Trade and Investment
Commission on Taxation

ICC Comments on OECD public consultation on the Proposed changes to Commentaries in the OECD Model Tax Convention on Article 9 and on related articles

The International Chamber of Commerce (ICC), as the world business organization speaking with authority on behalf of enterprises from all sectors in every part of the world, appreciates the opportunity to provide input on the OECD public consultation document on proposals for changes to the Commentary on Article 9 and other related articles. ICC advocates for a consistent global tax system, founded on the premise that stability, certainty and consistency in global tax principles are essential for business and will foster cross-border trade and investment.

ICC COMMENTS ON THE PROPOSED CHANGES

ICC acknowledges that Working Party 1 on Tax Conventions and Related Questions, in consultation with Working Party 6 and the Forum on Tax Administration's MAP Forum, has recently undertaken work on the Commentary on Article 9 to clarify its application, especially as it relates to domestic laws on interest deductibility, where some commentators have questioned its interaction with those rules. The current public consultation draft includes proposals for changes to the Commentary on Article 9 and other related articles, which are expected to be included in the next update of the OECD Model Tax Convention.

In this respect, ICC members would be interested in whether the work completed by Working Party 1 will be made publicly available in addition to the current public consultation document. ICC believes that it would be of interest to have insight on the varying views of the Working Party members, particularly taking into account the background to the competing views on the purpose of Article 9 (pricing versus accurate delineation of the transaction).

ICC notes that the proposed amendments appear to adopt a compromise position between: (i) the arguments advanced by some countries that the arm's length principle under Article 9 is focused on the pricing of a transaction in question (as opposed to determining its character); and (ii) the contrary position advanced by other countries that Article 9 enables a taxing administration to undertake a process of 'accurately delineating' a transaction by determining whether a purported loan is debt or equity. This appears to be consistent with the position taken in the OECD guidance on the transfer pricing of financial transactions. As such ICC suggests that this should be expressly confirmed in the guidance.

In substance, the proposed changes confirm that the question of deductibility (e.g., of interest on a loan) is a matter to be determined by domestic law – consequently, domestic law adjustments that reduce the amount of deductible expenses are not triggered for the application of Article 9 and so do not result in any obligation on the other Contracting State to make corresponding adjustments. This means that such domestic law limitations would not be considered to lead to economic double taxation of the sort that would typically be addressed by a Double Taxation Convention. ICC questions whether it is the OECD's intention in this regard to provide an absolute bar to resolution via Competent Authority proceedings, or whether the emphasis is on there being no automatic obligation outside the realms of Competent Authority proceedings. ICC questions whether the OECD could consider providing guidance to limit the situations in which a domestic override should be applied / identify situations where Contracting States should in fact provide corresponding adjustments such as where an interest limitation rule arises from a multilaterally-adopted principle such as BEPS Action 4, especially in cases where the domestic interest limitation rules of the states do not provide for a loss carry-forward, with a particular emphasis on loss carry-forward without time limitation.

On the other hand, in some source countries domestic rules do not enable a re-characterization of interest payments into dividends that are derived from a deemed capital contribution, but rather such rules result in a mere rejection of a deduction. The foregoing approach being contrary to the approach taken by the OECD in connection with the accurate delineation of the transaction embedded in a transfer pricing analysis. If the residence country does not follow the OECD's approach, such situation would result in an economic double taxation. It could also be the case that the source country does follow the approach of the accurate delineation of the transaction, thereby allowing for a re-characterization of the interest payments into dividends, while the residence country does not follow such an approach. The latter situation would lead to an economic double taxation too. Hence, it is suggested to encourage the use of mutual agreement procedures (MAPs) to solve these conflicts.

In the revised Article 9 commentary, a new paragraph 3.1 is put forward, which endorses a country's right to deny tax deductions regardless of the treaty position. While its content probably is appropriate in relation to financial transactions where a range of thin capitalisation rules exist at a country level (e.g., BEPS4 EBITDA test), this paragraph seems not to be explicitly limited to financial transactions – and it gives client entertaining as an example alongside BEPS4 rules. The existing commentary on Article 9 specifically notes that domestic thin capitalisation rules are not prevented by the treaty, but makes no such reference to client entertaining or broader categories of expense. ICC members understand that there are a range of views regarding the interaction between Article 9 and domestic rules regarding disallowance of expenses. Whilst we would welcome clarity and consistency through a broad discussion about this interaction, ICC members believe that it is inappropriate for this to be included in the commentary. Whilst new paragraph 3.1 seems to be merely clarificatory, it could be interpreted as being broader in its application as it alludes to overall tax deductibility rules under domestic deduction regimes (which is a question beyond the arm's length nature of the matter in question). ICC members believe that it is inappropriate for this to be included in the commentary as a result of a commentary that purports to merely be updating the commentary to reflect changes in relation to broader guidance on financial transactions.

