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Action 15: Multilateral Instrument

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**VI CONGRESSO BRASILEIRO
DE DIREITO TRIBUTÁRIO INTERNACIONAL**

19 – 20 August 2015

São Paulo, Brazil

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I. INTRODUCTION

1. Multilateral conventions on the tax matters

2. Action Plan on Base Erosion and Profit Shifting (2013)

3. On 16 September 2014 the OECD released the report on Action 15 of the BEPS Action Plan:

The report provides for an analysis of the tax and public international law issues related to the development of a multilateral instrument to enable countries that wish to do so to implement measures developed in the course of the work on base erosion and profit shifting (BEPS) and amend bilateral tax treaties.

4. On 6 February 2015 the OECD presented the latest developments in the OECD/G20 BEPS Project: Mandate to launch negotiations on a multilateral instrument to streamline implementation of tax treaty-related BEPS measures

5. On 28 May 2015 the OECD announced the countries that will participate in a meeting to begin substantive work on drafting a multilateral instrument under BEPS. Action 15:

- 83 countries have expressed interest in joining the discussion
- discussion will take place on 5 – 6 November 2015
- the Group will aim to conclude its work and open the multilateral instrument for signature by 31 December 2016.

II.1. MULTILATERALISM IN INTERNATIONAL TAX LAW BEFORE BEPS

1. Multilateral conventions on tax matters at the regional level

- 2008 West African Economic and Monetary Union (WAEMU) Income and Inheritance Tax Convention;
- 2007 Ibero-American Social Security Convention;
- 2005 SAARC (South Asian Association for Regional Cooperation) Income Tax Agreement;
- 2004 Andean Community Income and Capital Tax Convention;
- 1994 CARICOM (Caribbean) Income Tax Agreement;
- 1990 Arab Maghreb Union Income Tax Convention.

2. 1988 OECD/Council of Europe Convention on Mutual Administrative Assistance in Tax Matters

II.2. 1988 OECD/COUNCIL OF EUROPE CONVENTION ON MUTUAL ADMINISTRATIVE ASSISTANCE IN TAX MATTERS

The Convention was developed jointly by the OECD and the Council of Europe in 1988 and amended by Protocol in 2010. The Convention is the most comprehensive multilateral instrument available for all forms of tax cooperation to tackle tax evasion and avoidance, a top priority for all countries.

The Convention was amended to respond to the call of the G20 at its April 2009 London Summit to align it to the international standard on exchange of information on request and to open it to all countries, in particular to ensure that developing countries could benefit from the new more transparent environment.

The amended Convention was opened for signature on 1 June 2011*.

* (see OECD-1, News Convention on Mutual Administrative Assistance in Tax Matters June 2015)

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II.3. MULTILATERAL CONVENTIONS AND OECD MODEL COMMENTARIES (2014)

- § 37. When preparing the 1963 Draft Convention and the 1977 Model Convention, the Committee on Fiscal Affairs considered whether the conclusion of a multilateral tax convention would be feasible and came to the conclusion that this would meet with great difficulties. It recognized, however, that it might be possible for certain groups of Member countries to study the possibility of concluding such a convention among themselves on the basis of the Model Convention, subject to certain adaptations they might consider necessary to suit their particular purposes.

- §38. The Nordic Convention on Income and Capital entered into by Denmark, Finland, Iceland, Norway and Sweden, which was concluded in 1983 and replaced in 1987, 1989 and 1996, [7]provides a practical example of such a multilateral convention between a group of Member countries and follows closely the provisions of the Model Convention.

- §39. Also relevant is the Convention on Mutual Administrative Assistance in Tax Matters, which was drawn up within the Council of Europe on the basis of a first draft prepared by the Committee on Fiscal Affairs. This Convention entered into force on 1 April 1995.

§ 40. Despite these two conventions, there are no reasons to believe that the conclusion of a multilateral tax convention involving all Member countries could now be considered practicable. The Committee therefore considers that bilateral conventions are still a more appropriate way to ensure the elimination of double taxation at the international level.

