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

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EBIT Comments on Proposed Changes to Commentaries in the OECD Model Tax Convention on Article 9 and on Related Articles

Brussels, 28 May 2021

Dear Jeffrey,

EBIT's Members[1] thank the OECD for the opportunity to provide comments to the Public Consultation document "Proposed Changes to Commentaries in the OECD Model Tax Convention on Article 9 and on Related Articles"- 29 March - 28 May 2021. Below are a number of issues and comments that EBIT believes are important for the OECD to take into account.

General comments

EBIT Members are of the view that the approaches taken in the public consultation document are indicative of a next step in the direction of abolishing or at least diminishing the value of the arm's length principle, in particular in view of the developments of formulaic approaches under OECD Pillar I and Pillar II (e.g. the substance based carve-outs) and unilateral digital services taxes (and potentially the EU digital levy as well).

Differences of opinion exist between OECD member countries on how to approach issues related to capital structures (i.e. anti-abuse provisions or falling under Article 9). The proposed changes to the Commentaries, however, seemingly cover those differences with a flair of consensus which is as far as EBIT Members are aware non-existent on this matter. These issues are exacerbated even further by the EBITDA-rules under BEPS Action 4 - Limitation on Interest Deductions. Rather than adding a flair of consensus, EBIT Members believe it would be more useful to reflect the opinions of the different countries with regard to capitalisation issues and resolving double taxation. As an example, at least for the EU's Member States, such opinions were already published by the European Joint Transfer Pricing Forum related to its work for the period from March 2007 to March 2009.[2]

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[1] EBIT Members include Airbus Group, BP, Caterpillar, Constellation Brands, Diageo, GSK, Huawei, International Paper, Johnson and Johnson, JTI, Naspers, PepsiCo, Pfizer, P&G, Raytheon Technologies, RELX, Schroders and SHV Group. For more information on EBIT see: www.ebit-businesstax.com

[2] European Commission Staff Working Document accompanying the Communication to the Council, the European Parliament and the European Economic and Social Committee on the work of the EU Joint Transfer Pricing Forum in the period March 2007 to March 2009 and a related proposal for a revised Code of conduct for the effective implementation of the Arbitration convention (90/436/EEC of 23 July 1990) - Final Report of the EU Joint Transfer Pricing Forum on the Interpretation of some Provision of the Arbitration Convention - available at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52009SC1169&from=en

It seems rather strange to EBIT's Members that countries would exclude issues related to capitalisation from the scope of Article 9, in particular as arm's length approaches for determining an arm's length capitalisation have been developed and accepted under the Authorised OECD Approach (AOA). We are of the opinion that multinational enterprises have the freedom to choose how to finance their group members in the most efficient way. Hampering this free choice could lead to intervening with - or even distorting - business decisions.

As some countries label provisions targeting capital structures as anti-abuse provisions, access to MAP may be disallowed in such cases. EBIT Members are convinced that access to MAP should be granted to the maximum extent possible. The concept of anti-abuse should not be misused and we are of the opinion that capitalisation issues or the 30% EBITDA rule should not give rise to disallowing access to MAP. Therefore, countries should endeavour avoidance of double taxation in such case, meaning that in case one State disallows interest costs on excess debt based on domestic anti-abuse provisions, at least the country of the recipient of the interest should carve out the corresponding income part.

Article 9

The proposed changes seem to yield more weight to domestic legislation, leading to an increased danger of spill-over of those mismatches to the international tax scene. In turn, this will lead to unresolved double taxation. An example can be found in paragraph 3 of the revised guidance which indicates that:

> *3. [...] 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**[3] (including judicial doctrine), or in the OECD Transfer Pricing Guidelines.*

EBIT Members believe there is a need for giving clear priority to international rules and principles before considering the domestic qualifications (which will lead to unresolved double taxation when given priority and in case of mismatches).

We agree that the effective deduction of costs is governed by domestic legislation. The proposed Commentary can be read in such a way that the allocation of costs on the basis of Article 9 should come before the application of domestic legislation to those costs. We are seeing in practice, however, disputes over the location of where certain costs should be allocated, with the end result that those costs are not being deducted anywhere. For example, the recipient's State may qualify certain costs as shareholders costs, while the State of the provider qualifies those costs as services to be borne by the recipient. We are therefore of the view that all costs should be allocated and then deductible under the domestic law of that State. When a certain cost is felt not to be attributable to a particular group member it must be allocated to another group member. What we also see in practice is that countries do not make a formal adjustment on - say - services rendered, but indicate that the benefit test is not met - disallowing access to MAP as it strictly does not relate to taxation which is not in accordance with the treaty. Access to MAP should always be allowed.

EBIT Members find the following revised sentences in the proposed Commentary unclear and confusing:

> *2. [...} 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 re-writing of the accounts of associated enterprises 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*

[3] Emphasis added.

> *in the OECD Transfer Pricing Guidelines should be followed in any re-writing of accounts.*

The proposed Commentary seems to indicate that re-writing of the accounts is only permissible if the transaction is not performed under normal operating conditions and hence that 'abnormal' conditions can be revised. This may be interpreted as allowing to adjust commercially or economically rational transactions that are not found between unrelated parties. The 2017 OECD Transfer Pricing Guidelines indicate therefore that the mere fact that a transaction is not found in the open market, does not automatically lead to the transaction not being at arm's length (see for example paragraphs 1.11 and 6.108). It would therefore be useful if the proposed Commentary were to be explained further in that sense.

Article 6
With regard to paragraph 6 of the revised Commentary, EBIT Members consider that a reference to MAP would be appropriate. On the new paragraph 6.1 of the revised Commentary, EBIT Members agree that a mismatch in domestic legislation does not necessarily lead to economic double taxation but it may lead to higher taxation. We also agree that in case of such higher taxation no corresponding adjustment should be made if the overall allocation is at arm's length. If the mismatch between domestic legislations leads to a non arm's length result, corresponding adjustments (and MAP) should be available.

Article 7
EBIT Members recognize that the proposed redrafting of paragraph 59 of the Commentary is mirroring the revised Commentary on Article 9. The revised paragraph is only addressing the 'new' Article 7 and the application of the AOA. Similar issues may occur, however, under the application of the AOA under the 'old' Article 7. We believe that the same principle should apply, irrespective of whether the AOA is applied under the 'old' or 'new' text of Article 7.

Article 24
EBIT Members note the suggestion on the 'reversal of the burden of proof' element which is moved from paragraph 4 of the Commentary on Article 9 to paragraph 75 of the Commentary on Article 24. It would be useful to refer to / repeat in the same paragraph the point that tax authorities should be limited to asking only foreseeable relevant information and not to proceed to fishing expeditions.

Article 25
We welcome the addition of paragraph 12.1 to the Commentary on Article 25 (access to MAP for transfer pricing cases). We also believe that the Commentary could benefit from reminding the good faith application of tax treaties by the parties concerned.

EBIT Members trust that the above comments are helpful and are taken into account. We are keen to continue to engage in discussions which will help drive this project forward and in the further consultations that will be required if matters are to be implemented successfully.

Yours sincerely,

European Business Initiative on Taxation – May 2021

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