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Via e-mail: taxtreaties@oecd.org

Tax Treaties, Transfer Pricing and Financial Transactions Division
OECD/CTPA

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

Dear Sirs,

We would like to thank you for the opportunity to submit our comments on the OECD public consultation document "*Proposed changes to Commentaries in the OECD Model Tax Convention on Article 9 and on related articles*" released on 29 March 2021 ("**Discussion Draft**"). In this respect, please find hereinafter our observations.

1. Proposed changes to paragraph 2 of the Commentary on Article 9

It is our understanding that the proposed amendments to the third and fourth sentences of paragraph 2 of the Commentary on Article 9 of the OECD Model[1] are intended to contemplate the possibility for Contracting States to make a re-writing of the accounts of associated enterprises also in cases of

[1] OECD (2017), *Model Tax Convention on Income and on Capital: Condensed Version 2017*, OECD Publishing, Paris.

transactions undertaken on an arm's length basis, clarifying that the re-writing of the accounts of associated enterprises concerning transactions which are consistent with the arm's length principle is not per se prohibited but falls outside the scope of Article 9.

These proposed amendments would in effect enable Contracting States to adjust intercompany transactions based on domestic law provisions other than transfer pricing provisions, even in cases where the conditions of such transactions comply with the arm's length principle.

If this is the intended effect of the changes, we believe that it might be useful to consider a further coordination of these amendments with the proposed recommendation included in the last sentence of paragraph 2, according to which "*any*" re-writing of accounts should follow the arm's length principle and OECD Transfer Pricing Guidelines.[2] Such latter recommendation would in fact be breached whenever a Contracting State re-writes the accounts of associated enterprises based on domestic provisions which do not rely on the arm's length principle. To prevent such mismatch, we propose to amend the wording of the last sentence of paragraph 2 as follows:

> "*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* ***based on transfer pricing provisions***".

2. Proposed changes to paragraph 3 of the Commentary on Article 9

The proposed wording of the first sentence of paragraph 3 of the Commentary on Article 9 of the OECD Model[3] reads that Contracting States typically assess the arm's length nature of an interest payment by examining the "*terms and conditions of the loan such as the rate of interest*". In our opinion, an analysis only based on the terms and conditions of the loan could

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[2] OECD (2017), *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017*, OECD Publishing, Paris.
[3] OECD (2017), *Model Tax Convention on Income and on Capital: Condensed Version 2017*, OECD Publishing, Paris.

be insufficient to properly assess whether a financial transaction (and thus an interest payment) is consistent with the arm's length principle. In particular, we believe that referring only to the terms and conditions of the loan and to the interest rate could be misleading and that such reference should be instead replaced by a cross-reference to the full set of relevant principles and criteria set forth in the Transfer Pricing Guidance on Financial Transactions,[4] as implemented in the OECD Transfer Pricing Guidelines.[5]

As regards the determination of whether a purported loan should be actually regarded as a loan, the proposed wording of the third sentence of paragraph 3 of Article 9 provides that a Contracting State should take into account the "*factors discussed in its domestic laws (including judicial doctrine),* ***or*** *in the OECD Transfer Pricing Guidelines*" (emphasis added). With this wording, it is our understanding that, for the purpose of assessing the true nature of a loan, domestic laws would be placed on the same level of the OECD Transfer Pricing Guidelines, and, consequently, Tax Authorities could rely, alternatively, on the factors acknowledged by either of such sources. However, in our opinion the Discussion Draft should clarify how to deal with cases where the factors acknowledged by domestic laws diverge from those addressed by the OECD Transfer Pricing Guidelines, with particular reference to the possible double taxation deriving from adjustments based on the diverging factors provided by the domestic law. In this regard, we also believe that the third sentence of paragraph 3 should be coordinated with the recommendation included in the last sentence of paragraph 2, which provides that any re-writing of accounts should follow the arm's length principle and the OECD Transfer Pricing Guidelines[6] (see our proposed amendment to the last sentence of paragraph 2 illustrated in the first chapter of this document).

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[4] OECD (2020), *OECD Transfer Pricing Guidance on Financial Transactions Inclusive Framework on BEPS: Actions 4, 8-10,* OECD Publishing, Paris.
[5] OECD (2017), *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017*, OECD Publishing, Paris.
[6] OECD (2017), *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017*, OECD Publishing, Paris.

Finally, we believe that the Discussion Draft should clarify how to deal with cases where the factors acknowledged by the judicial doctrine differ from those set forth by the domestic law, with particular reference to Civil law countries.

Whatever position is taken on the above two remarks, we would recommend that the Discussion Draft explicitly takes the position that, irrespective of whether the factors taken into account to determine to what extent the purported loan is regarded as a loan derive from the OECD Transfer Pricing Guidelines or domestic laws (including judicial doctrine), any double taxation arising from such determination can be resolved by access to a mutual agreement procedure under Article 25.

