

Ms. Marlies de Ruiters,  
Head, Tax Treaties, Transfer Pricing  
and Financial Transactions Division,  
OECD,  
2 rue André Pascal,  
75116 Paris

08 January 2015

Ref.: TPG/PKR/PGI

Dear Ms Marlies de Ruiters,

**Re: FEE comments on Public Discussion Draft – Follow-Up Work on BEPS Action 6 (Preventing Treaty Abuse)**

- (1) FEE (the Federation of European Accountants, [www.fee.be](http://www.fee.be)) is pleased to provide you below with our comments in respect of the discussion draft that deals with follow-up work mandated by the Report on Action 6 “Preventing the granting of treaty benefits in inappropriate circumstances”(“the Report”) of the BEPS Action Plan. The following comments focus on an EU perspective.
- (2) FEE represents 47 professional institutes of accountants and auditors from 36 European countries, including all 28 European Union (EU) Member States. It has a combined membership of over 800.000 professional accountants, working in different capacities in public practice, small and big accountancy firms, businesses of all sizes, government and education. Adhering to the fundamental values of their profession – integrity, objectivity, independence, professionalism, competence and confidentiality – they contribute to a more efficient, transparent and sustainable European economy.

**Item A.4. – Alternative Limitation of Benefits (LOB) provisions for EU countries**

**Background**

- (3) The OECD discussion draft acknowledges that the LOB rule needs to be adapted to reflect certain requirements within EU law. Therefore, there is a need to draft an alternative provision in order to accommodate the concerns of EU Member States. Although specific comment on this was not requested in this paper we believe that it would be useful to provide you with our comments on this matter in advance of further consideration
- (4) The most relevant requirements within EU law to be taken into consideration in this context are:

- The **Treaty on the Functioning of the European Union**, especially insofar as it pertains to the Fundamental Freedoms;
- **EU Directives** and their transposition into national law of the Member States (which may differ between Member States if options within the Directives are available), i.e.:
  - Parent-Subsidiary Directive;
  - Merger Directive;
  - Interest and Royalty Directive;
  - Savings Taxation Directive.
- The **EU Arbitration Convention**. This is a procedure for resolving disputes where double taxation occurs as a result of an enterprise being affected by an upward adjustment of profits by a Member State different to the one in which the company is resident for tax purposes. Whilst most bilateral double taxation treaties include a provision for a corresponding downward adjustment of profits of the associated enterprise concerned, they do not generally impose a binding obligation on the Contracting States to eliminate the double taxation. In situations where competent authorities do not agree on the treatment of a transaction or situation, thereby leading to the potential for double taxation and the consequent use of the discretionary relief provision, the EU Arbitration Convention would probably force the Contracting Member States to resolve the potential double taxation within a limited time frame.

#### **Issues Arising from Potential Conflicts between the EU Fundamental Freedom of Establishment and the Limitation of Benefits (LOB) Provisions**

- (5) Paragraph 13 of the Report acknowledges that the LOB provisions, as currently drafted, need to be adjusted to take account of EU law. We have identified the following proposed amendments to the OECD Model Tax Convention that may be at variance with EU law and, therefore, may require alternative wording or a carve-out.
- a. Draft Article X para 2 c) ii - The rule that intermediate companies have to be **residents** of either Contracting State.
  - b. Draft Article X para 2 e) i - The **ownership test**, which requires that (on at least half of the days of the taxable period) at least 50% of the voting power and value are owned by a qualified person **resident** in the Contracting State (or that each intermediate owner is a **resident** of that Contracting State).
  - c. Draft Article X para 3 - The **active trade or business test**, which requires that the business of a person in **its country of residence** should be substantial compared to its own (or its associated enterprise's) business in the other Contracting State, if the person derives income from the source state activity or associated enterprise.

#### **Justification of Infringements to the Freedom of Establishment**

- (6) Infringements of the freedom of establishment can be justified in certain circumstances; in particular if intended to prevent abuse of law<sup>1</sup>. However, the Court of Justice of the European Union (CJEU) accepts preventing abuse of law as justification for infringements of the Fundamental Freedoms only if certain requirements have been fulfilled.
- (7) One requirement is that the taxpayer whose transaction is tackled by an anti-avoidance rule should have the possibility to demonstrate (without undue administrative constraints) that their actions were not abusive in the individual case under consideration.
- (8) However, the **discretionary relief provision** in the BEPS Treaty Abuse proposals will probably not fulfil this requirement as it **does not grant a right** to the taxpayer to receive the treaty benefit if he can substantiate that his actions were not abusive. The final decision is left solely to the discretion of the competent authority of the Contracting State from which benefits are being claimed (sometimes after consultation with the competent authority of the other Contracting State). Consequently, the discretionary relief provision is unlikely to constitute a proper justification for the above-mentioned infringements of the freedom of establishment.
- (9) The infringement could also be justified if the Contracting States implementing the infringing rule **mutually agree** on the allocation of the right of taxation. However, the current Article X OECD-MA draft takes a fundamentally different approach in that it **does not allocate the right of taxation**, but rather precludes the application of treaty benefits.
- (10) It could be argued that agreeing to the OECD's proposals constitutes an effective means of allocation of taxing right. However, the justification for infringement would still likely fail as such an allocation would not be in **mutual agreement**. The discretionary relief provision allows **a unilateral decision from just one of the Contracting States** (or without consensus between the competent tax authorities of the Contracting States).

