Tax Insights

BEPS: OECD Multilateral Convention

Snapshot

On 24 November 2016, the OECD released the widely-anticipated Multilateral Convention to Implement Tax Treaty-Related Measures to Prevent Base Erosion and Profit Shifting (the Convention). An explanatory statement that accompanied the released provides clarification of the approach taken and how each article is intended to affect treaties covered by the Convention.

Over 100 countries, including Australia, participated in the negotiation of the text.

The Convention is designed to swiftly implement the tax treaty-related measures arising from the G20/OECD BEPS project. It includes minimum standards on treaty abuse (Action 6) and improving dispute resolution (Action 14). The Convention includes articles on permanent establishment (PE) (Action 7) and hybrid mismatches (Action 2). The Convention supports all previously agreed BEPS approaches by allowing jurisdictions to select from alternative options, which they will do by filing reservations. Changes to the operation of double tax treaties always will be prospective and are subject to jurisdictions both signing up to and ratifying the Convention. The Convention does not address any domestic law changes in respect of BEPS.

The Convention will be open for signature from 31 December 2016, and a signing ceremony in Paris is planned for 5 June 2017.

Background

In 2013, the OECD published its BEPS action plan, which identified 15 separate actions for countering BEPS in a comprehensive and consistent manner. This work culminated in the release of a final package of reports in October 2015 outlining the consensus reached by all OECD and G20 members and other countries participating. The recommendations included tax treaty-related measures to be reflected in the OECD model tax treaty.

"The adoption of [the Convention] marks a turning point in tax treaty history" – OECD Secretary-General.

Full implementation of these measures requires existing double tax treaties to be updated, and an ad hoc group of more than 100 jurisdictions was formed to facilitate the swift and efficient revision of treaties. Negotiations concluded with the adoption of the text of this Convention on 24 November 2016. The Convention is capable of applying to both the OECD and UN model treaties.

Overview

Treaties covered

The Convention is restricted to treaties wholly or partly relating to taxes on income and is not intended for shipping, air transport or social security agreements.

Jurisdictions will provide the OECD as Depositary with a list of the double tax treaties they wish to modify under the Convention (Covered Tax Agreements (CTAs)). A bilateral treaty will be modified only if **both parties** to it agree to do so. There is no obligation for a jurisdiction to list all of its tax treaties as CTAs, and jurisdictions are free to pursue bilateral negotiations instead. Jurisdictions also may list a subset of treaties where they wish to adopt a different position for those treaties to that generally adopted by that country under the Convention.

Mechanism for modifying double tax agreements

The Convention does not function in the same way as an amending protocol to an existing bilateral treaty. It does not directly change the underlying text, but will be applied alongside the existing treaty, modifying its application on BEPS matters. Jurisdictions may prepare "consolidated" versions of treaties, but there is no requirement to do so.

Flexibility

The Convention will ensure all CTAs will comply with the BEPS minimum standards. The Convention also allows governments to strengthen their tax treaties with other optional BEPS measures that do not form part of the minimum standard.

There is significant flexibility in how this is achieved, which is necessary to accommodate specific tax treaty policies, to ensure that the Convention is compatible with as many treaties as possible. In some cases, the BEPS recommendations included alternative ways to address an issue and in other cases provided for a main provision to be supplemented with an additional provision. The Convention supports all previously agreed BEPS approaches by allowing jurisdictions to select from alternative options and by filing reservations which identify their choices.

In general, any reservations or choices made by jurisdictions will apply to all CTAs, but can be restricted to a subset of its CTAs based on objective criteria; for example, a jurisdiction can restrict changes to residence tiebreaker clauses to apply only to CTAs that already contain a tiebreaker of a specific description.

Transparency

The OECD will publish the list of CTAs of jurisdictions, along with their reservations and options. The Inclusive Framework on BEPS will review and monitor whether its members' treaties, as modified by the Convention, satisfy the BEPS minimum standards.

