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MLI minimum standards on treaty shopping and mutual agreement procedure. LATAM countries' position

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The Multilateral Convention to Implement Tax treaty Related measures to prevent BEPS (the Multilateral BEPS Convention or MLI)[1] rounded up the implementation of the treaty-based final BEPS outcomes in one single document. MLI is aimed at providing a framework that could allow amending existing bilateral treaties at once, bringing them in line with BEPS treaty-related minimum standard and recommendations without the need to endeavor complex and lengthy bilateral renegotiations.

In a historical signing ceremony hosted by OECD on June 7, last, 76 countries and jurisdictions signed or expressed their intention to sign MLI.[2]

MLI does not establish a single uniform set of tax rules, but rather offers significant options to signing jurisdictions; thus, MLI does not achieve full global convergence on treaty-based BEPS measures; even minimum standards on treaty abuse and mutual agreement procedure keep some degree of optionality. Moreover, MLI recognizes that any Covered Tax Agreement, as defined, may be amended by agreement between the parties to that agreement, so that states keep the right to renegotiate on a bilateral basis to the exclusion of MLI.

In substance, MLI 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. As regards Actions 6 and 14, MLI provides minimum agreed-upon standards.

Action 6 (aimed at preventing tax treaty abuse) and Action 14 (on dispute resolution) are key aspects of MLI; this contribution discuss the Actions' objectives, findings and recommendations, explore MLI options to implement the minimum agreed-upon standards, and assess the LatAm Countries responses upon the signing of MLI.

1. Action 6 outcome and MLI implementation of a minimum standard on treaty shopping

Action 6 of OECD/G20 BEPS Action Plan 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 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 an LoB provision patterned after that contained in Article 22 of the US Model Tax convention.

The Revised Discussion Draft (RDD), Part 1, 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 MLI 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 LoB clause (paragraph 1 to 6).

The Final Report, 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 parties to 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 provisions 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.

In particular concerning Action 6, Part III (Treaty Abuse) of MLI (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.

MLI 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 MLI's PPT rule as an interim rule.

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. Each party must notify 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, MLI.

The PPT rule of the MLI applies in place of or in the absence of similar provisions under the Covered Tax Agreements.

A party may choose to apply the simplified LoB provision to its Covered Tax Agreements, but the provision shall apply symmetrically to a Covered Tax Agreement only where both contracting jurisdictions has chosen to apply it. A simplified LoB provision, however, could still be applied asymmetrically by one of the parties to an agreement which has decided to do so, when the other party agree to such application notifying OECD accordingly.

2. Treaty shopping: LatAm countries responses

Looking at the options offered by Part III of MLI, speculations arose right after its issuance on what should be preferable from the perspective of LatAm countries.[3]

Given the relative scarce number of treaties involved in each case,[4] should LatAm states have stayed out of the MLI and renegotiate their bilateral agreements on a case-by-case basis? Whether on a multilateral or bilateral basis, should they have been inclined to a PPT, a PPT and a simplified LoB provision, or a bilaterally-negotiated detailed LoB provision? Should they have dispensed with any innovation and stayed behind BEPS recommendations in this area? From a different perspective, should CAN-Andean Pact modeled tax treaties be set aside, i.e., not included among listed treaties or should the countries concerned have pushed to obtain adapted multilateral guidance?

All these speculations are now over since signing LatAm states have already taken decisions that, in some way or another, embodied fundamental policy issues related to treaty law as well as a certain positioning regarding OECD and future relationships with OECD/G20 international tax endeavors.

The region countries' relative closeness to OECD is of no minor importance in this context. OECD wishes to make MLI a major political success and OECD's member states in the region (Mexico and Chile), as could have been easily predicted, align behind that goal, as do most running-for-membership countries, including Colombia, Costa Rica, and Argentina.[5] Notable exceptions within this group of runner-up LatAm countries are Brazil and Peru, which did not even participate of the signing ceremony, perhaps trying to preserve themselves from taking premature decisions in matters affecting its international tax policy.

Costa Rica's participation in MLI appears to be quite surprising and cannot be explained but for its interest in speeding OECD full membership approval. With a territorial system of taxation and without an expanded net of comprehensive tax treaties on income and wealth (only three Covered Tax Agreements), it would have been more reasonable to avoid MLI application complexities by renegotiating its existing treaties on a bilateral basis.

The position of other LatAm countries with similar characteristics (territorial taxation) and not yet MLI signatories (Bolivia, Dominican Republic, Guatemala, Paraguay) is still a question mark, though one might envision that they could be inclined to proceed on a bilateral basis, if and when needed, or simply do nothing.[6]

As some countries in the region align easily with OECD's recommendations embodied in MLI, even beyond what would appear to be sound from a technical perspective, similar but opposite political interests keep other LatAm countries out of the loop; this is notably the case of Ecuador and Venezuela where the current internal political climate conspires against transnational initiatives originated outside the region.[7]