III.1. DEVELOPING A MULTILATERAL INSTRUMENT IN ACCORDANCE WITH THE BEPS ACTION PLAN

The Action Plan relies on different types of instruments for actions to be implemented:

- ✓ Domestic law changes;
- ✓ OECD Model Convention;
- ✓ OECD Model Convention Commentary;
- ✓ Multilateral instrument;

The 15 BEPS Action Plan deliverables span three different areas*:

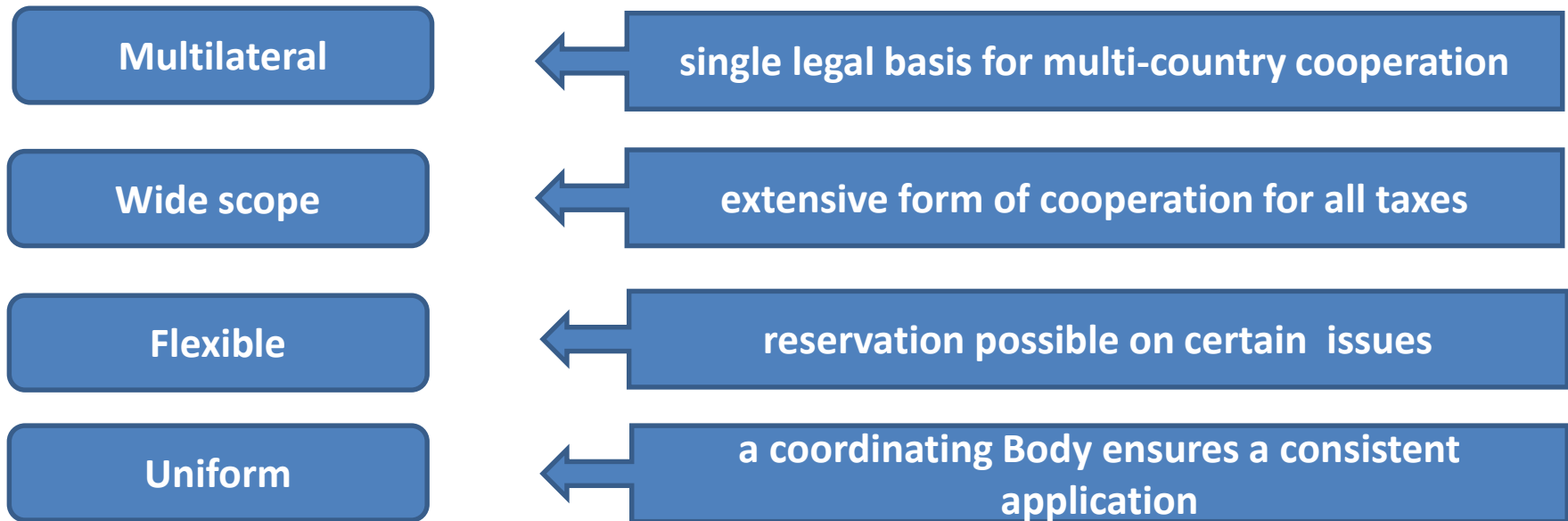
1. Recommendations for domestic law taking the form of best practices and model domestic rules;
2. Other reports, as well as changes to the OECD Model Tax Convention;
3. Internationally agreed guidance on implementation.

See: OECD (2014), Developing a Multilateral Instrument to Modify Bilateral Tax Treaties, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing.

<http://dx.doi.org/10.1787/9789264219250-en>, page 15

III.2. DEVELOPING A MULTILATERAL INSTRUMENT IN ACCORDANCE WITH THE BEPS ACTION PLAN : KEY BENEFITS

(AN OECD APPROACH)



III.3. DEVELOPING A MULTILATERAL INSTRUMENT IN ACCORDANCE WITH THE BEPS ACTION PLAN: THE UN'S RESPONSE ?

- Changes to the text of the OECD Model treaty and Commentary
- Recommendations for changes to domestic tax laws
- The UN's response to this work may lead to parallel changes to the UN Model treaty and Commentary, as well as recommended changes to domestic laws.

But it is worth noting that the OECD's BEPS Action Items are not necessarily exhaustive of the range of issues that may concern developing countries, nor are the solutions proposed necessarily ideal for developing countries.

The UN may wish to explore other options for protecting the tax base of developing countries.

(see http://www.un.org/esa/ffd/wp-content/uploads/2014/09/20140923_Paper_PreventingTaxTreatyAbuse.pdf)

While amendments to the OECD Transfer Pricing Guidelines or Commentary on the OECD Model Tax Convention can be made with relative speed, amendments to the network of over 3,000 bilateral tax treaties would require these treaties to be individually renegotiated.