#### **Potential Issues Arising from Conflicts between the LOB Provisions and EU Directives as transposed into national law**

- (11) When a dividend received by a legal person under a double taxation agreement qualifies for a tax exemption under the **EU Parent-Subsidiary Directive**, it would then seem logical that the competent authority should not deny treaty benefits under the LOB rule.
- (12) Likewise, if interest income or income from royalties received by a legal person under a double taxation agreement qualifies for a tax exemption under the **EU Interest and Royalties Directive**, it would then seem logical that the competent authority should not deny treaty benefits under the LOB rule.

---

<sup>1</sup> i.e. Centros case (C-212/97, point 24) - a Member State is entitled to take measures designed to prevent circumvention of their national legislation or to prevent improper or fraudulent advantage being taken of provisions of Community Law.

- (13) In some cases similar conflicts can occur with regard to the **Savings Taxation Directive** and the **Merger Directive**.

**Extension of the aforementioned comments regarding the LOB clause to the EFTA countries Iceland, Liechtenstein and Norway belonging to the European Economic Area (EEA)**

- (14) The freedom of establishment also applies to the EFTA States (Iceland, Liechtenstein and Norway)<sup>2</sup>. Consequently, FEE believes that the aforementioned constraints related to the freedom of establishment are also applicable with regard to the EFTA States and any adjustment of the LOB clause related to this should also be applicable to these States.

**Item B.11.-17. – Principal Purpose Test and its application to EU/EFTA countries**

- (15) There are issues arising for EU/EFTA countries from the potential application of Article X, para 7. The Principal Purpose Test, as currently drafted in the OECD paper, could be applicable provided that obtaining a treaty benefit was “one of the principal purposes”. The reference to “one of the principal purposes” means that obtaining a benefit under a tax convention need not be the sole or dominant purpose but merely one of the purposes of the transaction or arrangement. Based on current jurisprudence, neither the EFTA Court nor the CJEU would be likely to accept such wording as justification for an infringement of the freedom of establishment.
- (16) According to the wording of the Principal Purpose Test treaty benefits can be denied if **only one** of the principal **purposes** of the taxpayer is to obtain a treaty benefit. This contradicts the judicial interpretation of the freedom of establishment. According to the view of the CJEU and the EFTA court, a restriction of the freedom of establishment is only justified if the **only** purpose of such a transaction is to obtain a tax benefit.<sup>3</sup>
- (17) In conclusion, FEE recommends that the Principal Purpose Test be amended in such a way that it will only be applicable when the **only** purpose of the transaction is to obtain a treaty benefit.

---

<sup>2</sup> **Article 31** of the Agreement of on the European Economic Area - “...there shall be no restrictions on the freedom of establishment of nationals of an EC Member State or an EFTA State in the territory of any other of these States...”

**Article 34** of the same agreements -: “Companies or firms formed in accordance with the law of an EC Member State or an EFTA State and having their registered office, central administration or principal place of business within the territory of the Contracting Parties shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of EC Member States or EFTA States. ...”

<sup>3</sup> i.e. EFTA Court on 9 July 2014 (Olsen), the court stated that “What is decisive [to assess an artificial character] is the fact that the activity, from an objective perspective, has no other reasonable explanation but to secure a tax advantage” (see rec. 175)

Similar terminology has been used in CJEU judgements, i.e. C-112/14 as of 13 November 2014, where the court used the phrase “to identify the existence of a wholly artificial arrangement entered into for tax reasons alone” (see rec. 27) in their consideration of whether a national rule could justifiably restrict the fundamental freedoms.



For further information on this letter, please contact Paul Gisby, Manager, from the FEE Team on +32 2 285 40 70 or via e-mail at [paul.gisby@fee.be](mailto:paul.gisby@fee.be).

Yours sincerely,

Petr Kriz  
President

Olivier Boutellis-Taft  
Chief Executive