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Opinion Statement FC 14/2016

**on the OECD Discussion Draft
on Branch mismatch structures (BEPS Action 2)**

Prepared by the CFE Fiscal Committee

Submitted to the OECD in September 2016

The CFE (Confédération Fiscale Européenne) is the umbrella organisation representing the tax profession in Europe. Our members are 26 professional organisations from 21 European countries with more than 200,000 individual members. Our functions are to safeguard the professional interests of tax advisers, to exchange information about national tax laws and professional law and to contribute to the coordination of tax law in Europe.

The CFE is registered in the EU Transparency Register (no. 3543183647-05).

We will be pleased to answer any questions you may have concerning CFE comments. For further information, please contact Piergiorgio Valente, Chairman of the CFE Fiscal Committee, or Rudolf Reibel, CFE Tax Policy Manager, at brusselsoffice@cfe-eutax.org.

Introduction

This Opinion Statement by the CFE Fiscal Committee relates to the OECD discussion draft “BEPS Action 2: Branch Mismatch Structures”¹ (hereinafter the “Discussion Draft”), released for public consultation on 22 August 2016 as a follow-up to the Action 2: 2015 Final Report (the “Report”)².

Reference is made to the Opinion Statements submitted previously, i.e. (i) Opinion Statement FC 9/2014 of May 2014 and FC 4/2015 of February 2015 on Neutralising the Effects of Hybrid Mismatch Arrangements (BEPS Action 2)³.

Our comments below will, to the extent relevant, repeat and further expand on, our comments and observations submitted earlier and will, *mutatis mutandis*, apply to all recommendations in the Discussion Draft, thus avoiding the need to respond specifically to the questions raised.

1. EU Treaty Freedoms

As a general point, concern was raised regarding the compatibility of the solutions proposed by the OECD to counter BEPS with the EU Treaty freedoms. As the majority of OECD countries are EU member states, bound by the fundamental freedoms in the Treaty on the Functioning of the EU, notably the free movement of capital (Art.63 TFEU), and their interpretation by the EU Court of Justice, the success of any OECD solution to solve BEPS caused by hybrid mismatches will depend to a great extent on the compatibility of such a solution with the EU fundamental freedoms. One of the proposed rules that could result in a potential conflict with the EU Treaty freedoms is the branch payee mismatch rule where it does not concern a “wholly artificial arrangement”. In light of the Cadbury Schweppes decision⁴ of the Court of Justice of the European Union, a national tax measure aimed at countering tax avoidance which restricts an EU Treaty freedom (freedom of establishment in Cadbury case) may only be justified if it specifically relates to wholly artificial arrangements. Where a payment does not get taxed in the branch jurisdiction or in the jurisdiction where the head office of the branch is located as a result of a hybrid mismatch covered by the Discussion Draft, it would be difficult to successfully apply the branch payee mismatch rule where the arrangement/structure is not a wholly artificial arrangement that does not reflect economic reality.

2. Complexity of proposed rules in view of the tax treatment in one jurisdiction being contingent on the tax treatment in one or more other jurisdictions

2.1. The proposed recommendations to the types of mismatches identified in the Discussion Draft (i.e. (a) deduction/no inclusion outcome, (b) double deduction outcomes, and (c) indirect deduction/no inclusion outcomes) have in common that depending on the tax treatment in one jurisdiction, income is included as taxable income in other jurisdiction or no deduction is allowed in the payee jurisdiction. The correct implementation of these recommendations will

¹ www.oecd.org/tax/beps/Discussion-draft-Action-2-Branch-mismatch-structures.pdf

² www.oecd.org/tax/beps/neutralising-the-effects-of-hybrid-mismatch-arrangements-action-2-2015-final-report-9789264241138-en.htm

³ Both Opinion Statements: www.cfe-eutax.org/node/3676

⁴ Judgment of 12 September 2006 in case C-196/04:

<http://curia.europa.eu/juris/document/document.jsf?docid=63874&doclang=EN>

require initially the taxpayer and subsequently the tax authorities to confirm the tax treatment of certain payments. Therefore, these recommendations will be extremely difficult to implement in such a way to make it reasonably effective in practice.

- 2.2. By way of illustration of the comment made in par. 2.1 above, the proposed branch payee mismatch rule (i.e. denial of interest deduction by the payer jurisdiction) may not be practical as, under that rule, the payer (C Co) will be required to gather information as to the treatment of the interest payment at various levels within the group of companies.
- 2.3. Further, if the branch payee mismatch rule were to be introduced and that rule were to only apply to payments made under a structured arrangement or between members of the same control group, additional definition and tests would be required, thus making the proposed rule extremely complex. The risk of varying interpretations by the countries involved could increase and, as a result, the objective of the rule may not be realized.
- 2.4. In addition, limiting the branch payee mismatch rule to “structured arrangements”, would, for it to be effective, require that there is complete agreement between the jurisdictions as to the meaning and scope of this term. If there is no such agreement, attaining the objective to solve the issues addressed by the Discussion Draft would prove to be illusory.

3. Implementation under domestic law versus an amendment of tax treaties.

- 3.1. Hybrid mismatches addressed in Action 2 mainly result from differences in domestic laws of the relevant countries, whereas most branch mismatches seem to arise from the application and interpretation of tax treaties (Art. 7 and Art 23A OECD Model) in combination with the lack of implementation of the principles set forth in the tax treaties under domestic law. Accordingly, CFE recommends that the issue of branch mismatches to the extent possible should be addressed in tax treaties by way of clarifications or modifications rather than the introduction of isolated rules in domestic laws. Thus, ideally domestic laws may need to be amended to support the functioning of the modified treaty provisions.
- 3.2. There is an additional reason for the CFE’s recommendation to address, as a first step, branch mismatch structures through tax treaties. The disregarded branch structures and the diverted branch payments are essentially an issue of the different allocation by the jurisdictions involved of the assets and liabilities and income and expenses to permanent establishments. The recommended rules in paras 14-16 of the Discussion Draft, requiring modifications to domestic laws (i.e. exemption rules), should be such that they can operate effectively in practice. This will require existing tax treaties to be modified, first by clarifying the allocation (to permanent establishments) rules and the rules on the method for elimination of double taxation.
- 3.3. Explanation: As regards the disregarded branch structures, in many cases a tax treaty will be in place between the residence jurisdiction and the branch jurisdiction. The exemption method set forth in Art. 23A of the OECD Model Tax Convention provides for an exemption to be applied by the residence jurisdiction for the profit attributable to a permanent establishment (Art. 5 OECD Model). The profit attributable to the permanent establishment is determined on the basis of Article 7 of the relevant treaty. In view of the approach followed in Art. 7 and Art. 23A, the recommendation likely will have no effect in many cases, i.e. it may

contravene the said treaty rules. CFE recommends to amend the tax treaties, i.e. to grant exemption to the extent the profits generated by the branch are actually taxed in the branch jurisdiction or, alternatively, to include a provision similar to Art. 23B OECD (Credit Method) as the main rule for avoidance of double taxation.

3.4. As described above, in par. 2.3., the *ultimum remedium* of the branch payee mismatch rule gives rise to complications that, by all means and where possible, should be avoided. From this perspective, the best way to avoid (the need for) application of the branch payee mismatch rule is to address the branch mismatch structures at the level of the branch and home jurisdiction in the form of the implementation of the relevant proposed rules in tax treaties supplemented by the adoption of amendment of domestic law rules that are consistent with the treaty rules.