The creation of a new multilateral instrument which would allow countries to adopt specific measures without having to individually renegotiate treaties (see UN-1, Subcommittee on Base Erosion and Profit Shifting Issues for Developing Countries, page 17)

III.4. POSSIBLE STAGES OF THE DEVELOPING A MULTILATERAL INSTRUMENT IN ACCORDANCE WITH THE BEPS ACTION PLAN

I-st stage, the areas:

- hybrid mismatch arrangements,
- treaty abuse,
- the transfer pricing aspects of intangibles,
- documentation requirements for transfer pricing purposes,
- the issues raised by the digital economy

II-nd stage, the areas:

- CFC rules;
- interest deductibility;
- preventing the artificial avoidance of PE status,
- the transfer pricing aspects of intangibles,
- capital and highrisk transactions,
- data collection, mandatory disclosure rules,
- and dispute resolution.

III-rd stage, the areas:

- transfer pricing aspects of financial transactions,
- the development of a multilateral instrument to swiftly implement changes to bilateral treaties.

IV.1. Mandate to launch negotiations on a Multilateral Instrument to streamline implementation of tax treaty-related BEPS measures

The negotiations of the multilateral instrument should include implementation of the tax treaty provisions (§10):

on hybrid entities adopted during the course of the work on Action 2;

the work to improve dispute resolution under Action 14


the work to prevent treaty abuse under Action 6

the work to prevent the artificial avoidance of the PE standard under Action 7

any other treaty modifications developed during the course of the work on the remaining BEPS action items

VI.2. MANDATE TO LAUNCH NEGOTIATIONS ON A MULTILATERAL INSTRUMENT TO STREAMLINE IMPLEMENTATION OF TAX TREATY-RELATED BEPS MEASURES

The negotiations of the multilateral instrument should include implementation of the tax treaty provisions - Action 15: (§ 11):



Depending on the results of discussions to implement country-by-country reporting under Action 13, the negotiations could also include necessary modifications, if any, to bilateral tax treaties to provide for the exchange of such reporting. It would also include any changes to Article 9 of the OECD Model Tax Convention that may result from the work on Actions 8-10.

V.1. THE PRECISE CONTENT OF A MULTILATERAL INSTRUMENT?

The precise content of a multilateral instrument is yet to be defined but the sense of direction is clear.

The nature of the treaty-related BEPS measures will facilitate the conclusion of a targeted multilateral instrument, which could be further expanded at a later date.

- Addressing dual-residence structures
- Addressing transparent entities in the context of hybrid mismatch arrangements
- Addressing “triangular” cases involving PEs in third states:
- Addressing treaty abuse

V.2. THE PRECISE CONTENT OF A MULTILATERAL INSTRUMENT - HYBRID MISMATCH ARRANGEMENTS?

Addressing transparent entities in the context of hybrid mismatch arrangements:

Hybrid mismatch arrangements often lead to “double non-taxation” that may not be intended by either country, or to unintended long-term tax deferral. It is difficult to determine unequivocally which individual country has lost tax revenue under such arrangements...

... **a coherent policy response** that also avoids double taxation would be facilitated – both at the domestic level and at the multilateral level – by consistently modifying existing tax treaties so that the eligibility for tax treaty benefits of payments made to entities in another jurisdiction is determined based on whether the payment is considered to be income of a resident for purposes of the tax law of the jurisdiction of residence of the payee.

Action 2 states that “this may include:

(v) where necessary, guidance on **co-ordination or tie-breaker rules** if more than one country seeks to apply such rules to a transaction or structure.”

V.3. THE PRECISE CONTENT OF A MULTILATERAL INSTRUMENT - “TRIANGULAR” CASES INVOLVING PE IN 3-RD STATES (ACTION 7)?

- On 15 May 2015 the OECD released a discussion draft which includes proposals resulting from the work on Action 7: Prevent the Artificial Avoidance of PE Status
- On 15 June 2015 the OECD published Comments received on revised discussion draft - BEPS Action 7: Prevent the Artificial Avoidance of PE Status

V.4. THE PRECISE CONTENT OF A MULTILATERAL INSTRUMENT - “TRIANGULAR” CASES INVOLVING PE IN 3-RD STATES (ACTION 7)?

