



OECD alert

BEPS action 15: Final text of multilateral instrument released

On 24 November 2016, the OECD released the widely-anticipated text of the *Multilateral Convention to Implement Tax Treaty-Related Measures to Prevent Base Erosion and Profit Shifting* (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 jurisdictions participated in the negotiation of the text of the Convention. The chair of the Ad Hoc Group is Mike Williams from the UK, vice-chair of the Committee on Fiscal Affairs.

The Convention is designed to implement swiftly the tax treaty-related measures arising from the G20/OECD BEPS project. It includes a number of minimum standards that jurisdictions signing up to the Convention are required to implement. The Convention supports all previously agreed BEPS approaches by allowing jurisdictions to select from alternative options, which they will do by filing "technical reservations." The Convention includes articles on permanent establishment (PE), treaty abuse, dispute resolution and hybrid mismatches. Changes to the effect 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 that are needed.

Background

In 2013, the OECD published its 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.

Full implementation of these measures also 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 UN and OECD model treaties.

Treaties covered: Jurisdictions will provide the OECD as Depository with a list of the treaties they agree to amend under the Convention. A treaty will be modified only if all parties to it agree (Covered Tax Agreements). There is no obligation for a jurisdiction to list all of its agreements, and jurisdictions are free to pursue bilateral negotiations instead. Jurisdictions also may list a subset of treaties where they wish to adopt different provisions.

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. Jurisdictions may prepare consolidated versions of treaties, but there is no requirement to do so.

Flexibility: All 90 members of the *Inclusive Framework on BEPS* have committed to introducing measures to counter treaty abuse and to improve dispute resolution. The Convention will ensure all Covered Tax Agreements will comply with these minimum standards (even for jurisdictions not in the inclusive framework). 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 multiple 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 standardized technical reservations which identify their choices.

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

Clarity and transparency: Jurisdictions must provide the OECD as Depository with a list of the double taxation agreements that will be covered by the Convention, along with their reservations and options. The OECD will publish this information online. The *Inclusive Framework on BEPS* will review and monitor whether its members' treaties, as modified by the Convention, satisfy the BEPS minimum standards.

Overview

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. The measures are broadly based on the

agreed amendments to the OECD model treaty set out in the 2015 final BEPS reports.

Hybrid mismatches: While the majority of recommendations arising on hybrid mismatches were changes to domestic law, optional changes to the tax treaty treatment of 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 are included.

Treaty abuse (minimum standard): This addresses concerns that double tax treaties could be used to make available treaty benefits in unintended circumstances. An option is given to support the different approaches permitted under the minimum standard; principal purpose tests (or PPT, used by most countries) or simplified limitation on benefits rules supplemented with a PPT. A multitude of outcomes can arise where the approaches differ and asymmetric results are possible if both jurisdictions approve.

Alternatively, the use of *detailed* limitation on benefits rules (supplemented by a mechanism to deal with conduit arrangements) is permitted, but no text is included in the Convention since substantial bilateral customization 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 cover Japan and the US.

There are no changes to the text following the public consultation on so-called "non-CIVs."

PE: The threshold at which a PE (taxable presence) arises is lowered through (i) broadening the scope of dependent agent PEs (preventing the use of commissionaire arrangements and other matters); (ii) narrowing exemptions for fixed place of business PEs by requiring activities to be "preparatory or auxiliary" in character and/or by introducing an anti-fragmentation rule; and (iii) countering avoidance where long-duration construction contracts are split into a series of shorter contracts.

Improving dispute resolution (minimum standard): All Covered Tax Agreements now will include 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 endeavor to agree between themselves how double tax agreements should apply, and implement any agreement.

Mandatory binding arbitration: A subgroup chaired by Sweden comprising 27 jurisdictions developed new optional 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.

Other provisions: Minimum standard changes to the preambles of treaties, together with 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 own residents ("savings clause"), and an anti-abuse rule for PEs situated in third jurisdictions (not part of the action 7 recommendation) also are included.

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 constitutional arrangements. The Convention will be finalized 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 effect for a specific treaty only after the three-month period has expired for both jurisdictions. The default timings are:

- Modified withholding tax provisions will have effect for payments made after the first day of the following calendar year; and
- Changes relating to taxes levied with respect to taxable periods will have effect for taxable periods beginning on or after a period of six calendar months has elapsed (or less if both parties agree).

Jurisdictions can unilaterally replace the term "calendar year" with "taxable period" for their own application, and vice versa (potentially leading to asymmetry). Australia and the UK are expected to exercise this option.

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

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. An impressive 103 jurisdictions (and seven 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 and, as

noted above, it is compatible with existing OECD and UN model treaties.

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 always are 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 inclusion of a three-month period after ratification and before the Convention enters into force provides businesses with time to understand and apply the new rules. The first changes made by the Convention are likely to have effect from 1 January 2018.

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