In relation to paragraph 3 of the new proposed commentary on Article 9, ICC suggests amending the following sentence by introduction of the words underlined: "domestic laws (including judicial doctrine), <u>and /</u> or in the OECD Transfer Pricing Guidelines". This is to avoid any suggestion that domestic laws and the OECD Transfer Pricing Guidelines are in some way mutually exclusive.

ICC respectfully questions whether the proposed changes miss an important opportunity to reassert the role of double taxation conventions and eliminate economic double taxation. Specifically, the changes could compound a recent trend in the international landscape by providing further affirmation for the stance of countries unilaterally to apply domestic limitations that therefore override the treaty position – ultimately resulting in economic double taxation. The text notes that Contracting States are not required to provide any corresponding adjustment under the treaty to relieve that double taxation, which ICC believes has a potential negative impact on cross-border trade.

ICC members are also concerned about the comment related to reversing the burden of proof under Article 24. Indeed, some domestic transfer pricing regimes provide for a reversal of the burden of proof, especially, for example, when it comes to compliance with the transfer pricing documentation requirements. However, according to the proposed addition in the Commentary on Article 24, it is important that such rules equally apply to both residents and non-residents, in order to not be contrary to the principle of non-discrimination of Article 24. It should be noted, though, that it seems that the previous wording of par. 4 of Article 9 of the Commentary, which has now been deleted and replaced by a reference to paragraphs 75, as proposed to be amended and 80 of the Commentary on Article 24, previous left room for interpretation and assessment on a case-by-case basis, as per a potential variance with the principles laid down in Article 9. This room for interpretation and assessment appears to have now been totally removed from the Commentaries. ICC members are particularly concerned about this point.

In the revised Commentary to Article 9, the thin capitalisation paragraph is suggested to be replaced with the following (emphasis added):

"In considering whether an interest payment can be regarded as an arm's length amount, a State will typically examine the terms and conditions of the loan such as the rate of interest. It may also need to examine, based on the facts and circumstances, whether a purported loan should be regarded as a loan or as another kind of transaction, ***<u>in particular a contribution to equity capital</u>****. The State making a determination as to the extent to which the purported loan is regarded as a loan will do so taking into account factors discussed in its domestic laws (including judicial doctrine), or in the OECD Transfer Pricing Guidelines"*

Firstly, although there is an indicative renumeration of the terms and conditions of the loan, ICC respectfully suggests that reference should also be made, merely for sufficiency purposes, to additional comparability factors of intragroup financial transactions, apart from the rate of interest, such as the amount, maturity, currency, credit rating determinations, existence of collateral etc.

Furthermore, the highlighted text implies that a reclassification as a contribution to equity capital is the most likely (or most appropriate) outcome of a review of the transaction. In view of the fact that there is much more comprehensive guidance on the transfer pricing of financial transactions, ICC does not believe that these words are necessary and could be misleading. As such, ICC respectfully suggests that, at the very least, the words "in particular" should be removed and other examples should be given alongside a contribution to equity capital. This modification would also entail more clarity and, therefore, would contribute to a higher level of tax certainty.

ICC members also request further clarity regarding the reference to "*factors discussed in its domestic laws*" as administrations may seek to rely on this Guidance coupled with domestic general anti-avoidance rules (GAAR) to recharacterise loans where interest deduction is sought. Indeed, the domestic law of some countries may also require that an additional legal basis, such as an internal GAAR be invoked, apart from the transfer pricing rules, in order for a recharacterization to take place. Moreover, some internal GAARs do not explicitly provide for a recharacterization of a transaction but instead they only entail the non-granting of a tax benefit. Therefore, further clarifications should be very helpful in this respect.

Whilst ICC members have no concerns with the proposed changes to the Article 25 commentary, ICC notes that this is not strictly or solely related to the transfer pricing of financial transactions and therefore suggests that broader consultation may be appropriate.

About The International Chamber of Commerce (ICC)

The International Chamber of Commerce (ICC) is the world's largest business organization representing more than 45 million companies in over 100 countries. ICC's core mission is to make business work for everyone, every day, everywhere. Through a unique mix of advocacy, solutions and standard setting, we promote international trade, responsible business conduct and a global approach to regulation, in addition to providing market-leading dispute resolution services. Our members include many of the world's leading companies, SMEs, business associations and local chambers of commerce.
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