

BEPS Action 15

Multilateral Instrument

Client alert



On Thursday 25 November 2016, pursuant to Action 15 of the Base Erosion and Profit Shifting ("BEPS") initiative the OECD published the Multilateral Convention ("the Convention") that is intended to implement the treaty-related aspects of the initiative without needing to update/renegotiate individual tax treaties. The Convention is the product of an "ad hoc Group", in which 99 countries participated as full members, supported by several non-state jurisdictions and international and regional organisations. The Group was chaired by Mike Williams of HM Treasury in the UK.

The Convention, and the accompanying Explanatory Statement, are lengthy and complex documents. The comments below are based on our initial reading of them.

Overview of the Convention

The Convention is based on the following key principles:

- The Convention applies in relation to a treaty ("Covered Tax Agreement") where both contracting states (the "Parties") have notified the Secretary-General of the OECD (the "Depositary") that they intend the Convention to apply to it.
- In relation to BEPS minimum standards (for example, in relation to treaty abuse, Principal Purpose Test or full Limitation of Benefits clause), such minimum standard to apply automatically, with limited exceptions, to all Covered Tax Agreements.
- Where the minimum standard can be satisfied in more than one way (as in the preceding example), the Parties must endeavour to reach a mutually satisfactory solution.
- In relation to provisions which are not minimum standards (for example, the changes to the definition of permanent establishment), a Party to the Convention is entitled to opt out of that provision by expressing a "reservation"; this has the effect that the provision in question does not apply to any of that party's treaties.
- In a number of cases, the Convention allows a Party to opt out of applying a provision to a subset of its Covered Tax Agreements in order to preserve the operation of existing provisions that have specific, objectively defined characteristics.
- The Convention incorporates a number of alternatives and optional provisions that generally will apply only where both Parties to a Covered Tax Agreement affirmatively choose to apply them.
- A signing ceremony will take place in June 2017. However, the Convention enters into force, broadly, three months after at least five Parties have deposited with the Depositary instruments of ratification (or equivalents). For Parties depositing their instruments of ratification later, the Convention comes into force, broadly, three months after such deposit takes place. Once the Convention has come into force for both Parties to a Covered Tax Agreement, as a general rule the Convention takes effect, broadly, for taxable periods beginning on or after six months later, or, for withholding tax purposes, from the following 1 January. However, there are a number of options that Parties are entitled to exercise to depart from the general rules.

Areas covered by the Convention

The Convention covers four main areas:

- Treaty Abuse, including Limitation of Benefits clauses and the Principal Purpose Test, as well as an anti-triangulation clause for permanent establishments in third countries and changes to the tie-breaker for treaty residence.
- Improving dispute resolution, including changes to the Mutual Agreement Procedure and a Binding Arbitration mechanism.
- Changes to the definition of Permanent Establishment.
- Hybrid Mismatch Arrangements, including the treatment of transparent entities, dual resident entities, and methods to eliminate double taxation.

Selected aspects of these are discussed briefly below.



Treaty Abuse

In line with the BEPS Action 6 Report, the Convention's default provision in relation to treaty abuse is a Principal Purpose Test. As having a provision against treaty abuse is a BEPS minimum standard, there are only limited cases in which this rule may not be applied in relation to a Covered Tax Agreement.

The first case is where a Party chooses to apply the full Limitation of Benefits provision instead, as well as a rule to address conduit financing; in such a case, the Parties to the Covered Tax Agreement are required to reach a mutually satisfactory solution that meets the BEPS minimum standard. The second case is where the Covered Tax Agreement already contains a suitable Principal Purpose Test.

The Convention also allows a Party to notify the Depository that, as well as the Principal Purpose Test, it intends also to apply the Simplified Limitation of Benefits provision, and there are rules to determine what happens if one Party to a Covered Tax Agreement makes such a notification and the other does not.



Mutual Agreement Procedure and Binding Arbitration

BEPS Action 14 introduces a minimum standard for the Mutual Agreement Procedure ("MAP"), which is now included in the Convention by incorporating the provisions of Article 25(1) to (3) of the OECD Model. This includes allowing a three year time limit for presenting a case to the competent authority of the residence country, where the Covered Tax Agreement currently provides for a shorter time limit.

The Convention also brings in Article 9(2) of the OECD Model Convention (Compensating Adjustments), to ensure that transfer pricing disputes can be resolved through MAP and to allow signatory jurisdictions to give relief unilaterally. The convention also brings in strict time limits for progressing MAP issues which have previously only been recommended as best practice

The Convention allows a Party to opt to include a mandatory binding arbitration mechanism modelled on US style "last best offer" or "baseball" arbitration. This mechanism will apply only where both parties to a Covered Tax Agreement have exercised this option and notified the Depository accordingly. In October 2015, when the Action 14 Report was presented, some 20 countries, including the US, Japan, Germany, France, the UK, Italy, Spain, Canada and Australia, expressed a commitment to binding arbitration and it is expected that at least these countries will exercise the option.



Changes to the definition of Permanent Establishment

The changes proposed as part of BEPS Action 7 are not part of the minimum standard, and therefore, broadly, each party has to choose which of the recommended changes to adopt. The mechanism is, in most cases, that a Party has to notify the Depository, either communicating which provisions of its Covered Tax Agreements are affected by the change, or expressing a reservation on the change (i.e., choosing not to adopt it). In general, the change in question applies to a Covered Tax Agreement where, broadly, both Parties to it have chosen to adopt it.

In the early part of the BEPS process, there was a degree of pessimism as to whether the OECD could create an instrument to make changes to multiple treaties. The publication of this Convention demonstrates the determination of the country participants to succeed in that process. However, in achieving that ambition, we are left with a system that is even more complex than before, adding to the already significant compliance burden that companies are facing.

The Convention is a standalone document applying, where relevant, to override a Covered Tax Agreement, but without amending it. This, taken together with the complexity of the mechanics, may make it a lot harder, in practice, to determine the treaty position in relation to specific transactions. As well as looking at the double tax treaty, it will be necessary to check whether the two countries are Parties to the Convention, whether the treaty is a Covered Tax Agreement, whether the contracting states have deposited instruments of ratification, and what options or reservations they have exercised. At this stage we do not know how the OECD will make such information available.

In addition, the timing of the introduction of these rules is complex and heavily dependent on when sufficient Parties have deposited their instruments of ratification with the Depositary. In circumstances where sufficient Parties have deposited their instruments shortly after the signing ceremony, it is likely that the provisions in relation to withholding tax could come into effect from 1 January 2018, with the remaining provisions taking effect for taxable periods starting on or after 1 April 2018 at the earliest.

At a time when the number of disputes is expected to increase the improvements to the MAP process and the introduction of more widespread mandatory binding arbitration dispute resolution are very welcome.

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