COMMENTS ON PUBLIC CONSULTATION DOCUMENT: PROPOSED CHANGES TO COMMENTARIES IN THE OECD MODEL TAX CONVENTION ON ARTICLE 9 AND ON RELATED ARTICLES

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Dear Sirs,

In response to the public consultation document regarding the proposed changes to commentaries in the OECD model tax convention on article 9 and on related articles, we would like to express the following comments:

PROPOSED CHANGES TO THE COMMENTARY ON ARTICLE 9

1. Replace paragraphs 2 to 4 of the Commentary on Article 9 with the following:

> 2. This paragraph provides that the taxation authorities of a Contracting State may, for the purpose of calculating tax liabilities of associated enterprises, re-write the accounts of the enterprises if, as a result of the special relations between the enterprises, the accounts do not show the true taxable profits arising in that State. It is evidently appropriate that adjustment should be sanctioned in such circumstances. The provisions of this paragraph apply only if special conditions have been made or imposed between the two enterprises. ***and, therefore, the provisions would not apply to the*** ~~No~~ re-writing of the accounts of associated enterprises ~~is authorised~~ if the transactions between such enterprises have taken place on normal open market commercial terms (on an arm's length basis). ***In order to ensure the elimination of double taxation, the arm's length principle and the guidance on its interpretation in the OECD Transfer Pricing Guidelines should be followed in any re-writing of accounts.***

Comment: We agree with the proposed changes. We consider that these changes make the commentary clearer and firmer and that the reference to the ALP and TP Guidelines is appropriate to reinforce consistency in the revision of transaction between related parties between different countries.

> ***3. 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, in particular a contribution to equity capital. 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.

3.1 Once the profits of the two enterprises have been allocated in accordance with the arm's length principle, it is for the domestic law of each Contracting State to determine whether and how such profits should be taxed, as long as there is conformity with the requirements of other provisions of the Convention. Article 9 does not deal with the issue of whether expenses are deductible when computing the taxable income of either enterprise. The conditions for the deductibility of expenses are a matter to be determined by domestic law, subject to the provisions of the Convention and, in particular, paragraph 4 of Article 24. Paragraph 30 of the Commentary on Article 7 makes an equivalent statement for the application of Article 7. Examples of domestic rules that can deny a deduction for expenses include certain rules on entertainment expenses and on interest such as those recommended in the final report on Action 4 of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project.

Comment: We agree with the proposed changes. We consider that these changes are actual and relevant and the emphasis on the revision of loans is appropriate. The inclusion of 3.1 is useful in clarifying the difference between determining the nature/arm's length price and determining the taxable income considering unilateral anti-abuse measures and other anti-abuse measures covered in the BEPS Project are being included in the domestic legal framework of countries which might apply different approaches.

2. The following change to paragraph 6 of the Commentary on Article 9 and the next additional paragraph (which derives from a parallel statement in paragraph 66 of the Commentary on paragraph 3 of Article 7) are proposed to clarify the obligations of the State making a corresponding adjustment.

6. It should be noted, however, that an adjustment is not automatically to be made in State B simply because the profits in State A have been increased; the adjustment due only ~~if~~ ***to the extent that*** State B considers that the figure of adjusted profits correctly reflects what the profits would have been if the transactions had been at arm's length. In other words, ~~the paragraph may not be invoked and should not be applied~~ where the profits of one associated enterprise are increased to a level which exceeds what they would have been if they had been correctly computed on an arm's length basis. State B is ~~therefore~~ committed to make an adjustment of the profits of the affiliated company if it

considers that the adjustment made in State A is justified ~~both~~ in principle ***but only to the extent of the amount that reflects profits computed on an arm's length basis.*** ~~and as regards the amount.~~

6.1 As noted in paragraph 3.1 above, Article 9 applies only for the purposes of allocating profits to the two enterprises in accordance with the arm's length principle. It does not deal with the subsequent computation of taxable income, which is a question of domestic law. Any mismatch in this domestic law treatment does not in itself result in economic double taxation for the purposes of paragraph 2 and there is thus no obligation on State B to make a corresponding adjustment in these circumstances.

Comment: We understand that this proposed change might imply a partial solution to a double taxation issue, which might be problematic in practice, but we consider that the benefit from having a possibly unilateral and more efficient solution to double taxation outweighs the cons of a partial corresponding adjustment.

PROPOSED CHANGE TO THE COMMENTARY ON ARTICLE 25 (MUTUAL AGREEMENT PROCEDURE)

5. The following proposed new paragraph in the Commentary on Article 25 is designed to confirm the practices of OECD member States in admitting cases into the mutual agreement procedure and to reinforce one of the conclusions of the BEPS Action 14 Final Report.

12.1 More generally, the economic double taxation that may result from a primary adjustment consisting of the inclusion of profits of associated enterprises in an amount not justified by reference to the arm's length standard would result in taxation not in accordance with one of the objects and purposes of the Convention to eliminate double taxation. A denial of access to the mutual agreement procedure in these circumstances, with a view to eliminating the economic double taxation that could follow from such an adjustment, would likely frustrate an objective of the Convention. States should therefore provide access to the mutual agreement procedure in transfer pricing cases.

Comment: We agree with the proposed new paragraph, considering that the Convention should ideally seek to resolve all double taxation issues that may arise. This new paragraph, by requiring the States to provide access to MAP, also allows countries to be aware, and potentially solve, differences in their application of transfer pricing controls that might be negative for their own business environment. Nevertheless, we would like to mention regarding this matter, that despite many developing countries being members of the Inclusive Framework of the OECD BEPS Project, there are currently member countries that do not yet have MAP guidelines or experience in accordance with the minimum standard of Action 14, which is why we believe the inclusion of this new paragraph should ensure that Action 14 measures are enforced.