Mexico City, June 17th, 2015

Via e-mail
taxtreaties@oecd.org
Ms. Marlies de Ruiter
Head of the Tax Treaties,
Transfer Pricing and Financial Transactions Division
OECD/CTPA

Dear Ms. De Ruiter,

On behalf of IFA Grupo Mexicano, A.C. (Mexican Branch of the International Fiscal Association) kindly find below the comments on the Revised Discussion Draft on Action 6 (Prevent treaty abuse) of the BEPS Action Plan and its Proposals on how to deal with the issues for Follow-up Work on the Report on the Action 6 mentioned.

Comments

Part 1.- Alternative "simplified" LOB rule and presentation of the LOB rule in the OECD Model

When analyzing the simplified LOB rule we realized that in the simplified version included in the Revised Discussion Draft, the considerations related to paragraph 4 of Article X (Entitlement of Benefits), related to the derivative benefits, are missing. We consider that this omission should be corrected in the final version.

Additionally, considering that the simplified LOB rule includes only the basic items of the LOB test, but it does not include a rule to consider the Pension funds, Charities and Collective Investment vehicles as qualified persons, we believe that it is important to establish a clear threshold for considering this kind of persons as qualified persons.

Finally, regarding the presentation of the LOB rule in the OECD Model Tax Convention, we agree with the structure illustrated in the **Annex**, which describes the main features of the LOB in the Articles of the OECD Model and presents the alternative formulations of each paragraph in the Commentary.

Part 2.- Issues identified in the November 2014 Discussion Draft

A. ISSUES RELATED TO THE LOB PROVISION

1.- Collective investment vehicles: application of the LOB and treaty entitlement

We believe that because the success of the implementation of the TRACE project has not yet been proved and that while there was a "general support" of the conclusions of the 2010 CIV Report concerning the treaty entitlement of CIVs, the current perspective drafted in the Revised Discussion Draft leaves open an uncertainty window just by the mere fact of referring to the CIV report and to the expectations about the TRACE project of providing practical solutions to the issue. In our point of view, this uncertainty should be reduced within the final version of the Report on Action 6 by the end of September, 2015.

2.- Non-CIV funds: application of the LOB and treaty entitlement

We believe that in spite of the inclusion of the new treaty provision on transparent entities in Part 2 of the Report on Action 2 (Neutralising the effects of hybrid mismatch arrangements) that has been made and that, according with the Revised Draft Discussion, only "some of the concerns" have been considered in the possible inclusion of a derivative benefits provisions in the LOB rule, such statement would not be enough to provide the certainty needed for either the global investors and the governments involved about the provisions and cases that they should apply on their non-CIV funds; and in consequence, we highly recommend to address this uncertainty.

What is more, the Revised Discussion Draft provides that all of the work on Action 6, would not be finished on the original final due date (September 2015) but in any event afterwards (new due date: before December 2016), increasing the uncertainty around this issue.

3.- Commentary on the discretionary relief provision of the LOB rule

Our point of view and in benefit of certainty, is that it would be important to specify the concepts: “clear non-tax business reasons”, ”a substantial relationship to its State of residence” and “expeditiously” for those companies that are not treaty shopping.

We do believe that it will be a challenge for the competent authorities to set the basis needed to ensure the procedures, timing and conditions between the Contracting States, however, any uncertainty and lack of definitions would prevent the aligning between the new provisions.

4.- Alternative LOB provisions for EU countries

The introduced alternative test would be met if more than 90% of the beneficiaries are resident of either Contracting State or another state; if those individuals are entitled to the benefits of a tax treaty between that other state and the state from which the benefits are claimed and finally; with respect to interest and dividends, they would be entitled to the same or lower rate of tax under a tax treaty between the source state and such other state as it would apply if the individual were a resident of the same state as the pension fund.

In this regard, we believe that the introduction of this alternative will likely translate in extra cost and complexity, specifically for those beneficiaries or participants that would not be retired in the residence state of their pension funds, considering the number of beneficiaries and locations of their participants. In consequence, we believe that it is recommendable to provide a proper guidance about the foreign participation in a pension fund or a qualified person.

5.- Requirement that each intermediate owner be a resident of either Contracting State.

Our point of view on this matter, is that this restriction is questionable and disproportionate, and that it would result in ineligibility for a treaty benefit where no treaty

shopping exists. Even more if the concerns about abuse will already be covered by the work on Action 3 on CFC Rules.