Timetable and entry into effect

The Convention will be open for signature from 31 December 2016, and a signing ceremony in Paris is planned for 5 June 2017. After signing, individual signatories will need to ratify the Convention in line with their domestic arrangements. The Convention will be finalised and enter into force once it has been ratified by five jurisdictions. Following a period of three months after the date of ratification by the fifth state, the Convention will enter into force for those five jurisdictions at the start of the subsequent calendar month. The same three-month period will apply for all other jurisdictions that subsequently ratify the Convention.

The Convention can enter into force for a specific treaty only after the three-month period has expired for **both countries**. The provisions of the Convention shall have effect with respect to a particular CTA:

- For taxes withheld, where the event giving rise to such taxes occurs in the calendar year that begins on or after this Convention enters into force for both countries; and

- For all other taxes levied by a Contracting Jurisdiction with respect to '"taxable periods", beginning on or after the expiration of a period of six calendar months (or a shorter period, if both Contracting Jurisdictions agree and notify the Depositary) from when the Convention enters into force for both countries.

Different timing provisions apply for dispute resolution and cases could be eligible even where the dispute relates to a period before the Convention was in force.

Operative provisions

The Convention contains measures that are based on the agreed amendments to the OECD model treaty set out in the 2015 final BEPS reports.

Hybrid mismatches (Action 2)

While the majority of recommendations arising on hybrid mismatches were changes to domestic law, optional treaty changes are included in respect of:

- The treatment of fiscally transparent entities;
- The use of competent authority tiebreaking procedures to determine the residence of otherwise dual resident entities; and
- The application of the exemption and credit methods of double tax relief.

Treaty abuse

The Convention includes two treaty-based **minimum standards:**

Preamble: The Convention modifies a CTA to include preamble language stating that the purpose of the CTA is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty-shopping arrangements.

Other treaty abuse: The Convention addresses concerns of treaty abuse. The OECD proposes three alternative rules to address situations of treaty abuse:

- Option 1: Principal purpose test (or PPT, used by most countries);
- Option 2: PPT plus the simplified limitation on benefits (LOB); or
- Option 3: Detailed LOB plus an anti-conduit mechanism

The Convention only contains language in respect of Options 1 and 2. Option 1 is presented as the default option. With respect to Option 3, no text is included in the Convention since substantial bilateral customisation is likely to be required. Jurisdictions must confirm that their treaties will comply with the minimum standard requirements if this approach is taken. This will likely apply to Japan and the US.

A multitude of outcomes can arise where the approaches differ and asymmetric results are possible.

The Convention also includes optional provisions on:

- Minimum shareholding periods to apply reduced rates on dividends;
- Capital gains derived from immovable property;
- A jurisdiction’s right to tax its owns residents (“savings clause”); and
- An anti-abuse rule for PEs situated in third jurisdictions.

Permanent establishment (Action 7)

The threshold at which a PE (taxable presence) arises is lowered through:

- Broadening the scope of dependent agent PEs (preventing the use of *commissionaire* arrangements and other matters). This addresses similar arrangements to those targeted by Australia's multinational anti-avoidance law and the UK DPT;

- Narrowing exemptions for fixed place of business PEs by requiring activities to be "preparatory or auxiliary" in character and by introducing an anti-fragmentation rule; and

- Countering avoidance where long-duration construction contracts are split into a series of shorter contracts.

Improving dispute resolution (Action 14)

All CTAs will now include a **minimum standard** for mutual agreement procedures (MAPs). If a tax treaty-related case qualifies to be considered under the MAP, upon the request of a taxpayer, the competent authorities should endeavour to agree between themselves how double tax agreements should apply, and implement any agreement.

The Action 14 minimum standard also provides that jurisdictions should provide access to the MAP procedure in transfer pricing cases and should implement the resulting mutual agreements (e.g. by making appropriate adjustments to the tax assessed).

Mandatory binding arbitration (Action 14)

A subgroup developed new **optional** mandatory binding arbitration provisions based on the principles set out in the 2015 BEPS recommendations. The rules will apply only if both parties to a treaty opt in. Unlike in most other areas of the Convention where reservations are standardized, parties are free to determine the scope of cases that will be eligible for arbitration (subject to acceptance by the other relevant parties).

