Australia signs the OECD's Base Erosion and Profit Shifting Multilateral Instrument

15 June 2017

In brief

Australia is one of 76 jurisdictions that sign, or indicated its intention to sign, the Organisation for Economic Cooperation and Development (OECD) Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (BEPS) (the Multilateral Instrument) on 7 June 2017. The Multilateral Instrument provides participating jurisdictions with a means to swiftly modify its bilateral treaties to implement measures developed as part of the OECD/G20 BEPS Project without having to negotiate changes on a treaty-by-treaty basis. Whilst the signing of the Multilateral Instrument represents a significant step forward in global efforts to combat BEPS, it adds a new layer of complexity to international transactions going forward.

In detail

The Multilateral Instrument contains 26 Articles dealing with a range of issues in tax treaties, including the treatment of transparent and dual resident entities, dividend transfer transactions, capital gains from the disposal of 'land-rich' entities, artificial avoidance of permanent establishments and mutual agreement procedures. Further details of these Articles are set out in our Tax Policy Bulletin.

Overview of Australia's provisional choices

Australia's provisional choices, lodged with the OECD on 7 June 2017, broadly reflect the principles set out in Treasury's discussion paper released in December 2015. That is, Australia has chosen to:

- apply the Multilateral Instrument to all bilateral tax treaties that do not already incorporate BEPS rules
- adopt the minimum standards and as many optional Multilateral Instrument Articles as possible, and
- make limited use of the reservation system.

As outlined below, Australia has indicated that the Multilateral Instrument should apply to all but one of its existing bilateral treaties. The one exclusion is the recently renegotiated tax treaty with Germany that already includes extensive provisions to deal with BEPS (see our TaxTalk Alert on the new German tax treaty for further details). Australia's choices with respect to specific Articles reflect a similar approach, with certain treaties carved out where they already include similar provisions.

Australia has chosen to adopt all four of the mandatory Articles, covering:

- the purpose of a Covered Tax Agreement (a Covered Tax Agreement is a treaty in force between two jurisdictions where both parties have indicated that they wish the treaty to be covered by the Multilateral Instrument)
- prevention of treaty abuse
- Mutual Agreement Procedures, and
- corresponding (compensating) adjustments.

With respect to the prevention of treaty abuse, Australia has chosen to adopt the Principal Purpose Test (PPT) only (all 68 signatories made a choice to adopt a version of the PPT). Broadly, the PPT will deny treaty benefits to a person if the person's principal purpose is to take advantage of the treaty unless it is established that granting that benefit in the circumstances would be in accordance with the object and purpose of the relevant provisions of the treaty. The introduction of the PPT into Australia's tax treaties will create further uncertainty for taxpayers seeking to rely on a treaty to secure particular tax outcomes given the scope and nature of the test which is highly dependent on the specific facts and circumstances of the particular transactions or arrangements, and the need to consider both direct and indirect transactions and arrangements to assess whether the principal purpose was to obtain a tax benefit under the treaty. The PPT threshold is lower than the 'sole or dominant purpose' test in Australia's general anti-avoidance rules and has some similarities with Australia's diverted profits tax which takes effect for income years commencing on or after 1 July 2017.

With regard to the optional Articles, perhaps the only surprise is that Australia has chosen not to adopt Article 12 in relation to artificial avoidance of permanent establishment status through dependent agent arrangements. Treasury has noted that "*Australia will not adopt Article 12 at this time. Australia will consider adopting these rules bilaterally, however, in future treaty negotiations to enable bilateral clarification of their application in practice. Pending this, the Multinational Anti-avoidance Law will continue to safeguard Australian revenue from egregious tax avoidance arrangements that rely on a 'book offshore' model.*" Given that the new tax treaty with Germany includes a substantially similar article to Article 12 of the Multilateral Instrument, it was surprising that Australia chose not to adopt this across all its tax treaties by way of the Multilateral Instrument, instead opting to deal with this issue on a treaty-by-treaty basis in future negotiations. However, this choice may reflect the trend across the signatories to the Multilateral Instrument - only 28 (including only 11 OECD countries) of the signatories chose to adopted the new dependent agent concept. This is concerning, as reliance on a domestic anti-avoidance provision (such as the Multinational Anti-Avoidance Law, which is a unilateral measure that effectively expands the Australian concept of permanent establishment), rather than a mechanism within the treaty, gives rise to a risk of double taxation that cannot be dealt with via treaty dispute resolution mechanisms.