Addressing “triangular” cases involving PEs in third states:

so-called triangular cases can arise where income of a tax treaty resident is attributed by the country of residence to a PE in a third State and exempt from tax in the residence State, often together with low taxation in the State of the PE.

Bilateral treaties can provide rules that partially address such cases, but comprehensively addressing the problem requires incorporating a solution into all of a country’s tax treaties.

Thus, a multilateral instrument represents the most efficient mechanism for action.

V.5. THE PRECISE CONTENT OF A MULTILATERAL INSTRUMENT - ADDRESSING TREATY ABUSE (ACTION 6)?

- On 22 May 2015 the OECD released a new discussion draft which includes proposals resulting from the work on Action 6: Prevent Treaty Abuse
- On 18 June 2015 the OECD published a Comments received on revised discussion draft BEPS - Action 6: Prevent Treaty Abuse

V.6. THE PRECISE CONTENT OF A MULTILATERAL INSTRUMENT - ADDRESSING TREATY ABUSE (ACTION 6)?

The issue:
Treaty-shopping

Measures to integrate into DTTs:

- The title and preamble of DTTs should clarify that the DTT cannot be used to avoid taxes (no treaty shopping, no double non-taxation)
- Introducing LOB-clauses into DTTs
- Applying PPT-test where LOB is not efficient (obtaining tax benefits cannot be the primary goal)

Measures to implement in domestic tax laws

- General anti avoidance rules

The **Multilateral Instrument should be sufficiently precise** to cover all the cases that could be applied differently in practice by each individual OECD Member State.

VI.1. The BEPS project: a threat for tax sovereignty of developing countries?

BEPS is impelled by G20, involving some other countries, but is imposed on the remaining ones, i.e. developing countries.

Developing countries will have to change domestic law and treaties, check that BEPS respects the foundations of national and international tax policy, constitutional rules and legislation

There is a potential risk of emptying the substance of tax sovereignty of developing countries

but

The OECD proposes a multilateral (binding) instrument to bring tax treaties in line with the changes of the BEPS Project

Does the implementation by a multilateral instrument allow to properly address these issues?

VI.2. BEPS vs. sovereignty & the multilateral instrument - providing flexibility in the level of commitment

BEPS: A toolbox for a multilateral instrument (2014)

“A multilateral instrument ... is feasible and, moreover, would be the most efficient way to modify the existing network of bilateral tax treaties”...“a multilateral instrument offers an expansive and adaptable toolkit: once the substantive measures have been agreed, all the necessary mechanisms are at our disposal to reflect them as multilateral undertaking while providing defined flexibility in the level of commitment if necessary”

VI.3. BEPS and tax sovereignty: the multilateral instrument

BEPS: A toolbox for a multilateral instrument (2014)

“...public international law allows various options for the modification of treaties as long as the principle of sovereignty and State consent is respected”

“The bilateral tax treaties will be *modified* automatically by the multilateral instrument”

“The substantive rules contained in the bilateral tax treaties will remain in force in areas not covered by the multilateral instrument”

VI.4. BEPS and tax sovereignty: the multilateral instrument

The erosion of the substance of sovereignty exists even in the presence of implementation through a multilateral instrument, since the content of the latter may not take into account the different problems and economic objectives of such countries

- A multilateral instrument implementing the BEPS project may produce formal respect of tax sovereignty, but not that of its substance
- The consultation of business and the civil society at OECD may not solve specific problems arising in each country

VII.1. The key elements of multilateralism

Multilateralism

- 1) requires an agreement of parties;
- 2) must be inclusive, i.e. its aim is to integrate all States in a community of rules;
- 3) all States should have the same rights and obligations;
- 4) it must establish instruments for settling disputes between the parties: negotiation, mediation, arbitration. The European Union is the organization with greater jurisdictional structure;
- 5) it should be attractive and provoke interest in joining.

WTO example:

Does the WTO better take into account the huge inequalities between the South and the North?

