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Global Tax Alert

OECD releases multilateral instrument to modify bilateral tax treaties under BEPS Action 15

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Executive summary

On 24 November 2016, the Organisation for Economic Co-operation and Development (OECD) released the text of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (BEPS) under BEPS Action 15 (the multilateral instrument). The text and the related explanatory statement were formally adopted by approximately 100 countries at a ceremony hosted by the OECD following the conclusion of the negotiations during the week of 21 November 2016. The text of the multilateral instrument and explanatory notes are available on the OECD website.

The multilateral instrument under BEPS Action 15 is a key part of the OECD's effort toward implementation of the tax treaty related BEPS measures into existing bilateral or regional tax treaties as quickly and consistently as possible.

In general, the multilateral instrument will only enter into force after five countries have ratified it and will apply for a specific tax treaty, after all parties to that treaty have ratified the instrument; and a certain period has passed to ensure clarity and legal certainty.

It is expected that the multilateral instrument will be open for signature as of 31 December 2016 and a first high-level signing ceremony will take place in the week beginning 5 June 2017.

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Detailed discussion

Background

On 5 October 2015, the OECD released its final report on developing a multilateral instrument to modify bilateral tax treaties (Action 15) under its BEPS Action Plan.[1] This report was released in a package that included final reports on all 15 BEPS Actions.

The multilateral instrument was developed over the past year, via negotiations involving more than 100 jurisdictions including OECD member countries, G20 countries and other developed and developing countries, under a mandate delivered by G20 Finance Ministers and Central Bank Governors at their February 2015 meeting.

Content

The multilateral instrument will operate to modify tax treaties between two or more parties. It will not however, function in the same way as an amending protocol to a single existing treaty, which would directly amend the text of the tax treaty. Instead, it will be applied alongside existing tax treaties, modifying their application in order to implement the BEPS measures. As a result, while for internal purposes, some Parties may develop consolidated versions of their Covered Tax Agreements as modified by the multilateral instrument, doing so is not a prerequisite for the application of the multilateral instrument.

The tax treaty related BEPS measures covered by the multilateral instrument include (elements of): (i) Action 2 on hybrid mismatch arrangements, (ii) Action 6 on treaty abuse, (iii) Action 7 on the artificial avoidance of the PE status; and (iv) Action 14 on dispute resolution. The substance of the tax treaty provisions relating to these actions was agreed under the final BEPS package released in October 2015. The multilateral instrument does not modify or add to the substance of these provisions. The instrument is solely focused on how to modify the provisions in bilateral or regional tax treaties in order to align these treaties with the BEPS measures.

The only action for which the negotiations both related to developing the substance of the provision and the modalities of its implementation in bilateral and regional tax treaties, concerns the mandatory and binding arbitration provision which was announced in the final report on Action 14.[2] A group of countries (20 countries) expressed their willingness to voluntarily include mandatory and binding arbitration in their existing tax treaties at the time of conclusion of the Action 14 final report. Eventually, 27 countries participated in the subgroup which developed this provision.

The intention of the multilateral instrument is to enable all countries to meet the treaty-related minimum standards that were agreed as part of the final BEPS package. These include the minimum standard for the prevention of treaty abuse under Action 6 and the minimum standard for the improvement of dispute resolution under Action 14. Given, however, that each of those minimum standards can be satisfied in multiple different ways, and given the broad range of countries and jurisdictions involved in the negotiations, the multilateral instrument was designed to be flexible enough to accommodate the positions of different countries and jurisdictions. The multilateral instrument is also drafted to provide flexibility in relation to provisions that do not reflect minimum standards.

The multilateral instrument provides that flexibility by:

- Allowing countries to specify the tax treaties to which the multilateral instrument applies
- Creating flexibility with regard to the provisions that relate to a minimum standard, in order to allow countries to choose for the option that fits them best
- Including the possibility to opt out of provisions when the provisions do not relate to a minimum standard
- Including the possibility to opt out of provisions for treaties with existing provisions with specific, objectively defined characteristics
- Allowing a choice to apply optional or alternative provisions, such as for example the optional provision on mandatory and binding arbitration

Implications and next steps

The multilateral instrument of BEPS Action 15 is a key part of the OECD's effort toward implementation of the recommended measures. The instrument will implement the tax treaty related BEPS measures into existing bilateral or regional tax treaties.

Currently more than 3000 of such treaties are in force. Bilateral renegotiations of these treaties in the conventional ways would potentially take decades and would therefore hamper the swift implementation of the treaty related BEPS measures. The multilateral instrument could potentially lead to the amendment of at least 2000 of these treaties in the coming years.

Governments are currently preparing their lists of treaties to be covered by the multilateral instrument and are considering which options to select and reservations to make. They will have to notify this to the OECD, who will be the depositary of the multilateral instrument and will support governments in the process of its signature, ratification and implementation.

The multilateral instrument will be open for signature as of 31 December 2016 and a first high-level signing ceremony will take place in the week beginning 5 June 2017, with the expected participation of a significant group of countries.

The multilateral instrument will enter into force after five countries have ratified it and will apply for a specific tax treaty after all parties to that treaty have ratified the multilateral instrument and a certain period has passed to ensure clarity and legal certainty.

Detailed Global Tax Alerts will be issued on both the technical features of the multilateral instrument and on its effects on the implementation of the treaty related BEPS Actions (Actions 2, 6, 7 and 14).

Endnotes

1. See EY Global Tax Alert, *OECD releases final report on developing a mulitlateral instrument to modify bilateral tax treaties under BEPS Action 15*, dated 10 October 2015.
2. See EY Global Tax Alert, *OECD releases final report on improving the effectiveness of dispute resolution mechanisms under Action 14*, dated 8 October 2015.

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