

Paris, 21 January 2010

Revised Discussion Draft of a New Article 7 of the OECD Model Tax Convention dated 24 November 2009 (the "Revised Article 7 Draft")

Dear Jeffrey,

First and foremost, thank you to the OECD for the excellent work on the Revised Article 7 Draft. BIAC commends the project team for bringing clarity and focus to the Revised Article based on its purpose and for establishing direct mechanisms for carrying out that purpose.

The language and structure of the new Article 7 are vast improvements and we think will be a workable format for handling attribution of income issues in practice. In particular, we applaud the direct attention to elimination of double taxation. We think the revised language provides the required additional direction that is both necessary and critical for the goal of elimination of double taxation.

As in any work there are features that in the written explanation are obscure or incomplete. We have noted several points in the Commentary that we think could be revised for improvement. They are set forth below.

Cordially,



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Detailed Comments on Certain Paragraphs of the Commentary under Article 7

Paragraph 27: This paragraph appears to depart from the objective of determining the profits attributable to a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions. Instead, this paragraph includes language that either can authorize a jurisdiction to impose tax on notional charges that are not occurring or can authorize a jurisdiction to depart from the determination of profits on an arm's length basis in circumstances that involve a notional charge with respect to which tax is not imposed. In either case, such a provision would be antithetical to the limited objective of determining the profits attributable to a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, and the Commentary should therefore not include such a provision.

Paragraph 38: The last sentence states that the determination of the profit attributable to a permanent establishment requires deduction of an arm's length charge or of the actual expenses. The selection of which deduction is correct is "Depending on the circumstances" but the published guidance does not identify the circumstances that warrant deduction of all or part of the expenses rather than deduction of an arm's length charge. The circumstances in which deduction of all or part of the expenses satisfies the arm's length standard should be clarified.

Paragraph 46: The introductory prepositional phrase of Paragraph 46, "In some cases," suggests that it is an example of some of the circumstances described in Paragraph 45, but it involves a completely different set of circumstances. We suggest deleting "In some cases, however" and substituting "In cases in which the States do not agree that the amount of profits treated as attributable to a permanent establishment was in conformity with the requirements of paragraph 2".

Paragraph 48: The last sentence of this paragraph contains a superfluous and unsupported assertion about the likelihood that taxpayers will have recourse paragraph 3 of Article 7. This prediction does not provide any guidance. We cannot perceive of a benefit to including this sentence in the Commentary and therefore suggest deleting it.

Paragraphs 53 through 57 and 67: These paragraphs appear to suggest that the tax authority that makes an adjustment will, on its own initiative, both give notice to the other tax authority about an adjustment that could create double taxation and invoke the mutual agreement procedure to prevent double taxation. The obligation of the tax authority making such adjustments to initiate an exchange of information about the adjustments and to invoke the mutual agreement procedure should be stated explicitly. In addition or alternatively, the right of the affected taxpayers to act to invoke the mutual agreement procedures in such circumstances should also be stated explicitly. While we recognize that Commentary paragraph 62 refers to a taxpayer being able to use the mutual agreement procedure in this context, we think that further clarification is necessary.

Also, the language of paragraph 57 regarding when a corresponding adjustment is required (“only if it considers that the adjusted profits correctly reflect what the profits would have been if the permanent establishment’s dealings has been transactions at arm’s length”) is, we think, incomplete in dealing with the problematic circumstances that it contemplates. The alternate version of paragraph 3 in part deals with the vacuum that can come from invoking paragraph 57. The alternate version, according to paragraph 67 of the Commentary, creates a legal obligation on the State being asked to give a corresponding adjustment. It further states that if the two Contracting States do not reach an agreement to eliminate the double taxation, they will both be in violation of their treaty obligation. However, it can be foreseen a situation where the two States do not reach an agreement and the mutual agreement procedure is open but does not produce the intended result (avoidance of double taxation). We would like to see more guidance in the Commentary on remedies that taxpayers have in this situation. In particular, workable guidance is requested when the treaty between the States does not provide for arbitration (For example, paragraphs 86 and 87 of the Commentary to Article 25 suggest the use of supplementary dispute resolution mechanisms. A similar mechanism should be provided for this Article as well.)

Paragraph 59: We applaud this language. We are concerned that the treatment of secondary adjustments in this paragraph, while fully consistent with the position we are advocating, would not be correct in cases in which the treaty adopts the alternative positions to which we objected in paragraph 27. Our preferred approach would be to eliminate the alternative positions that paragraph 27 allows.

Paragraph 62: We suggest inserting the concluding two sentences of paragraph 67 as the concluding two sentences of paragraph 62. Paragraph 62 should make clear that, in the context of a mutual agreement procedure pursuant to paragraph 3 of article 7, the failure to reach an agreement to eliminate double taxation would be a violation of the of the treaty obligations and that the obligation to eliminate double taxation is much stronger than the standard of paragraph 2 of Article 25.

Paragraph 66: We have concerns about this provision. As a general matter, we are concerned that the process of the recommended paragraph 3 of article 7 would create a race among tax authorities to initiate an adjustment and rewards the first tax authority to make an adjustment with that adjustment if it is in accordance with paragraph 2 of article 7. The alternative provisions that Commentary paragraph 66 authorizes addresses this concern by requiring a mutual agreement procedure. The countervailing consideration is imposing on tax authorities and taxpayers increased costs for mutual agreement procedures whenever a tax authority makes an adjustment pursuant to paragraph 3 of article 7. On balance, we are of the view that the alternative of paragraph 66 imposes too great a cost on tax authorities and taxpayers and should be withdrawn. The recommended paragraph 3 allows for a mutual agreement procedure in the case of a proposed adjustment that is not in accordance with paragraph 2 of article 7, and we favor limiting mutual agreement procedures to such circumstances.