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Tax Treaties, Transfer Pricing and Financial Transactions Division
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By email: taxtreaties@oecd.org

Dear Sophie and Stewart

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

Thank you for the opportunity to comment on the public discussion draft *Proposed changes to Commentaries in the OECD Model Tax Convention on Article 9 and on related articles* published on 29 March 2021 (the 'Discussion Draft').

These comments have been written from the perspective of Deloitte's UK firm.

General comments

Additional clarity on the interaction between the Articles of the 2017 OECD Model Tax Convention on Income and on Capital (the 'OECD Model Treaty'), and recent developments arising from the OECD/G20 Base Erosion and Profit Shifting (BEPS) project is welcome. In particular, as the implementation of domestic tax laws based on BEPS Action 4 *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments* continues worldwide, it is important that businesses and tax authorities have a clear and consistent understanding of the expected tax treaty treatment of any disallowances arising.

There are concerns that the draft revisions emphasise domestic law measures as the priority rules, rather than supporting and encouraging the recognition of the protections from double taxation provided by the OECD Model Treaty for cross-border transactions. This may make some sense in the context of interest, where it is acknowledged in Chapter X of the Transfer Pricing Guidelines that domestic measures on determination of debt and equity remain important. However, the broad nature of the guidance (not being limited to or making reference to interest) provides countries with justification and incentives for existing or new domestic measures which are designed to bypass or have the effect of bypassing the protections of double tax treaties. As referenced in our letter on the 2020 Review of BEPS Action 14 (*Making Dispute Resolution Mechanisms More Effective*) in January 2021, this is a trend that has the potential to undermine existing double tax treaties and the OECD's important role in reducing double taxation and preventing barriers to international trade.

In line with the preamble to the Model Tax Convention, which sets out an intention to eliminate double taxation – i.e. not just double taxation arising from transfer pricing – the Commentary should take the opportunity to emphasise this point and deter policy decisions or tax authority practices that could increase double taxation.

The draft revised Commentary to Article 9 does not emphasise that economic double taxation will in all likelihood arise when a non-transfer pricing domestic tax law measures results in a denial of a deduction for a cross-border payment. It would be helpful if the Commentary were to also explicitly note that, notwithstanding that a domestic measure could be formally outside the scope of Article 9, and compliant with Article 24, its adoption may still conflict with the intentions of double tax treaties through Article 9 and the treaty preamble. It is a fundamental goal of double tax treaties that multinational businesses should be taxed only once on their commercially generated profits and other business income. In the absence of bona fide and justified policy considerations, such as those underpinning Action 4 and disallowances for entertainment expenses, the default position should be to allow deductions for all genuine (cross-border) business expenses.

Such issues frequently arise in relation to the treatment of intra-group services. As you will be aware, in May 2018, the OECD announced it was considering starting a project to revise transfer pricing guidance in the area of intra-group services and invited public comments. An update on the status of this potential project would be welcome as a focus on this area could also reduce the incidences of double taxation in relation to cross-border intra-group service payments.

Specific comments

Draft revisions to Commentary on Article 9

Draft paragraph 3 states *"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."* International consistency could be encouraged by changing the ordering such that the OECD Transfer Pricing Guidelines are referred to before domestic laws/judicial doctrine. It would also be helpful to reference that the OECD Transfer Pricing Guidelines give further detail on how to implement the arm's length principle as set out in Article 9.

Paragraph 10.5 of the February 2020 report *Transfer Pricing Guidance on Financial Transactions* explicitly cross-references and quotes existing paragraph 3(b). If paragraph 3(b) is deleted, this will need to be taken into account when the February 2020 report is formally incorporated into the Transfer Pricing Guidelines.

Draft revisions to Commentary on Article 7

The draft changes to paragraph 59 result in a complex sentence:

"In other words, regardless of which State makes the initial adjustment, where that State adjusts the profits attributable to the permanent establishment to a level that is different from what they would have been if they had been correctly computed in accordance with the principles of paragraph 2, the other State is obliged to make an appropriate corresponding adjustment but only to the extent that it considers that the adjusted profits correctly reflect what the profits would have been if they had been correctly computed in accordance with these principles."

Consideration should be given to whether this could be made clearer, perhaps with an accompanying example.

Draft revisions to Commentary on Article 24

Draft paragraph 75 implies that all additional information requirements are *"intended to ensure similar levels of compliance and verification in the case of payments to residents and non-residents."*

There remains the potential for excessive information requirements, over and above that required under the indirect charging method set out in Chapter VII of the OECD Transfer Pricing Guidelines, with the primary intention of increasing tax revenues and circumventing the protections of the double tax treaty under Articles 24 and 25. For example, a country may deny legitimate deductions for cross-border service charges unless disproportionate levels of additional information are provided.

Draft paragraph 75 would be improved and more in line with the intention of double tax treaties to reduce instances of double taxation if it instead read:

Also, paragraph 4 does not prohibit additional information requirements with respect to payments, made to non-residents, including the reversal of the burden of proof, ***when it is reasonable to do so and such requirements are*** *intended to ensure similar levels of compliance and verification in the case of payments to residents and non-residents.*

Draft revisions to Commentary on Article 25

Access to the mutual agreement procedure (MAP) should be available in all cases of economic double taxation potentially not in accordance with the treaty, not just transfer pricing cases. In emphasising that MAP access should be granted in transfer pricing cases, the proposed revision risks reducing the willingness of jurisdictions to grant access for other cases. This is a particular concern in relation to the denial of deductions under domestic laws for cross-border intra-group charges for royalties and services.

It would be helpful if it could be made clear that such cases should be eligible for MAP, such that properly determined royalty and services charges made at arm's length in accordance with the OECD Transfer Pricing Guidelines agreed under MAP should not be subject to further domestic tax measures.

It is hoped that improvements in relation to MAP access will also arise as part of the 2020 Review of BEPS Action 14 (*Making Dispute Resolution Mechanisms More Effective*) and in response to the public consultation in January 2021.

Yours sincerely

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