



## Tax Insights

### Multilateral Convention: An Australian perspective

#### Snapshot

On 7 June 2017, representatives from 68 countries, including Australia, signed the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (the Convention) at a ceremony hosted by the OECD in Paris. A further 8 jurisdictions have expressed their intent to sign the Convention. The United States has not signed the Convention.

The participation of these 68 jurisdictions is expected to result in the modification of over 1,100 double tax treaties in line with the BEPS recommendations – about one-third of the global total. The Convention remains open to interested parties, and the OECD hopes that 90 jurisdictions will have signed by the end of 2017.

Australia has advised its various notification and reservation positions on a provisional basis, to be confirmed upon ratification of the Convention. Based on countries' known positions, the Convention will modify 30 of Australia's 44 current tax treaties. The extent to which the Convention will modify these

*"Renegotiating tax treaties has always been a significant hurdle. It's time-consuming, resource-intensive, and cumbersome. And that's what makes this Convention so remarkable. Tonight, with the strokes of your pens, you will begin amending more than 1100 tax treaties. This would normally have taken decades!" – Angel Gurria, OECD*

treaties will depend on the final adoption positions taken by each country upon ratification.

The first stage is for the Convention itself to come into force (following ratification by five countries) and then to come into force for Australia (following ratification by Australia).

With respect to Australia's tax treaties impacted by the Convention (Covered Tax Agreements (CTAs)), the first changes made by the Convention are likely to have effect from early 2019. Careful analysis will be needed since the application of the Convention to a particular tax treaty will be complex.

Although the Convention will apply prospectively, groups that currently benefit from tax treaties should begin to analyse the impact of the modifications in respect of existing arrangements. For example, under the new anti-abuse rules (typically the "principal purpose test"), it may be the case that arrangements entered into prior to the Convention operating (and which are currently resulting in treaty benefits) may cease to be eligible for such benefits once the Convention applies.

## Objective

The Convention is designed to implement swiftly the tax treaty-related measures arising from the G20/OECD BEPS project.

The Australian Minister for Revenue and Financial Services, Kelly O'Dwyer, stated on 8 June 2017 that "*the Convention is a key outcome of the OECD/G20 Base Erosion and Profit Shifting (BEPS) project, which aims to ensure that multinationals pay tax in the jurisdiction where economic value is created or added*" and observed that "*the Convention complements the Government's Multinational Anti-avoidance Law, the Diverted Profits Tax and the Tax Avoidance Taskforce, and reinforces our efforts to level the playing field for Australian businesses*".

The Convention will implement "minimum standard" changes to existing bilateral tax treaties in respect of the treaty preamble (relevant to object and purpose), treaty abuse and improving dispute resolution.

Further, depending on the reservations and notifications made by each party, optional changes to modify tax treaties in respect of Permanent Establishments (PEs), transparent entities, residency tiebreakers, double tax relief, minimum shareholding periods, capital gains derived from immovable property and mandatory binding arbitration will be facilitated.

Each of the signatories (except Norway) has deposited a provisional list of their reservations and notifications. The provisional lists of CTAs, options, notifications and reservations are published on the [OECD website](#), in the OECD's capacity as Depository. The OECD may launch a publicly accessible online matching tool.

*"[the Convention] goes to the heart of our efforts ... to help restore citizens' trust in the fairness and transparency of global governance systems and the legitimacy of the processes underpinning global integration" (...) [the Convention] puts an end to treaty shopping and will provide taxpayers with greater certainty through improvements to the Mutual Agreement Procedures" – Angel Gurría, OECD*

## Who's in and who's out

Out of the 68 countries (see Appendix) that have signed the Convention to date, 35 are Australia's tax treaty partners. But only 30 of these 35 treaties will be modified either because:

- Australia has not listed the tax treaty as a CTA (Germany); or
- Australia's tax treaty partners have not listed their tax treaty with Australia as a CTA (Austria, Korea, Sweden and Switzerland).