6.- Issues related to the derivative benefits provision

A. It is important to consider that, the **Proposal 1**("***New Treaty provisions on "special tax regimes"")*** is pretty close to the proposal made by the US Treasury with respect to the new definition in Article 3, paragraph 1, l) named "special tax regimes". However, in addition to the absence of a definition of the terms: "a preferential tax rate of taxation" and "a low effective rate of taxation", included in the proposed paragraph X), there are certain issues to observe:

i. Exclusions:

The Proposal 1 takes a broad approach regarding the key features of a special tax regime, but, differently than the scope of the proposal made by the US Treasury (which is excluding any legislation, regulation or administrative practice that satisfies a substantial activity requirement with respect to ***Royalties),*** the Revised Discussion Draft is excluding from the definition of special tax regime: any legislation, regulation or administrative practice that satisfies a substantial activity requirement with respect to ***financing income*** (the term special tax regime includes notional interest deductions that are allowed without regard to liabilities for such interest) or those ***designed to prevent double taxation***.

ii. New provisions and their scope of application:

The Revised Discussion Draft includes new provisions that would be added to Articles 11 (Interest), 12 (Royalties) and 21 (Other income) of the OECD Model that would deny treaty benefits with respect to interest, royalty payments or other income ***beneficially owned by residents benefiting from a special tax regime in their country of residence at any time during the taxable period in which such income was paid*.**

On the other side, the proposal made by the US Treasury about these provisions ***only would deny treaty benefits with respect to related party payments.***

B. The **Proposal 2** ("***New general treaty rule intended to make a tax treaty responsive to certain future changes in a country´s domestic tax laws")*** is also similar to the proposal made by the US Treasury with respect to the tax treaty responsive to future changes that would trigger a special tax regime. However, we observed the following issues that would generate constitutional issues in certain jurisdictions:

i. The Revised Discussion Draft has established a new general rule that is considering that, at any time after the signing of the Convention, either Contracting State provides ***an exemption*** from taxation to resident companies or individuals for substantially all foreign source income (including interest and royalties), the provisions of Article 10 (Dividends), 11 (Interest), 12 (Royalties) and 21 (Other income) may cease to have effect for payments to companies / individuals resident of either Contracting State.

In addition, the difference between the Proposal 2 made in the Revised Discussion Draft versus the one issued by the US Treasury is that, for the OECD Model the partial treaty termination would only apply if a country provides an exemption from taxation; while the US Model proposal would also apply if there is a reduction on the tax rate below 15%.

We believe that, this turn off on the treaty provisions would raise constitutional issues in certain jurisdictions, due to the uncertainty about the notification process between the Contracting States. Furthermore, the OECD proposal includes just as an option, to notify the other treaty country of the change in domestic law, lacking the certainty of the application of this new general treaty rule.

B. ISSUES RELATED TO THE PPT RULE

12.- Inclusion in the Commentary of the suggestion that countries consider establishing some form of administrative process ensuring that the PPT rule is only applied after approval at a senior level

We would like to have a recommendation about the time frame in connection with said administrative process.

14.- Aligning the parts of the Commentary on the PPT rule and of the Commentary on the LOB discretionary relief provision that deal with the principal purposes test

In this regard, we would like to stress out that throughout the document the reference is "principal purpose test" and not "one of the principal purposes test", which gives the idea that the test is, as we consider it should be, that treaty benefits will be denied only when **the** principal purpose of entering into a transaction is to benefit from a tax treaty unless in accordance with the object and purpose of the relevant provisions of the Convention, i.e.: an artificial arrangement, but not when only one of the principal purposes of entering into a transaction is to benefit from a tax treaty unless in accordance with the object and purpose of the relevant provisions of the Convention.

We know the name of the test "one of the principal purposes test rule" would be too long, but our point is that is different to state that "the principal purpose" of a transaction was to benefit from a tax treaty than to state that "one of the principal purposes" of a transaction was to benefit from a tax treaty.

On the other hand, there is no explanation of the changes to paragraph 63.1. of the Commentary, some of which are material.

Paragraph 63 used to make reference to "clear reasons, unrelated to the obtaining of treaty benefits, for its formation, acquisition, or maintenance and that any reasons, related to the obtaining of treaty benefits were clearly secondary to those unrelated reasons", which recognized that obtaining treaty benefits could clearly be secondary to certain unrelated reasons.

The proposed paragraph 63 merely disregards that a taxpayer may enter into a given transaction and still consider secondarily, benefitting from a tax treaty as a tax reason for entering into said transaction.

