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Multilateral BEPS Convention opens choices to LATAM countries

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The recent appearance of the Multilateral Convention to Implement Tax treaty Related measures to prevent BEPS (the Multilateral BEPS Convention or the Convention)[1] rounded up the implementation of the treaty-related final BEPS package (actions 2, 6, 7, and 14) in one single document which will be open for signature as from December 31, 2016. A signing ceremony will be held in Paris, in June 2017.[2]

The Convention aims to provide a framework that could amend all existing bilateral treaties at once (approx. 3,000) and bring them in line with BEPS treaty-related minimum standard without the need to endeavor complex and lengthy bilateral renegotiations.[3]

As Jonathan Schwarz pointed out in a recent contribution to this blog,[4] the Multilateral BEPS Convention does not establish a single uniform set of tax rules, but rather offers significant choices to states that wish to become a party, enabling the Convention to be a political success (in fact, more than 100 jurisdictions were involved in the process which led to its recent conclusion), but not necessarily achieving global convergence on treaty-related BEPS measures.[5] Moreover, the Convention recognizes that any Covered Tax Agreement, as defined, may be amended by agreement between the parties to that agreement, so that states may choose to renegotiate on a bilateral basis to the exclusion of the BEPS Convention.

In substance, the Multilateral BEPS Convention covers the outcomes of BEPS Actions 2, 6, 7 and 14, focusing on how the Convention would need to modify the provisions of bilateral tax agreements in order to implement those measures.[6]

This piece is focused exclusively on Action 6, aimed at preventing tax treaty abuse. It starts with a retrospective view of the Action's objectives, as well as findings and recommendations of the interim and final documents, explore the Convention's options for implementing the minimum agreed upon standard, and assess the LATAM Countries possible responses in light of their past policy and practice towards treaty shopping.

Action 6 of OECD/G20 BEPS Action Plan, dated September 2013, was aimed at (i) developing Model Treaty provisions and recommendations on the design of domestic tax rules to prevent the granting of treaty benefit in inappropriate circumstances, (ii) clarifying that tax treaties are not intended to be utilized to generate double non-taxation, and (iii) identifying tax policy considerations that countries should consider before deciding to sign a tax treaty with another

country.

As a first interim response, the September 2014 Deliverable[7] recommended that double tax conventions include in the Title and the Preamble a clear statement that treaties are not aimed at creating opportunities for non-taxation or reduced taxation, including treaty shopping. It also recommended to include a general treaty anti-abuse rule to prevent arrangements one of the principal purposes is to obtain treaty benefits (Principal Purpose Test or PPT), and a specific LoB provision patterned after the LoB provision contained in Article 22 of the US Model Tax convention.

On November 21, 2014, the OECD released a Discussion Draft[8] identifying 20 different issues to be addressed as part of the follow-up work on this Action, including specific questions and comments to the public; as a result of this invitation for comments, over 750 pages of public comments were received[9] and a public consultation meeting was held on January 22, 2015.[10] Later on, on meetings that took place on March 5-6, and March 11-13, 2015, the Working party 1 (WP1) addressed the great majority of the still open issues and discussed additional proposals related to some issues.

A Revised Discussion Draft (RDD)[11] was released on May 22, 2015, reflecting the conclusions and proposals arrived at the WP1's March meetings, on which the CFA invited for comments; comments were discussed at WP1's meetings held on June 22-26, 2015, at which time WP1 was asked to produce a final version of the Report on Action 6.

Part 1 of The RDD presented the Alternative Simplified LoB rule and the Annex to the RDD the wording of the Entitlement to Benefits proposed clause, together with accompanying Commentaries to be included in the OECD MC. The footnote to the proposed clause (as drafted in the Annex) gave treaty signatories the alternative to adopt (i) the detailed version of paragraphs 1 to 6 (LoB clause) together with the implementation of the anti-conduit mechanism described in the proposed Commentaries, (ii) paragraph 7, only (PPT), or (iii) PPT together with any variation of the detailed LoB clause (paragraph 1 to 6).

In line with the interim documents, the Final report[12] issued in October, 2015, Section A, provided for the new treaty anti-abuse rules, with a certain degree of flexibility on implementation. Thus, the following approach was recommended: (i) inclusion of a clear statement in the treaty in the sense that the states that enter into the tax treaty intend to avoid creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including treaty shopping arrangements); (ii) a specific anti-abuse or LoB rule; and (iii) a more general anti-abuse rule (the PPT rule) aimed at addressing situations that would not be covered by the LoB rule.