VII.2. The key elements of multilateralism

- Developed countries have limited negotiation power and technical skills
- If we take the models of developed countries for a multilateral instrument, we have no space for discussion and developing countries just should accept what they are given – but this approach is not acceptable
- BEPS only focuses on countering the erosion of the tax base, harmful regimes, how to get more information... It says nothing about the taxpayers' rights, which are instead a key component of national Constitution

VIII. Actions which *per se* do not require multilateral instrument

ACTION 3

Strengthen CFC rules

- *“... Design of controlled foreign company rules”*
- *Prevention of “... excessive deductible payments such as interest and other financial payments”*

ACTION 12

Require taxpayers to disclose their aggressive tax planning arrangements

- *Mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures*
- *One focus will be international tax schemes, where the work will explore the usage of a wide definition of “tax benefit” in order to capture such transactions.*

IX.1. Areas of possible common interest (for developed and developing countries)

ACTION 1

Address the tax challenges of the digital economy

- *The ability of a company to have a **significant digital presence** in the economy of another country without being liable to taxation due to the lack of nexus under current international rules*
- *The characterization of income derived from new business models,*
- *The application of related source rules,*
- *To ensure the effective **collection of VAT/GST** with respect to the cross-border supply of digital goods and services*

ACTION 4

Limit base erosion via interest deductions and other financial payments

- *“... design of rules to prevent base erosion through the use of interest expense, for example through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income, and other financial payments that are economically equivalent to interest payment”*

IX.2. Areas of possible common interest (for developed and developing countries)

ACTION 6

Prevent treaty abuse

- To clarify that tax treaties are not intended to be used to generate double non-taxation

ACTION 11

Establish methodologies to collect and analyse data on BEPS and the actions to address it

- The work will involve assessing a range of existing data sources, identifying new types of data that should be collected, and developing methodologies based on both aggregate and micro-level data

ACTION 14

Make dispute resolution mechanisms more effective

Develop solutions to address obstacles that prevent countries from solving treaty-related disputes under MAP, including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases

Yukos example: Claimants' requests for arbitration against Respondent made reference to **Article 26(4)(b) of the ECT (Energy Charter Treaty, 2080 UNTS 95, signed on 17 December 1994)** and the **Arbitration Rules of the United Nations Commission on International Trade Law, 1976 ("UNCITRAL Rules")**.

IX.3. Areas of possible common interest (for developed and developing countries)

The U.S. Treasury believes that a Limitation on Benefits (“L.O.B.”) clause is sufficient to prevent “treaty shopping” and that the multilateral instrument would not offer any new mechanisms. The L.O.B. provision in most U.S. treaties limits treaty shopping by requiring that meaningful contact must exist between a corporation and its country of residence before tax treaty benefits are extended.

It is believed that the U.S. may sign the multilateral instrument if it includes **mandatory binding arbitration**. On June 8, 2015, G-7 leaders encouraged more countries to join in their commitment to mandatory binding arbitration.

X.1. Areas of developed countries' concern

ACTION 2

Neutralize the effects of hybrid mismatch arrangements

- ... To neutralize the effect (e.g. double non-taxation, double deduction, long-term deferral) of hybrid instruments and entities

ACTION 5

Counter harmful tax practices more effectively, taking into account transparency and substance

- Improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for any preferential regime.

- A holistic approach to evaluate preferential tax regimes in the BEPS context

ACTION 7

Prevent the artificial avoidance of PE status

- Changes to the definition of PE to prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions

X.2. Areas of developed countries' concern

ACTIONS 8, 9, 10

Assure that transfer pricing outcomes are in line with value creation **Action 8 – Intangibles**

Develop rules to prevent BEPS by moving intangibles among group members. This will involve: (i) adopting a broad and clearly delineated definition of intangibles; (ii) ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with (rather than divorced from) value creation; (iii) developing transfer pricing rules or special measures for transfers of hard-to-value intangibles...

Action 9 – Risks and capital

Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members. This will involve adopting transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital.

Action 10 – Other high-risk transactions

Develop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties. This will involve adopting transfer pricing rules or special measures to: (i) clarify the circumstances in which transactions can be recharacterised; (ii) clarify the application of transfer pricing methods, in particular profit splits, in the context of global value chain...

ACTION 13 – Re-examine transfer pricing documentation

- Rules regarding transfer pricing documentation to enhance transparency for tax administration
- A requirement that MNE's provide all relevant governments with needed information
- Global allocation of the income, economic activity and taxes paid among countries