	Australia's Tax Treaties	Not covered by Convention	Covered by Convention
1	Argentina		Argentina
2	Austria	Not listed as a CTA by Austria	
3	Belgium		Belgium
4	Canada		Canada
5	Chile		Chile
6	China		China
7	Czech Republic		Czech Republic
8	Denmark		Denmark
9	Fiji		Fiji
10	Finland		Finland
11	France		France
12	Germany	Not listed as a CTA by Australia	
13	Hungary		Hungary
14	India		India
15	Indonesia		Indonesia
16	Ireland		Ireland
17	Italy		Italy
18	Japan		Japan
19	Kiribati	Kiribati did not sign	
20	Korea	Not listed as a CTA by Korea	
21	Malaysia	Malaysia did not sign	
22	Malta		Malta
23	Mexico		Mexico
24	Netherlands		Netherlands
25	New Zealand		New Zealand
26	Norway		Norway
27	Papua New Guinea	Papua New Guinea did not sign	
28	Philippines	Philippines did not sign	
29	Poland		Poland
30	Romania		Romania
31	Russian Federation		Russian Federation
32	Singapore		Singapore
33	Slovak Republic		Slovak Republic
34	South Africa		South Africa
35	Spain		Spain
36	Sri Lanka	Sri Lanka did not sign	
37	Sweden	Not listed as a CTA by Sweden	
38	Switzerland	Not listed as a CTA by Switzerland	
39	Taiwan	Taiwan did not sign	
40	Thailand	Thailand did not sign	
41	Turkey		Turkey

<b>42</b>	United Kingdom		United Kingdom
<b>43</b>	United States	United States did not sign	
<b>44</b>	Vietnam	Vietnam did not sign	
<b>Total</b>	<b>44</b>		<b>30</b>

Information on the main features of the Convention and Australia's provisional provisions is available on the [Treasury website](#). These positions will be confirmed upon ratification of the Convention.

Consistent with Treasury's December 2016 [Consultation Paper](#) (the Consultation Paper), Australia's new tax treaty with Germany concluded on 12 November 2015 is excluded from the scope of the Convention as it is compliant with the OECD's recommended BEPS tax treaty proposals. Interestingly, some aspects of the treaty with Germany differ to the reservations and notifications made by Australia under the Convention.

We outline below a few of the key measures addressed by the Convention.

### Permanent establishment

Australia has chosen not to adopt the Convention in relation to the artificial avoidance of a PE through commissionaire arrangements or similar strategies (ie, the expanded scope of the dependent agent PE). We note that this provision was included in the new German tax treaty.

Australia has implemented specific domestic anti-tax avoidance measures, in particular the Multinational Anti-Avoidance Law (MAAL), which has similar aims to the Convention in respect of PE avoidance. Treasury has indicated that Australia will consider whether to adopt this expanded definition of PE on a bilateral basis, rather than via the Convention.

Given that position, the MAAL could potentially apply to a foreign entity selling into Australia, and so effectively expand the scope of PE in that case. But for an Australian entity selling into a foreign country, the existing PE definition in the treaty will continue. The United Kingdom has taken the same approach.

By contrast, New Zealand has indicated that it will adopt the expanded scope PE definition under the Convention: but given that Australia has made a reservation on this matter, the Australia / New Zealand treaty will not be affected on this matter by the Convention, as only one country has agreed to the expanded scope definition.

### Treaty abuse: minimum standard

The "treaty abuse" minimum standard under Article 7 of the Convention introduces new anti-abuse rules that will enable tax administrations to deny treaty benefits in certain circumstances. Article 7 allows countries to choose between three options in complying with the minimum standard. This flexibility can lead to some complexity in practice. The "Principal Purpose Test" (PPT) only (option 1) was the runaway winner for the signatory jurisdictions, including for Australia. Australia's tax treaty partners' choices are as follows:

- 19 countries have chosen the PPT only option (option 1): Belgium, China, Czech Republic, Denmark, Fiji, Finland, France, Hungary, Ireland, Italy, Japan, Malta, the Netherlands, New Zealand, Romania, Singapore, South Africa, Spain, Turkey and the UK.
- Canada and Poland selected option 1 but also indicated their intention to pursue a Limitation of Benefits (LOB) provision through bilateral negotiations.
- 7 countries have opted for the "simplified LOB plus PPT" option (option 2): Argentina, Chile, India, Indonesia, Mexico, Russia and Slovak Republic.
- No jurisdiction chose the detailed LOB plus an anti-conduit mechanism option (option 3).