Moreover, recognizing that LoB and PPT may not be appropriate for all countries and that domestic law may include provisions that make it unnecessary to combine both to prevent treaty shopping, the Final Report set forth a *minimum standard* of commitment, consisting of (i) a combined approach of LoB and PPT rule, (ii) a PPT rule alone, or (iii) an LoB rule supplemented by a mechanism that would address conduit financing arrangements, not already dealt with in tax treaties.

The Final Report also included in this Section A changes to the OECD MC aimed at ensuring that tax treaties do not inadvertently prevent application of domestic anti-abuse rules to fight strategies that seek to circumvent provision of domestic tax laws.

Section B of the Final Report provided for a reformulation of the Title and Preamble of the OECD MC, clarifying the shared intention of the parties to avoid creating opportunities for tax evasion and avoidance, in particular through treaty shopping arrangements.

Section C, finally, identify tax policy considerations that countries should consider before deciding to enter into a tax treaty with another country.

In particular concerning Action 6, Part III (Treaty Abuse) of the Multilateral BEPS Convention (articles 6 and 7) deals with the minimum standard and optional alternatives to prevent treaty abuse.

The minimum standard requires (i) the inclusion of an express statement in the Preamble stating the common intention to eliminate double taxation without creating opportunities for non-taxation or reduce taxation through tax evasion or avoidance, including through treaty shopping arrangements, and (ii) at least a PPT or Principal Purpose Test rule, which is the only approach deemed to satisfy the minimum standard by its own.

Options include (i) supplementing the PPT rule by application of a simplified LoB provision, or (ii) a standalone detailed LoB provision, used in conjunction with a mechanism that deals with conduit arrangements not already dealt with in tax treaties.[13]

The Multilateral BEPS Convention does not include a detailed LoB provision, so that parties that prefer to use it are allowed to opt out of the PPT and agree to reach a bilateral agreement that satisfy the minimum standard, or accept the PPT rule of the Convention as an interim rule.[14]

The Preamble text contemplated in paragraph 1 of article 6 is to be included in place of or in the absence of similar Preamble language of the covered tax agreement.[15] Each party must notify the Depositary (OECD) of whether each of its covered tax agreements contains Preamble language, and the text of the relevant paragraph. When all contracting parties have made such notification, the Preamble language is to be replaced by the text contained in paragraph 1 of article 6 of the Convention.

The PPT rule of the Convention applies in place of or in the absence of similar provisions under the covered tax agreements.[16]

A party may choose to apply the simplified LoB provision to its covered tax agreements by notifying the Depositary, but the provision shall apply symmetrically to a covered tax agreement only where all contracting jurisdictions has chosen to apply it. A simplified LoB provision, however, could be applied asymmetrically by one of the parties to an agreement which has decided to do so, when the remaining parties agree to such application notifying the Depositary accordingly.[17]

Looking at this menu of possibilities offered by Part III of the Convention, one might speculate on what would be preferable from the perspective of Latin American countries. What should they do? Should they stay out of the Multilateral BEPS Convention and renegotiate their bilateral agreements on a case-by-case basis? Whether on a multilateral or bilateral basis, should they be inclined to a PPT, a PPT and a simplified LoB provision, or a bilaterally-negotiated detailed LoB provision? Should they dispense with any innovation and stay behind BEPS recommendations in this area? Countries need to take decisions in this area in a very short time and, to do so, will have to address fundamental policy issues related to their treaty network and future relationship with

OECD/G20 international tax endeavors.

For political reasons it is hard to foresee OECD members or running-for-membership countries in the LATAM region staying out of the Multilateral BEPS Convention; this group includes Mexico, Chile, Colombia, Peru, Costa Rica, and Argentina; and because of its special OECD status, Brazil. Beyond this group, LATAM countries' responses are less predictable, particularly those coming from countries following a territorial system of taxation and/or without an expanded net of comprehensive tax treaties on income and wealth that might choose to proceed on a bilateral basis or simply do nothing (within this group are, *inter alia*, Bolivia, Dominican Republic, Guatemala, Paraguay, and Uruguay).[18] Other country reactions in the LATAM region might be influenced by current internal political situations, unfavorable for this type of international initiatives to be followed (Ecuador, Venezuela).

Among those countries expected to be inclined to sign the Multilateral BEPS Convention, responses to options provided therein (PPT, PPT and simplified LoB provision, detailed LoB rule with or without a PPT interim rule) would most likely follow each country's past experience and tax policy design concerning treaty shopping. Countries with a tradition in the application of GAAR to treaties would possibly favor PPT, as its treaty-based equivalent, while countries that have mostly relied on LoB, would favor LoB in any of its variances (i.e., simplified or detailed LoB). Therefore, before addressing LATAM countries responses to the Multilateral BEPS convention, it is important to identify what selected countries in the region have been doing in this area thus far.

