STUDIO
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legale - tributario

Milan, June 30, 1016

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Subject: BEPS 15 - request for input on the development of a multilateral instrument to implement the tax treaty-related BEPS measures

Dear Sirs,

Thank you for the opportunity to provide inputs on the development of a multinational instrument to implement the tax treaty BEPS related issues.

We understand that inputs are requested on technical issues to be considered in adapting the BEPS measures through the multilateral instruments, as well as the approach to be taken into account in developing a mandatory binding MAP arbitration clause. In the following, our comments will therefore be mainly focused on potential issues regarding mandatory binding MAP arbitration, which however should be considered as they are strictly linked and may also generally affect the application and interpretation of all dispute resolution systems.

We also note that the majority of the States presently involved in MAP cases have committed to provide for mandatory MAP arbitration by adopting the option to be drafted in the multilateral instrument, and appreciate that such relevant achievement will contribute to improve resolution procedures in a large number of cases where existing treaties do not grant that a solution is reached to solve tax disputes. Improvements are

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nevertheless mostly needed in countries showing a lower number of MAP cases (or no cases at all), as this may not only derive from the size of their cross border trades, but also by the timing and efficiency of the procedures in place to solve disputes according to administrative agreements with other countries. The adoption of the BEPS outputs, besides all efforts to make the application the more simple and clear, will increase the challenges to achieve a fair distribution of profits across jurisdictions, and more than before settlement procedures will be required to solve disagreements between governments and taxpayers. However, consensus has not yet been reached among all BEPS participating countries on the adoption of the mandatory binding MAP arbitration due to a number of reasons, including the fact that the State sovereignty in administering and collecting its own taxes would be affected. Possible concerns of countries that are still considering committing to adopt arbitration, or are reluctant to implement such procedure, may nonetheless be addressed in designing such provision, which may ensure full independency and high level professional expertise of the deciding body members, as well as transparency in the decision process. Involvement of non OECD member representatives, such as UN or other international organization, may also help to satisfy the needs and particular features of the developing countries tax systems.

1. Introduction

While the BEPS package is mainly aimed at addressing tax avoidance and ensuring that profits are taxed where value is created, tax treaties (including the modifications that may be adopted by way of a multilateral instrument implementing BEPS) should on the other hand ensure that activities carried on in different jurisdiction do not lead to double taxation.

The 2015 action 14 final report - making dispute resolution mechanism more effective – therefore recognizes that BEPS measures must be complemented with actions to ensure certainty and predictability for business. The BEPS Action plan is therefore an opportunity to implement effective procedures to resolve disputes between Contracting States regarding the interpretation or application of the tax treaties, including the new provisions arising from BEPS actions.

As for the development of a multilateral instruments that would modify or complement existing treaties, the Public Discussion Draft on Action 15 is therefore envisaging measures (i.e. a single MAP clause in line with article 25 of the OECD Model) that, once and if agreed, should at least allow Mutual Agreement Procedures in a wide and consistent way across all BEPS project participating States (including non OECD Members States). In addition, the multilateral instrument would provide for a mandatory binding arbitration clause, thus requiring coordination with the existing arbitration procedures already in place under some existing tax treaties (i.e. US-Italy) as well with the EU arbitration convention.

2. MAP access

2.a. Element 1.1. of the minimum standard set in Action 14 final report requires that access to MAP shall be granted in transfer pricing cases.

Some States (i.e., Italy) may however take the view that MAP on "transfer pricing" should only cover cases where the taxpayer and the tax Authorities do not agree on the amount of the price to be charged on a given transaction, while only domestic remedies would be available where, in the view of the tax Authorities, no transaction took place, or no price should have been charged in the disputed case.

Although this may be supported by local law, as well by the possible definition of transfer pricing provisions in the domestic tax law, the outcome does not seem in accordance with purpose of tax treaties, as this may lead to disagreement between Contracting States and possible double taxation, which could not be avoided by corresponding adjustments (Article 9).

Besides the possible amendments to the OECD Commentary, the drafting of the multilateral instrument and/or the explanatory report may thus make clear that MAP access, including mandatory MAP arbitration, should be granted by all signatory States, including non OECD Members, in all cases of cross border profit adjustments.

2.b. Similar double taxation issues may also arise where treaty benefits are denied under a general domestic anti-abuse provisions which would not fall under the PPT rule to be implemented under Action 6 of the BEPS Action Plan, being different in its wording, or at least be interpreted in a different way (see Element 1.2. of the Action 14 report).

Implementation of Action 15 may therefore make clear that disputes arising on treaty's application shall be resolved under MAP procedures in all cases of GAAR (general anti-avoidance rules), i.e. including beneficial ownership clause, alleged conduit structures, structured arrangements (see Action 2, Neutralizing the effect of hybrid mismatch arrangements) and other treaty's or domestic anti abuse clauses.

