, essentially *"relevant facts and circumstances*" shall be established by the taxpayer, would not result in a significant trade barrier and therefore come into conflict with the EU principle of proportionality. Particular reference is made in this respect to the doctrine initiated by the ECJ judgment in the *Cadburry Schweppes* case (C-196/04), which limits the use of subjective criteria for the purpose of establishing the existence of artificial arrangements and leaves as a rule the burden of proof of abuse with governments. In other words, European taxpayers who conduct non-abusive economic activities should enjoy treaty protection without disproportionate compliance obligations and shifting of the burden of proof to the taxpayer.

Another point of concern is the current wording of the PPT rule set forth in Article X(7) in the Report, whereby in essence, this provision would have the effect of denying a benefit under a tax convention where *"one of the principal purposes of an arrangement or transaction (…) is to obtain a benefit under the convention"*. We feel that this criterion, which is very vague in its terms, is at risk of paving the way to subjective, and therefore unpredictable, interpretations on the part of tax authorities. The latter would result in substantial legal uncertainty virtually affecting all cross-border operations and potentially, depending on the applicable interpretation in a given jurisdiction, in a series of double taxation scenarios (e.g. in the case of withholding tax at source). For these reasons, we believe that the application of a LOB clause focusing on objective characteristics of the party seeking benefits should constitute the privileged avenue for the purpose of implementing Action 6. Should, nevertheless, the recourse to the PPT rule be envisaged, such recourse should be limited to exceptional circumstances. In this respect, we welcome the suggestion made in the current OECD Discussion Draft to subject the application of the PPT to appropriate administrative process.

EBF recommendations

In light of the above observations, we take the view that Action 6 should not apply to regulated and supervised bank subsidiaries and branches in the EU. We consider full treaty benefits on an unequivocal basis should be granted. In the case these benefits are not granted, clarification and adaptation of the provisions of the Report are necessary in order to reduce the burden for these institutions, especially in terms of administrative compliance.

When there is no treaty abuse, swift administrative relief should be granted in any case. To this end, further clarification would be welcome with respect to the procedure foreseen under Article X(5) of the Report and perhaps a review of the existing mutual agreement procedure set forth under Article 25, paragraph 5 of the OECD model tax convention could be considered as well.

Finally, the application of LOB provisions based on objective characteristics of the party seeking treaty benefit should be privileged over the application of the PPT rule for the purpose of implementing Action 6. A combined application of LOB and PPT rules on a general basis would bear the risk of multiplication of uncertainties and disproportionate burden of proof on the part of taxpayers. Should nevertheless the recourse to the PPT rule be envisaged, such recourse should be limited to exceptional circumstances and appropriate administrative process should be defined to this end so as to avoid excessive recourse to PPT on the part of tax authorities that would result in a lack of reliability of tax treaties.

We hope that our comments will contribute to the discussion. We remain at your disposal should you require any further clarification.

Yours sincerely,

Wim Mijs