MLI is aimed at amending bilateral treaties patterned after the OECD MC, to the exclusion of bilateral treaties modeled otherwise (e.g., CAN/Andean Pact treaties). But there is also a substantial reason for the latter's exclusion. All LatAm signing countries commit themselves to amend Covered Tax Agreements, adopting the text of the Preamble provided for in Part III, Article 6, 1, MLI. This imply a commitment to avoid creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including treaty shopping. Full compatibility of this commitment with exclusive source jurisdiction within CAN or similarly-modeled treaties could have been hardly accomplished; those opportunities are somehow inherently associated to the allocation of exclusive jurisdiction to one of the parties to the treaty since, in turn, the latter might decide not to tax, thus creating an instance of double non-taxation. The same trouble could have risen should Argentina attempt to apply the preamble to its similarly modeled treaty with Bolivia. In fact, this was an issue under the old, not yet in force, treaty between Argentina and Chile, also patterned after the Andean Pact's original rules (Decision 40). The old treaty with Chile was precisely denounced by Argentina because the exclusive attribution of jurisdiction to Chile, combined with a special holding regime in Chile (Chilean Platform companies), allowed Argentine corporate residents to invest in third foreign countries through Chile without paying taxes on dividend yields in Chile and Argentina (double non-taxation).[8]

The only signatory LatAm country adopting PPT as the sole minimum required standard is Costa Rica. All others adopted a combination of PPT and the simplified LoB; the SLOB would apply symmetrically or asymmetrically, depending on the position adopted by the counterparty to the Covered Tax Agreement. None decided to go for a detailed (bilaterally agreed) LoB provision.

One might have thought that signing LatAm countries applying GAAR or statutorily allowed to apply GAAR in a treaty context would favor PPT (its treaty-based equivalent) as the sole test,[9] while those traditionally relying on LoB would favor LoB in any of its variances (i.e., simplified or detailed LoB).[10] That group of countries lacks pre-MLI 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).

As an exception within the Argentine treaty network, article 24 of the current treaty between Chile and Argentina[11] contains a LoB provision combined with a PPT rule; looking it retrospectively, and in light of the position now expressly taken by Argentina upon the signing of MLI, this treaty clause marked a first step towards Argentina´s new policy against treaty shopping.[12]

All in all, it is now clear that countries in the region have chosen to follow MLI's strictest choice regarding treaty shopping: A combined minimum standard consisting of a PPT and a SLOB.

One may now expect a more or less extended period of time where LatAm countries used to applying GAAR (now PPT) will need to become familiar with the application of a more narrow and objective SLOB rule, while countries used to applying LoB clauses will face the interpretation troubles coming from the application of a more widely designed standard (PPT). This would be a learning process involving Competent Authorities and tax administrations' decision as well as court precedents. On top of this new gymnastics, the proper scope of application of PPT and GAAR should be found to avoid overlapping, keeping in mind that, conceptually, PPT and GAAR are not Interchangeable at will, and that application of GAAR should be now constrained to cases where domestic rules sought to be circumvented. In a highly competitive world, countries in the region should face all this challenges without adding unwarranted hurdles that might risk attracting genuine inbound FDI.

3. LatAm position regarding MAP

Article 25 of the OECD Model Tax Convention (OECD, 2014) provides a mechanism through which the competent authorities of the Contracting States may resolve differences or difficulties regarding the interpretation or application of the Convention on mutually-agreed basis. This mechanism, the mutual agreement procedure or MAP, is of crucial importance in connection with the work on BEPS issues and reflects the comprehensive and holistic approach of the BEPS Action Plan.

The relevant part of the OECD/G20 Action Plan read as follows: The actions to counter BEPS must be complemented with actions that ensure certainty and predictability for business. Work to improve the effectiveness of the mutual agreement procedure (MAP) will be an important complement to the work on BEPS issues. The interpretation and application of novel rules resulting from the work described above could introduce elements of uncertainty that should be minimized as much as possible. Work will therefore be undertaken in order to examine and address obstacles that prevent countries from resolving treaty-related disputes under the MAP.

Consideration was also going to be given to supplementing the pre-BEPS existing MAP provisions in tax treaties with a mandatory and binding arbitration provision.

The Final Report on Action 14[13] developed a minimum standard with respect to the resolution of treaty-related disputes. The minimum standard ensured (i) that treaty obligations related to MAP are fully implemented in good faith and that MAP cases are resolved in a timely manner; (ii) the implementation of administrative processes that promote the prevention and timely resolution of treaty-related disputes; and (iii) that taxpayers can access the MAP when eligible; Article 25 of the OECD MC is agreed to be amended in accordance with these objectives, and countries also agreed on a number of best practices

Part V of MLI[14] is accordingly aimed at facilitating access to MAP; to that end, MLI provisions apply in place or in the absence of existing treaty provisions. The purpose is that MAP be in line with the latest OECD MC standards as amended by the proposals arising from the final report on Action 14.

Broaden rules apply in connection with the submission of cases (cases may now be filed with the tax authorities of both contracting states), time for submission (three years counted as from the first notification of an action resulting in taxation which is not in accordance with the treaty), and implementation of an agreement resulting from a MAP (states are compelled to implement it notwithstanding any time limits in their domestic laws). In the field of transfer pricing, the granting of correlative adjustments is recommended.

All signing LatAm countries adhere to the minimum standard on mutual agreement procedure under MLI, and the recommendation concerning the recognition of corresponding adjustments in transfer pricing cases, but none adopts mandatory binding arbitration upon request of a taxpayer in case states fail to agree in a mutual agreement procedure (Part VI, MLI).

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