Typically, a taxpayer can request arbitration where a case has been subject to a MAP for at least two years without resolution. The arbitration panel will comprise of three arbitrators: the competent authorities have one nomination each with a chair from a third jurisdiction appointed by the other two arbitrators.

Two different types of decision-making processes are facilitated:

- "Final offer" rules, whereby each competent authority presents its own proposed resolutions and the arbitrators choose their preferred outcome; and

- The "independent opinion" approach, which results in a decision written by the arbitrators based on their analysis of the information provided.

If jurisdictions have mandated different default approaches, arbitration cannot proceed until the competent authorities can agree on an approach.

Comments

The substance of the majority of the measures already had been agreed in the final BEPS recommendations, but the challenge has been to design an instrument with sufficient flexibility to enable as many jurisdictions as possible to sign, while limiting complexity. Over 100 jurisdictions and international bodies participated in the negotiations, demonstrating the breadth to which the BEPS project now extends.

More than 2,000 treaties could be amended through the Convention—about two-thirds of the worldwide total—if all those participating ratify the Convention. Widespread adoption should help to ensure consistency in the implementation of the BEPS project, which it is hoped will result in more certainty for businesses and tax authorities. The Convention will be open for signature by any jurisdiction, not just those involved in the process so far.

A significant group of countries are expected to sign the Convention during a ceremony scheduled for 5 June 2017. Provisional information on the covered treaties, reservations and options selected by each jurisdiction will be available on signature of the Convention. The effect of the Convention on a particular tax agreement can be determined only once notifications have been provided by both parties. The OECD will act as a depositary for publication of covered treaties, reservations and options to provide tax authorities and businesses with the clarity required to determine the application of the new measures.

The commencement provisions are always prospective. They are driven by the date of ratification but differ for withholding tax provisions and those relating to taxes levied with respect to taxable periods, with the option to vary the default provisions in some cases. The first changes made by the Convention are likely to have effect with respect to particular CTAs from 1 January 2018.

Australian perspective

Australia is widely seen to be the global leader in relation to BEPS implementation and has actively participated in the development of the Convention.

On 26 November 2016, two days following the release by the OECD, the Minister for Revenue and Financial Services released a statement. According to the Minister, the Convention represents another significant step in the global fight against multinational tax avoidance and the completion of the final action of the OECD/G20 BEPS Project. In this regard, Treasury will be releasing a discussion paper on the Convention.

Whilst the Convention aims to enable swift modification of bilateral tax treaties to implement the OECD/G20 BEPS recommendations, Australia has already been an early adopter of these recommendations. Our new treaty with Germany which was concluded on 12 November 2015 is highly compliant with the OECD's recommended BEPS treaty proposals, in particular the main rules to prevent treaty abuse contained in BEPS Action 6.

A brief comparison of the provisions of the Convention and the Australia/ Germany treaty is shown in Table 1 below. This may provide an indication of the way that Australia will address issues associated with the adoption of the Convention.

The Convention	Included in Australia/ Germany treaty?
BEPS Action 2: Neutralising the Effects of Hybrid Mismatch Arrangements	
Transparent entities	Yes
Dual resident entities	Yes
Application of methods for elimination of double taxation	Yes, Option A
BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances	
Modified preamble and optional text (Minimum Standard)	Yes
Prevention of treaty abuse by way of three alternative rules (Minimum Standard)	Yes, PPT
Dividend transfer transactions (holding period)	Yes
Capital gains from alienation of shares or interests in entities deriving their value principally from immovable property (holding period)	Yes
Anti-abuse rule for permanent establishments situated in third jurisdictions	No
Application of tax agreements to restrict a party's right to tax its own residents	No
BEPS Action 7: Preventing the Artificial Avoidance of Permanent Establishment Status	
Artificial avoidance of permanent establishment status through commissionaire arrangements and other similar strategies	Yes
Artificial avoidance of permanent establishment status through the specific activity exemptions	Yes
Splitting-up of contracts	Yes
Definition of person closely related to an enterprise	Yes
BEPS Action 14: Making Dispute Resolution Mechanisms More Effective	
Mutual agreement procedure (Minimum Standard)	Yes
Corresponding adjustments (Minimum Standard)	Yes
Mandatory binding arbitration	Yes

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