At glance, it is worth noting that some relevant LATAM jurisdictions rely on the application of GAAR in a treaty setting, with particular emphasis after the 2003 Copernican change in the OECD MC Commentaries' approach towards GAAR application to treaties.

GAAR are either applied to recharacterize income or redefine the beneficiary under a treaty, in both inbound and/or outbound (round trip) situations, i.e., when the jurisdiction is the source or the residence country, respectively. This group of countries lacks treaties with LoB provisions unless LoB were demanded by a treaty-partner country's position (e.g., the case of the treaties signed by Argentina, Colombia, Panama, Brazil and Peru with Mexico which, with its traditional widespread LoB policy, has been a notable exception to the application of GAAR to treaties in LATAM).

Mexico's extended treaty network include treaties with comprehensive LoB provisions (namely the treaties with Barbados, Colombia, china, UAE, USA, India, Israel, Kuwait, Panama, South Africa and Ukraine); treaties with more limited anti-abuse provisions (Austria, Bahrain, Brazil, Canada, Hungary, Lithuania, The Netherlands, Peru, Qatar, UK, Check Republic, Slovenia, Russia and Singapore); and treaties with an anti-abuse provision solely applicable to the interest and royalty clauses. Mexico's treaty policy concerning the inclusion of LoB clauses has been consistently applied long before the BEPS Action Plan was launched, and the Final Report on Action 6 delivered.[19]

Among countries using or allowing the use of GAAR in a treaty setting are Argentina and Colombia, although in the latter case there are no cases decided yet (GAAR were introduced in 2012). Similarly, Brazil, Chile, and Peru contemplate application of domestic GAAR though their application in a treaty setting is not expressly stated. GAAR in Peru and Chile are also quite recent (2012 and 2014, respectively), while the business purpose test and substance over form criteria under the National Tax Code in Brazil are also rather recent judicial development.[20] Finally, it is

worth noting that in recent years Argentina has resorted aggressively to GAAR, particularly in the case of round trip investments, and regardless of an express treaty authorization.[21]

At first sight it would be sound for LATAM countries to enter the Convention and/or prevent treaty shopping onward in accordance with their own legal tradition and, thus, countries applying so far domestic GAAR should be inclined to apply PPT which is precisely the corresponding treaty equivalent standard, while countries like Mexico should perhaps refine its treaty LoB in accordance with the Convention's simplified LoB or a bilaterally agreed upon detailed LoB meeting the minimum standard. A third group of countries, basically territorial jurisdictions with a very narrow treaty network could analyze, as a matter of tax policy, whether it is in their best interest including anti-treaty shopping rules of any type in its bilateral agreements.

Notwithstanding the foregoing, and perhaps influenced by the BEPS mood and the Final Reports of the Action Plan whose outcomes are being taken almost unconditionally and without reservation by some countries in this region, as if they were the sole reveled truth in international taxation, it should be expected that, at least for the time being, new treaties in the region adopt the most strictest version available of all possible choices; as an illustration, article 24 of the new treaty between Chile and Argentina[22] contains an LoB provision combined with a PPT rule, though it is not yet clear whether the Chilean treaty anti-treaty shopping design is a first step in a new Argentine policy path to avoid treaty shopping, or just a concrete response to a troublesome treaty relationship with Chile, marked by past practices of Argentine taxpayers perceived as abuses under the old, no longer in force treaty. In any case, Argentina should reassess once again its treaty policy towards treaty shopping before entering the Convention, with the view of adopting a balance position between fighting treaty shopping effectively, in one hand, and avoid harming genuine FDI into the country, in the other hand. In this sense, the following paragraph illustrates on some inadvertent consequences of adopting LoB to a common fact pattern in the region.

It has been usual for the global company to invest in LATAM through a holding company organized in an extra-zone country having treaties with the LATAM jurisdiction where operating subsidiaries are going to be established. These schemes have been allowed under GAAR as long as the holding company evidences economic as well as legal substance. Now, should a country migrate to an LoB rule, the tax perception of this common investment scheme will vary dramatically: Under an LoB scrutiny the sole objective fact that the controlling shareholder is a resident of a third country would prevent the entity to benefit from the treaty, unless its shares are listed in a recognized stock exchange in the same country, which might not be the case.

Major efforts in LATAM should be concentrated in preventing the country's own residents to abuse a treaty under round trip schemes, but at the same time avoiding to jeopardize genuine inbound FDI (e.g., channeled through treaty regional holdings) by adding unwarranted hurdles coming from objective and robotic LoB provisions alien to the country's traditional treaty policy and practice, whether adopted in a simplified or detailed form.