2.c. Besides the above mentioned cases, it is generally desirable that States who will be signing the multilateral instrument including a MAP clause, whether or not providing for a mandatory binding arbitration, shall reach a common understanding and agree on minimum standards and best practices as detailed in the final report on Action 14.

In this respect, Action 14 report (par. 17) envisages possible amendments to the OECD Model Convention Commentary as further detailed under Element 3.1., although the procedures and interpretation from non OECD States may differ from such Commentary.

In the course of the discussions for the development of the multilateral instruments, contracting States – including those who have not yet declared their commitment to the mandatory binding arbitration – may however accept to implement a MAP and/or arbitration clause and express possible disagreements by way of reservations and observations to either the multilateral instrument and or the interpretation provided in the explanatory report (i.e., access to arbitration is granted in all treaty's disputes - such as that relating to the interpretation of terms, or the new tie breaker residence rule proposed by BEPS Action 6 - other than that relating to transfer pricing only, where local transfer pricing rules differ from OECD standards).

3. Other MAP issues

3.a. As to anti-avoidance and anti-abuse measures to be adopted via a Multilateral Instrument (MLI), the topic appears to be even more critical.

The first issue in this respect is that many jurisdictions derive the definition of abuse of law from commercial law provisions: in this respect, the absence of a proper definition of abuse of law within the international law context may lead to misleading results. So far, an unavoidable starting point of such MLI shall be to find a shared definition of abuse of law relevant for (income) tax purposes with (public) international law relevance.

3.b. The second issue in this respect derives from the underlying reason for any claim raised by a Tax Authority based upon an abuse of law claim. An abuse of law claim usually is raised whenever the taxpayer (improperly) obtains a tax benefit in a tax jurisdiction for transferring the taxable income in another one (which it is unlikely willing to raise the same claim). If such abuse of law is shared also by the other jurisdiction (based upon the shared definition agreed according to paragraph 2.e. above) this means that the Multilateral Instrument shall provide for allocation criteria among the jurisdictions involved.

3.c. Any allocation criteria become increasingly difficult in cases where the jurisdictions involved are more than two. Any distinction among the (classical) division between Source State and Residence State risks to become meaningless. In addition to that, allocation criteria based upon the BEPS principles shall take into consideration that also countries where a branch is located becomes relevant. If this is true, then an MLI which considers only the jurisdictions that may apply the Treaties (i.e. other than the ones where a branch is located) could lead to some conflicts of allocation and/or legitimacy of a country to be included in the income allocation.

3.d. In any case, where a transaction or a series of transactions is deemed to be included within the (internationally) shared abuse of law definition for all the countries involved based upon the MLI definition, a result leading to a

double (or multiple) taxation for the taxpayers involved would be undesirable.

3.e. Conclusively, an MLI which desires to face the abuse of law on the international context, will need not only to gain (i) a shared definition of abuse of law; (ii) allocation criteria between the jurisdictions involved, but also shared criteria to re-characterize a transaction or a series of transactions based upon common standards. In this respect, what is provided for under U.S. Code § 368 of IRC could be of inspiration - in other words, a list of admitted reorganizations which qualifies for a specific tax treatment.

3.f. The operations of multinationals companies with associated companies are carried in multiple jurisdictions and should comply with local transfer rules. In most cases, particularly where such jurisdictions apply similar standards, comparable or identical transactions are priced in the same manner and it is desirable, to the extent possible, that all interested States may reach a common agreement on the transfer policy to be applied.

Disputes that may arise between two Contracting States may however affect transfer pricing policy applied with a third State, and taxpayers may not be willing to initiate a bilateral MAP or other arbitration procedure, as the outcome may spread over more countries and raise further disputes.

For example, assume that Country A (Italy) is adjusting the profit of company A in relation to services paid to an affiliate company B resident in country B. Country A and country B may reach an agreement under a MAP or arbitration procedure which would increase country A revenues for a given amount, but then country C may also claim the same increase in relation to comparable services rendered by company B, or possibly a larger amount which country B did not agree upon. Another and simpler example is that of company D supplying goods or services to all its affiliate companies in countries E,F,G,H, which, according to country D tax Authorities, would require an upward profit adjustment that such other countries are not willing to equally accept.

There is not a simple solution in order to settle bilateral disputes which may also directly or indirectly affect the policy (and possibly also APA) of other

jurisdictions, although similar situations are becoming more frequent for headquarters and other entities supplying goods and centralized services to all group companies. In the context of a multilateral instruments, a possible step forward in the remedies to solve double taxation issues would be a "multilateral MAP" or arbitration procedure, whereby third States which are involved in similar disputes with the same taxpayer, or may be affected by the outcome of a bilateral procedure, may be called to join a resolution procedure and agree on its outcome.

Yours sincerely,

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