Access to timely and effective dispute resolution mechanisms has been viewed as a key benefit of the Multilateral Instrument by business but only 25 of the 68 signatories chose to adopt arbitration procedures. Australia has chosen to adopt Articles 18-26 with respect to arbitration so that taxpayers will be able to refer Mutual Agreement Procedure disputes that remain unresolved after two years to independent and binding arbitration subject to the following conditions:

- disputes which have been the subject of a decision by a court or administrative tribunal will not be eligible for arbitration, or will cause an existing arbitration process to terminate
- breaches of confidentiality by taxpayers or their advisors will terminate the arbitration process, and
- disputes involving the application of general anti-avoidance provisions will be excluded from the scope of arbitration.

Treaties potentially impacted by the Multilateral Instrument

The framework for the Multilateral Instrument is complex, and understanding its impact on specific bilateral treaties will depend on:

- whether each jurisdiction has adopted (and ratified) the Multilateral Instrument
- which treaties each jurisdiction has indicated would be covered by the Multilateral Instrument, and
- specific choices made by each jurisdiction in relation to each Article of the Multilateral Instrument.

Table 1 below lists those jurisdictions with which Australia has a tax treaty and which Australia has indicated it wishes to be covered by the Multilateral Instrument. Those jurisdictions shaded in grey, however, have not yet signed the Multilateral Instrument (nor indicated an intention to do so), or did not list their treaty with Australia as one that would be covered by the Multilateral Instrument in their adoption choices. This means that, at least in the short to medium term, these treaties will not be impacted by the Multilateral Instrument.

Table 1: Tax Treaties that Australia wishes to be covered by the Multilateral Instrument

Argentina	Hungary	Netherlands	Spain
Austria	India	New Zealand	Sri Lanka
Belgium	Indonesia	Norway*	Sweden
Canada	Ireland	Papua New Guinea	Switzerland
Chile	Italy	Philippines	Taiwan / Taipei
China	Japan	Poland	Thailand
Czech Republic	Kiribati	Romania	Turkey
Denmark	Korea	Russian Federation	United Kingdom
Fiji	Malaysia	Singapore	United States
Finland	Malta	Slovak Republic	Vietnam
France	Mexico	South Africa	

** Norway's MLI position is unknown at the time of publication*

Some treaties listed above may be carved out of specific Articles of the MLI through the choices made by Australia or a counterparty to the particular treaty. For example, in relation to arbitration the following 14 treaty partners have signalled their intention to adopt arbitration: Belgium, Canada, Fiji, Finland, France, Ireland, Italy, Japan, Malta, Netherlands, New Zealand, Singapore, Spain and the United Kingdom and these countries do not currently intend to adopt arbitration: Argentina, Chile, China, Czech Republic, Denmark, Hungary, India, Indonesia, Mexico, Poland, Romania, Russia, Slovak Republic, South Africa and Turkey.

Following the signing ceremony in Paris last week, each jurisdiction will now need to take steps to implement the Multilateral Instrument into domestic law. In Australia's case, the Multilateral Instrument will need to be enacted into law and then formally ratified. Due to the Parliamentary process that must be followed for treaties in Australia, it is unlikely that Australia will be in a position to ratify the agreement this calendar year. Therefore, we anticipate that the Multilateral Instrument could potentially take effect in Australia from 1 January 2019 (for rules relating to withholding taxes) and 1 July 2019 (for rules relating to other taxes), subject to its ratification by Australia's treaty partners that have also chosen to adopt the Multilateral Instrument.

The takeaway

The Multilateral Instrument adds significant complexity to cross-border transactions. Taxpayers will need to understand which countries have signed and ratified the Multilateral Instrument, which agreements are Covered Tax Agreements and specific choices by each country. This is not a simple exercise, and at least during the initial implementation years, will change constantly as jurisdictions ratify the Multilateral Instrument and potentially change their provisional choices. Whilst it is likely to be some time before the Multilateral Instrument comes into effect, taxpayers will need to consider its potential impact for all future transactions.

Let's talk

For a deeper discussion of how these issues might affect your business, please contact:

Christian Holle, Sydney
+61 (2) 8266 5697
christian.holle@pwc.com

Peter Collins, Melbourne
+61 (3) 8603 6247
peter.collins@pwc.com

Michael Bersten, Sydney
+61 (2) 8266 6858
michael.bersten@pwc.com

Angela Danielleto, Sydney
+61 (2) 8266 0973
angela.danieletto@pwc.com

Michael Taylor, Melbourne
+61 (3) 8603 4091
michael.taylor@pwc.com

Michael Bona, Brisbane
+61 (7) 3257 5015
michael.bona@pwc.com