3. Proposed new paragraph 3.1 of the Commentary on Article 9

We favour the introduction of a new paragraph 3.1 on the rationale and scope of Article 9 and its relationship with the domestic law. The proposed changes adequately clarify that 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 (in accordance with the other provisions of the Convention). In this regard, the deductibility of expenses is exclusively a matter to be determined by domestic law, subject to the provisions of the paragraph 4 of Article 24.

However, a fundamental question arises as to whether and how Article 9 deals with domestic provisions, other than domestic transfer pricing provisions, providing certain conditions for the deductibility of expenses that overlap with the criteria indicated in the OECD Transfer Pricing Guidelines[7] for assessing the arm's length nature of controlled transactions. For instance, with reference to intra-group services, domestic laws may limit the deduction of the expenses based on the same or equivalent condition which govern the benefit test included in section B.1.1 of Chapter VII of the

[7] OECD (2017), *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017*, OECD Publishing, Paris.

OECD Transfer Pricing Guidelines[8]. In such cases, it should be in our view clarified that an adjustment formally based on this kind of domestic provisions (even if the latter are not qualified by domestic rules as transfer pricing provisions) shall be covered within the scope of Article 9 inasmuch as they reflect criteria and conditions addressed by the OECD Transfer Pricing Guidelines and, consequently, be eligible for the mutual agreement procedure under Article 25 of the OECD Model[9] to resolve any double taxation issues.

4. Proposed changes to paragraph 4 of the Commentary on Article 9

The proposed changes to paragraph 4 of the Commentary reflect the clarification made on the nature and scope of Article 9. In this respect, the admissibility from a tax treaty perspective of special procedural rules implemented by some countries and aimed at verifying that the pricing of a transaction between associated enterprises is consistent with transfer pricing rules, such as the reversal of the burden of proof or certain presumptions, does not deal with Article 9 but with the non-discrimination clause. Although we agree with the rationale behind this proposal, we believe that further clarifications would be needed.

Where specific documentation or evidence ensuring that taxpayers give appropriate consideration to transfer pricing requirements in establishing prices and other conditions for transactions between associated enterprises is considered inadmissible by special procedural domestic rules (for instance because it was provided after a certain deadline imposed by procedural law), it should be clarified that such documentation or evidence can be submitted and will have to be taken into account in subsequent mutual agreement procedure where the domestic procedural rules do not apply. This may be the case, for instance, with reference to documents or data not available during the audit that are provided by the taxpayer at a later stage, but after a certain deadline imposed by domestic law.

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[8] OECD (2017), *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017*, OECD Publishing, Paris.
[9] OECD (2017), *Model Tax Convention on Income and on Capital: Condensed Version 2017*, OECD Publishing, Paris.

This would be consistent with the purposes of the Convention to eliminate economic double taxation as it would allow taxpayers the possibility to provide any document or evidence apt to prove that the transfer pricing applied in a controlled transaction is in accordance with the arm's length principle. Conversely, a preclusion determined by the application of a special procedural domestic rule would affect the consistency of the outcome of the mutual agreement procedure with the principles governing the Convention itself (and the arm's length principle primarily).

5. Proposed new paragraph 12.1 of the Commentary on Article 25

The proposed new paragraph in the Commentary on Article 25 provides a clear statement of the purposes of the Convention to eliminate double taxation by suggesting to the OECD member countries to provide access to the mutual agreement procedure also in cases of primary adjustment not justified by reference to the arm's length standard.

In this regard, the definition of primary adjustment provided by the OECD Transfer Pricing Guidelines[10] covers exclusively an adjustment based on the domestic transfer pricing provision of a Contracting State that is consistent with the arm's length standard. As stated by the OECD Transfer Pricing Guidelines[11], indeed, a "*primary adjustment is an adjustment that a tax administration in a first jurisdiction makes to a company's taxable profits as a result of applying the arm's length principle to transactions involving an associated enterprise in a second tax jurisdiction*". Therefore, we believe that the term "primary adjustment" might be inconsistent with the scope of paragraph 12.1 which provides for the access to the mutual agreement procedures also in the case of adjustments not justified by reference to the arm's length principle and would recommend using a different terminology. Based on the above, we propose to amend the wording of the first sentence of paragraph 12.1, as follows:

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[10] OECD (2017), *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017*, OECD Publishing, Paris.
[11] OECD (2017), *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017*, OECD Publishing, Paris.

> "*More generally, the economic double taxation that may result from* ~~***a primary adjustment***~~ ***the re-writing of accounts or more in general an 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* […]"

Moreover, the last sentence of paragraph 12.1. indicates that "*States should therefore provide access to the mutual agreement procedure in transfer pricing cases*". In our opinion the Discussion Draft should clarify that Contracting States should grant access to the mutual agreement procedure also in the case of re-writings of accounts of associated enterprises which are based on domestic provisions other than transfer pricing provisions.

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Please feel free to contact us at public-consultations@maisto.it with any questions or comments concerning this letter.

Sincerely yours,

Maisto e Associati