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Submitted by email to: taxtreaties@oecd.org

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BUSINESS AT OECD INPUT ON PROPOSED CHANGES TO COMMENTARIES IN THE OECD MODEL TAX CONVENTION ON ARTICLE 9 AND RELATED ARTICLES

Dear Tax Treaties, Transfer Pricing and Financial Transactions Division, Centre for Tax Policy and Administration,

Business at OECD (BIAC) thanks the OECD for the opportunity to submit comments on the recently proposed changes to the Commentary on Article 9 of the OECD Model Tax Convention that clarify its application to taxation of transactions between associated enterprises and to other related articles.

We believe ongoing dialogue with the business community on their experiences and suggested improvements to proposed changes to commentaries in the OECD Model Tax Convention is meaningful and will continue to be helpful to the OECD's efforts to clarify how the articles of the convention apply.

Business at OECD looks forward to continuing to provide feedback on future proposed changes to the commentaries in the OECD Model Tax Convention and to other areas of interest to the OECD.

Sincerely,

Will Morris

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Chair, Taxation and Fiscal Policy Committee,
Business at OECD (BIAC)

COMMENTS

1. We welcome the OECD's commitment to soliciting taxpayers' input on the proposed changes to (i) the Commentary on Article 9 of the OECD Model Tax Convention that clarify how the article applies in the context of the taxation of transactions between associated enterprises, particularly as it relates to interaction with domestic laws on interest deductibility, and (ii) the commentary on related articles, including Article 7 (business profits), Article 24 (non-discrimination), and Article 25 (mutual agreement procedure).

2. Some of our members express concern that the suggested revisions to the thin capitalization discussion in paragraphs 2 to 4 of the Commentary on Article 9 could suggest that a reclassification of a purported loan as a contribution to equity capital is the most likely or appropriate outcome upon review of a transaction, despite existing guidance on the transfer pricing of financial transactions that provides instructive criteria for when such reclassification would be technically supported. It could be more appropriate to either omit the language "in particular a contribution to equity capital" or to provide additional examples of potential rechacterizations to avoid the implification that a reclassification to contribution to equity capital is the default presumption.

3. With respect to the proposed deletions in paragraph 3 of the Commentary on Article 9, we believe that it would be useful to retain the language referencing the interplay between domestic law and tax treaties, rather than making the comparison between domestic law and the OECD Transfer Pricing Guidelines, which do not stand in place of tax treaties in that they only represent internationally agreed principles and provide guidelines for the application of the arm's length principle.

4. We also believe it would be useful to retain—rather than delete—paragraph 3, subparts (a) and (c) of the Commentary on Article 9. This language provides multinational taxpayers the ability to rely on the arm's length principle—the cornerstone of Article 9—to ensure consistency with the result reached under domestic rules and ensure an absence of double taxation. Consequently, removing the language could result in an increase in cross-border disputes and mutual agreement procedure applications, which is a less efficient result, particularly where respective treaty partners have not agreed to binding arbitration, and potentially could raise an issue with the application of non-discriminatory treaty clauses.

5. With respect to new paragraph 3.1, which addresses the domestic deductibility of expenses once the profits of two related enterprises have been allocated in accordance with the arm's length principle, our members are concerned that the new language could legitimize a practice that leads to double taxation by oversteering the arm's length principle and delegating to domestic law how the conditions for the deductibility of expenses are set. Article 9 of the OECD Model Tax Convention provides that transactions between associated companies must be structured as if they were between independent third parties (arm's length principle). However, the proposed new language in paragraph 3.1 of the Commentary on Article 9 posits the computation of taxable income as "a question of domestic law." This runs counter to the arm's length principle and would

inhibit jurisdictions from providing correlative relief in the form of corresponding counter-adjustments in the event another jurisdiction makes a transfer pricing adjustment, meaning double taxation is the inevitable result.

6. The proposal for the new paragraph reinforces the increasing need for treaty partners to consider including an arm's length test and the interest limitation recommendations from BEPS Action 4 within their respective domestic laws and to do so consistently to prevent double taxation. In this regard, it is critical for the Commentary on Article 9 to reference new Chapter X of the OECD Transfer Pricing Guidelines on Financial Transactions, which addresses debt-equity classification, which some members believe is equally or more important than the determination of allocation of interest expenses amongst treaty partners.

7. Also, as currently drafted, new paragraph 3.1 cites to broad categories of expenses unrelated to financial transactions, including client entertainment expenses. While we welcome guidance providing clarity and think it useful to promote discussion about achieving consistency in the interaction between Article 9 and domestic rules regarding disallowance of expenses, we think any proposed revisions to the Commentary on Article 9 should be limited to financial transactions.

8. While we have no concerns with the proposed changes to the Commentary on Article 25, we note that this is not strictly or solely related to the transfer pricing of financial transactions and therefore suggest that broader consultation may be appropriate.