[1] Downable text (http://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf) and Explanatory Statement (http://www.oecd.org/tax/treaties/explanatory-statement-multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf)

[2]

http://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm

[3] The Convention operates to modify tax treaties between two or more Parties to the Convention. It will not function in the same way as an amending protocol to a single existing treaty, which would directly amend the text of the Covered Tax Agreement; instead, it will be applied alongside existing tax treaties, modifying their application in order to implement the BEPS measures (accord., Explanatory Statement, 13). This feature raises an additional complexity to the application of tax treaties; in effect, as Schwarz commented, *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* (Schwarz, *BEPS Multilateral Convention Unveiled,* Kluwer International Tax Blog, November 25, 2016).

[4] Schwarz, id. footnote 3. For further reference also see IBFD, Tax Treaty Monitor, Brian J. Arnold in Cooperation with IBFD's Tax Treaty Unit, *The Proposed OECD Multilateral Instrument,* December 2016, p. 683 ss.

[5] Explanatory Statement, points 14, 15.

[6] Explanatory Statement, point 8.

[7] http://www.oecd.org/ctp/preventing-the-granting-of-treaty-benefits-in-inappropriate-circumstances-9789264219120-en.htm

[8] http://www.oecd.org/tax/treaties/discussion-draft-action-6-follow-up-prevent-treaty-abuse.htm

[9] http://www.oecd.org/tax/treaties/comments-action-6-prevent-treaty-abuse.htm

[10] https://www.oecd.org/tax/treaties/public-comments-action-6-follow-up-prevent-treaty-abuse.pdf

[11] http://www.oecd.org/tax/treaties/discussion-draft-action-6-prevent-treaty-abuse.htm

[12] http://www.oecd.org/tax/preventing-the-granting-of-treaty-benefits-in-inappropriate-circumstances-action-6-2015-final-report-9789264241695-en.htm

[13] Explanatory Statement, point 88, 89, 90.

[14] Explanatory Statement, point 90.

[15] Explanatory Statement, point 81.

[16] Explanatory Statement, point 93.

[17] Explanatory Statement, 100-102.

[18] Members of the ad hoc Group included, however, The Dominican Republic, Guatemala Jamaica and Uruguay, so that their active participation in the negotiation might determine these

countries' position at the signing stage. For a complete list of countries in the ad-hoc group see http://www.oecd.org/tax/treaties/multilateral-instrument-for-beps-tax-treaty-measures-the-ad-hoc-group.htm

[19] See Teijeiro, *LoB Clauses, PPT Standard, and the Latin American Treaty Network Choices,* Kluwer International Tax blog, June 5, 2015.

[20] Id. footnote 19.

[21] Inbound investment: See, Ruling AFIP 57/94, re-characterization of insurance premium paid to foreign insurers under loan agreement as additional interest (higher borrowing cost), treaty with Spain and Italy; and DNI Memorandum 3/06, reallocation of income from DEG to participants under a participated loan agreement ruled by the treaty with Germany. Outbound investment: See, DNI Memorandum 64/09, use of an Austrian intermediary (shell) holding company without any economic substance; DNI Memorandum 799/10, double non-taxation obtained by using an interposed Chilean holding company (Chilean Platform regime) under a no longer in force Andean Pack-type treaty. Similarly, Tax Court, *in re* Molinos Rio de la Plata, August 14th, 2013, decision affirmed by the Federal Court of Claims. In the same sense, the Memorandum of Understanding (MOU) annexed to the Tax Treaty with Spain, approved by Law 26,918, published on December 28, 2013, set forth two interrelated principles of application: (i) the treaty does not prevent applying domestic GAAR, and (ii) treaty benefits shall not be granted to a person who is not the beneficial owner of the income originated in the other contracting State or the items of wealth situated therein.

[22] Approved by law 27,274.

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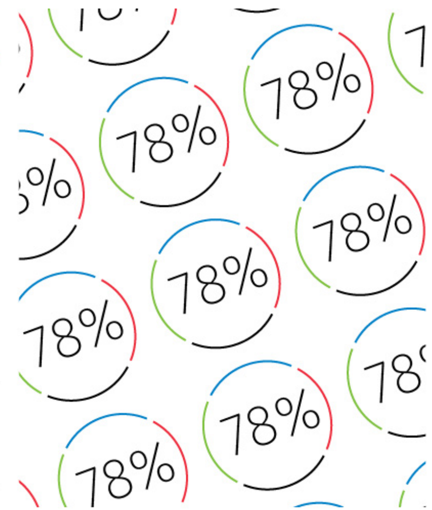

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