Additionally, it is worth noting that the proposed paragraphs 63.1 and 63.2 of the Commentary on the discretionary relief provision of the LOB rule forget to make reference

to if “one of the principal purposes” of carrying out a transaction in a given way is the obtaining of tax treaty benefits then those treaty benefits should be denied, ***unless*** it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.

On the other hand, we find too arbitrary to state in the proposed paragraph 63.1. that “It is not necessary to find conclusive proof of intent but the competent authority must be able to conclude, after an objective analysis of the relevant facts and circumstances, that none of the principal purposes for the establishment, acquisition or maintenance of the person and the conduct of its operations was to obtain benefits under the Convention” because it cannot be judged lightly and so arbitrarily; the consequences of denying tax treaty benefits when they should not be denied could be fatal.

We also believe that the burden of proof that one of the principal purposes of carrying out a certain transaction was to obtain tax treaty benefits unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention should lie with the competent authority, since there is no clear guidance as to what is considered to be “in accordance with the object and purpose of the relevant provisions of the Convention”.

15.- Whether some form of discretionary relief should be provided under the PPT rule

We would like to have a time frame of when will the competent authority determine that the benefits would have been granted to a person upon request to contribute to certainty.

We did not see that the proposed paragraphs 16-19 take on account the re-characterization of income or a transaction that a competent authority may make under domestic laws, for which the discretionary relief should also be provided. Plus, the discussion draft under revision mentions that it is adding paragraphs 16 to 24 but paragraphs 20-24 are missing in the revised discussion draft.

16.- Drafting of the alternative "conduit-PPT rule"

Our comments are on Example D, which although recognizes expressly that "seeking the benefits of the treaty between State R and S is clearly a factor in SCO's decision" and that "it may even be a decisive factor, in the sense that, all else being equal, the availability of treaty benefits may swing the balance in favour of borrowing from RCO rather than from another lender", concludes that "whether the obtaining of treaty benefits was one of the principal purposes of the transactions would have to be determined by reference to the particular facts and circumstances".

We find that conclusion incongruent because it makes no reference to the requirement that the obtaining of treaty benefits be in accordance with the object and purpose of the relevant provisions of the Convention.

Regarding Example E, we believe it should conclude that there is no conduit arrangement, not because RCO has subsidiaries located around the world and because said subsidiaries carry out similar activities in countries which have treaties which offer similar or more favorable benefits, but because RCO is the holding company which natural role is to consolidate licenses from its subsidiaries and sublicense them to said subsidiaries.

Finally, as for Example F, our opinion is that the example should not reach said conclusion considering a given number of employees (50), but a sufficient and qualified number of employees to undertake a given activity, which in some cases might suffice to be 1, and this would still be a real business performing substantive economic functions, depending on the nature of the business.

17.- List of examples in the Commentary on the PPT rule

Example G admits that the decision to establish RCO as a regional company in State R, was made considering, among other factors, "the comprehensive double taxation treaty network of State R, including its tax treaties with the five States in which TCO owns subsidiaries, which all provide low withholding tax rates".

Notwithstanding this, the example concludes that “it would not be reasonable to deny the benefits of the treaties concluded between State R and the five States”. Although we agree with the conclusion, we believe it is confusing, since it does not make reference of the obtaining of the tax treaty benefits being in accordance with the object and purpose of the relevant provisions of the Convention.

C. Other issues

18.- Application of the new treaty tie-breaker rule

In this regard, we would like to have a specification of what “expeditiously” and “as soon as possible” mean in the proposed paragraph 24.2 in order to have certainty.

19.- The design and drafting of the rule applicable to permanent establishments located in third States

On this topic we have two comments:

a) Paragraph 105 of the discussion draft proposes deleting the specific exemption for royalties provided in subparagraph f) arguing that many situations that would have otherwise been covered by subparagraph f) would be dealt with by subparagraph e), however our concern is that not all of the circumstances of subparagraph f) will be dealt with but only “many” of them, which we believe is not enough.

b) About the proposed changes to the provision included in the paragraph 42 of the Report on Action 6, we think the effective rate of tax on the profits of the permanent establishment in the third jurisdiction should be compared to the effective tax rate of the Residence State, and not to “the general rate of company tax” as proposed.

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The participation of IFA Grupo Mexicano, A.C. is made on its own behalf exclusively as an IFA Branch, and in no case in the name or on behalf of Central IFA or IFA as a whole.

We hope you find these comments interesting and useful. We remain yours for any questions or comments you may have.

Sincerely,

IFA Grupo Mexicano, A.C.