If Australia's tax treaty partner has chosen to adopt the PPT under option 1, there is a "match" with the Australian approach, and the tax treaty with Australia will be modified to effectively include the PPT. Complexity arises if Australia's tax treaty partner has chosen to adopt a position other than option 1.

### A principal purpose

The PPT contained in the Convention states:

*"Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement **shall not be granted** in respect of **an item of income** or capital if it is **reasonable to conclude**, having regard to all relevant facts and circumstances, that obtaining **that benefit** was **one of the principal purposes** of any arrangement or transaction that resulted directly or indirectly in that benefit, **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 the Covered Tax Agreement."* [emphasis added]

The PPT has a positive limb and a negative limb:

- The positive limb requires that the treaty benefit be "one of the principal purposes" of the arrangement or transaction.
- The negative limb states that the PPT is not triggered if the granting of that benefit in the particular circumstances would be in accordance with the object and purpose of the relevant treaty provisions.

Whilst Australian taxpayers are familiar with the concept of sole or dominant purpose via the general anti-avoidance rule, the lower test of "one of the principal purposes" is increasingly being adopted, including under the MAAL and the Diverted Profits Tax (DPT).

The positive limb has such a low threshold ("one of the principal purposes"), that it could well be applied by tax authorities to many transactions and structures which involve treaty benefits. It also remains to be seen how much comfort can be taken from the exclusion under the second limb.

The updated OECD Commentary contains examples of the operation of the PPT that suggest that the negative limb should be interpreted as equating the "object and purpose" of the relevant provision with the existence of economic substance in the relevant treaty country. However, this is not expressly

stated in the PPT itself and thus there could very well be some variance of approaches.

### **Mandatory arbitration rule**

Australia has adopted the mandatory binding arbitration rule. Taxpayers will be able to refer Mutual Agreement Procedure (MAP) disputes that remain unresolved after two years to independent and binding arbitration. However, Australia has made a reservation to exclude disputes involving the application of Part IVA of the *Income Tax Assessment Act 1936*, thus excluding DPT and MAAL matters from mandatory binding arbitration.

### **Timetable and entry into effect**

Countries which have signed and intend to proceed will need to ratify the Convention in line with their domestic arrangements. Thereafter, the Convention can enter into force for a specific treaty three-months after ratification by 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 the 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 Depository) 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.

Legislation will be introduced “as soon as practicable” to give the Convention the force of law in Australia. Based on that, Australia may ratify the Convention some time in 2018, and it could therefore have effect for a particular tax treaty from early 2019.

Even though there will be some time before existing treaties are impacted by the Convention, Australian businesses should start analysing the impact of the Convention on existing arrangements to avoid the risk of potentially losing tax treaty benefits when the Convention comes into effect.

## Appendix

### 68 jurisdictions that signed the Convention in June 2017

Andorra	Germany	Netherlands
Argentina	Greece	New Zealand
Armenia	Guernsey	Norway
Australia	Hong Kong	Pakistan
Austria	Hungary	Poland
Belgium	Iceland	Portugal
Bulgaria	India	Romania
Burkina Faso	Indonesia	Russia
Canada	Ireland	San Marino
Chile	Isle of Man	Senegal
China	Israel	Serbia
Colombia	Italy	Seychelles
Costa Rica	Japan	Singapore
Croatia	Jersey	Slovak Republic
Cyprus	Korea	Slovenia
Czech Republic	Kuwait	South Africa
Denmark	Latvia	Spain
Egypt	Liechtenstein	Sweden
Fiji	Lithuania	Switzerland
Finland	Luxembourg	Turkey
France	Malta	United Kingdom
Gabon	Mexico	Uruguay
Georgia	Monaco	

### 8 jurisdictions that expressed their intent to sign

Cameroon	Lebanon
Côte d'Ivoire	Mauritius
Estonia	Nigeria
Jamaica	Tunisia

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