

BEPS Multilateral Convention Unveiled

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Publication of text of *The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (BEPS Convention) by the OECD on 24 November 2016 is one of the key milestones in the OECD/G20 Project to tackle Base Erosion and Profit Shifting. The BEPS Convention will be open for signature from 31 December 2016 and a signing ceremony is to be held in June 2017 in Paris.

Delivery of this document which aims to provide a framework that, in principle, could amend all the world's estimated 3,000 bilateral double tax treaties together in order to bring them in line with changes proposed in the BEPS treaty-related measures: Action 2- hybrid instruments, Action 6 - treaty abuse, Action 7- permanent establishments and Action 14- dispute resolution. The contents of the proposals have been much discussed. Only the dispute resolution provisions, which make up about one fifth of the BEPS Convention, have not been previously published in the course of the BEPS project.

Far reaching effect

Although aimed at countering corporate tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid, the effect of these changes will be far ranging. The BEPS Convention will override bilateral treaties even where no low or non-tax locations are involved and will apply to all taxpayers with cross-border activities, not just the huge multinational enterprises whose corporate structures triggered the BEPS project.

No world tax order

The BEPS Convention does not establish a single set of tax rules of universal application. It offers a significant amount of choice to states that wish to become a party. That will undoubtedly enable the convention to be a political success following the participation of over 100 countries in the process so far. The BEPS Convention however requires states to specify the double tax treaties to which it is to apply ("Covered Tax Agreements"). Signatory states will need to identify the double tax treaties to which the BEPS Convention is to apply by notifying the OECD Secretary General (the "Depositary"). Thus both parties to a particular double tax treaty will need to identify the treaty between them for the BEPS provisions to be engaged.

Flexibility in adopting the substantive provisions is allowed by several devices. Opting out of provisions or parts of provisions with respect to treaties that contain existing provisions that are BEPS compatible but retain the language of the bilateral treaty are permitted. Thus where BEPS final Reports contain a minimum standard that can be satisfied in different ways, the BEPS Convention does not give preference to a particular way of meeting that minimum.

Secondly, signatory states may opt out of some particular provisions in the BEPS Convention in all or some of their treaties. Thirdly, some articles allow for a choice among alternative provisions. The BEPS Convention contemplates that there may be mismatches between states in making these choices and set out a mechanism for addressing the mismatch. Fourthly, some part of the BEPS Convention apply "in place of or in the absence of" an existing provision.

One consequence of this lack of uniformity may be to encourage, rather than discourage treaty shopping. Existing treaties that follow the OECD and UN Models show a high degree of uniformity which itself is a disincentive to seek attractive anomalies. The greater the disparity among treaties, then more taxpayers, and, in particular, the largest multinational enterprises may see to benefit from them.

How wide will disparities be in practice?

About one half of the text of the BEPS Convention deals with the mechanisms for exercising the choices. The sheer complexity of the many choices offered in the document, the prescriptive nature of some choices along with the consequences may act as a deterrent to some states electing out of provisions. States are required to notify the position they take on 20 issues at the time of signature of the BEPS Convention and must notify their final position, at the latest, when instruments of ratification are deposited (Article 29). Having agreed to a signing ceremony in June 2017, states intending to sign, are thus committed to an urgent and detailed review of their treaty networks.

Asymmetries that result from mismatching choices will also mean that states will need to consult with existing treaty partners to attempt to minimise such mismatches, triggering in effect, multiple mini treaty negotiations.

The challenges taken on by the drafters of the BEPS Convention were immense. A simple multiparty agreement among 100 or more parties to amend thousands of bilateral agreements is complex enough. Such an agreement that then offers a multiple choice on so many items would tax the ingenuity of the most accomplished legal drafters. Is the complexity of the instrument an inevitable consequence of this? Is the framing of the choices by officials from a few very large countries intended to take control of the treaty making process of smaller countries? Will it have that effect even if unintended?

For those who work with double tax treaties, the key tasks have been the interpretation and application of treaty provisions. The BEPS Convention matrix raises an additional new task for the next few years, that is trying to decide what the text of a specific treaty is as amended by the BEPS Convention.

Dispute resolution

The BEPS Convention proposes to improve dispute resolution by mutual agreement in two ways. Firstly, states may agree that a case can be presented in either contracting state (not just the state of residence as under the present OECD Model article 25(1)). Improving access to MAP in this way is a useful but modest step forward. Secondly, provision for corresponding adjustments in transfer pricing cases, modelled on Article 9(2) of the OECD Model is included, since many treaties do not contain this. However, since this is optional, the extent to which it will be adopted by states who have not included it so far, remains to be seen.

Arbitration

An optional provision for compulsory binding arbitration sets out the procedures in some detail. Last best offer (baseball) arbitration is the default method with states free to agree other methods. Perhaps the most disappointing aspect of this part of the BEPS Convention is that it merely continues bilateral arbitrations and does not contemplate multistate dispute resolution. This leaves the EU Arbitration as the only multistate dispute resolution instrument. Given the trend towards value-chain analysis in transfer pricing and that transfer pricing accounts for the bulk of MAP cases, this is a surprising shortcoming. If the 20 states who have indicated interest in arbitration are the same as those who currently include arbitration in their treaties, then the good intentions displayed by this part of the BEPS Convention will only have modest effect in practice.

The Future of the BEPS Convention

The BEPS Convention may evolve into a truly international framework for some standardisation of international taxation - any signatory state may propose amendments and conferences may be convened to deal with convention matters. The Convention also recognises that any Covered Tax Agreement may be amended by agreement between the parties to that agreement. Thus states may choose to renegotiate on a bilateral basis to the exclusion of the BEPS Convention. Thus, although many provisions are of general application, the purpose of the BEPS Convention is narrow. Preventing tax avoidance alone is not the driver behind tax treaties and over time, the application of the BEPS Convention may narrow as it is replaced again by simpler bilateral (or multilateral agreements).