The **BEPS** Monitoring Group

Comments on the Public Discussion Draft on

DEVELOPMENT OF A MULTILATERAL INSTRUMENT TO IMPLEMENT THE TAX TREATY RELATED BEPS MEASURES

These comments have been prepared by the BEPS Monitoring Group (BMG). The BMG is a network of experts on various aspects of international tax, set up by a number of civil society organizations which research and campaign for tax justice including the Global Alliance for Tax Justice, Red de Justicia Fiscal de America Latina y el Caribe, Tax Justice Network, Christian Aid, Action Aid, Oxfam, and Tax Research UK. These comments have not been approved in advance by these organizations, which do not necessarily accept every detail or specific point made here, but they support the work of the BMG and endorse its general perspectives. It has been drafted by Sol Picciotto, with contributions and comments from Attiya Waris, Jeffery Kadet and Tommaso Faccio.

SUMMARY

The reports resulting from the project on Base Erosion and Profit Shifting (BEPS) include a number of proposals for changes in tax treaties, formulated as amendments to the OECD Model Convention and its Commentaries. The Multilateral Instrument (MLI) is intended to provide a method for quickly amending existing bilateral treaties. Hence, it must take the form of an actual self-standing treaty, and not a model. However, there are differences in the texts of the actual treaties to be amended, especially those involving developing countries, and based on the UN model. Hence, we suggest that the MLI should be accompanied by Country Schedules, bilaterally agreed, to ensure clarity as regards which treaties are amended and how. This would ensure that tax authorities, taxpayers and courts know which treaties have in fact been amended and their new language.

The core provisions of the MLI should be the basic provisions for preventing abuse of tax treaties and eliminating double non-taxation. Several variants have been proposed in BEPS Action 6, and it is essential that the MLI includes options which are suitable for developing countries. The revisions of the Permanent Establishment definition have been drafted in relation to the OECD Model, and a variant should be included which is compatible with the UN model, in consultation with the UN Committee.

The proposals for strengthening the Mutual Agreement Procedure (MAP) for resolving tax treaty disputes are unsuitable for developing countries, and should remain purely voluntary. This applies in particular to Mandatory Binding Arbitration, which we regard as illegitimate for all countries. Tax treaty provisions are binding in domestic law, and can be enforced through national tribunals. Accordingly, MNEs should not be given further privileges over other taxpayers. The MAP is an 'amicable procedure', and it is not appropriate to try to convert it into a supranational dispute settlement procedure. It is contrary to the due process of law, and indeed in many countries regarded as unconstitutional, for contentious interpretations of legal provisions to be made by secret and unaccountable administrative procedures, rather than by courts or tribunals in an open legal process. To make it mandatory for all conflicting interpretations to be resolved would provide a guarantee that aggressive tax

planning would be riskless, and create an incentive to continue BEPS behavior. The main cause of the increase in tax disputes is the subjective basis of the transfer pricing rules, and it is inappropriate to expect the MAP to resolve issues which negotiators have failed to deal with in a principled manner.

GENERAL COMMENTS

1. The Discussion Draft (DD) asks for comments to be limited to technical issues. However, as we have repeatedly stated, it is impossible to separate discussion of technical details from the underlying policy aims. The attempt to technicise the discussion of BEPS proposals has had the effect of creating significant barriers to the involvement of a wider range of interested persons, limiting involvement in the main to practitioners who are paid to provide tax advice to large multinational enterprises (MNEs). The lack of effective public consultation has greatly weakened the political accountability of the BEPS project.

2. We cannot refrain from pointing out also that the approach adopted in the BEPS project of attempting to patch up existing rules is resulting in an enormous increase in the complexity of the international tax system. This patch-up will require many changes to tax treaties and their commentaries, which are intended to be introduced as rapidly as possible by this multilateral instrument (MLI). Virtually all these changes aim to prevent the abuse of tax treaties by the many ingenious techniques devised by tax advisers. Yet underlying all these techniques is one basic strategy: exploitation of the fiction of separate legal personality and the 'independent entity' principle. Ending these abuses could have been achieved far more easily and with greater coherence by clearly stating as a guiding principle that MNEs should be treated in accordance with the economic reality that they operate as integrated firms. This was implicit in the mandate from the G20 to reform the system so that MNEs could be taxed 'where economic activities occur and value is created'. Instead, the MLI will introduce a plethora of anti-abuse rules for revenue administrations to apply. This will require high levels of expertise and sophistication, which are often beyond the capacity of administrations in developed let alone developing countries. This approach is also a recipe for disagreements and conflicts, which will benefit only the legions of paid tax advisers, to the detriment in particular of developing countries, which do not have the capacity to successfully monitor and challenge potential exploitation of these anti-abuse rules by tax practitioners.

3. Given the above concerns and our belief that the initial two-year BEPS project is only the beginning, we recommend that the OECD and the governmental participants in the ongoing BEPS projects remain aware of the broader G20 mandate to achieve taxation reflecting 'where economic activities occur and value is created' and reassess in the future the simplifying recognition of the integrated nature of MNEs.

The Form of the MLI: a Self-Standing Convention

4. The MLI should be designed as far as possible to minimize legal complications. This has been made difficult because the reports from the BEPS Actions which have proposed new provisions for tax treaties with related commentaries have been formulated as amendments to the OECD model convention. Many actual bilateral treaties are not based on this model, especially those of developing countries, which generally begin from the UN model convention. No doubt the OECD countries will in due course integrate the changes resulting from the BEPS project into the OECD Model and its commentaries, perhaps together with other amendments resulting from continuing work. The UN Committee of Tax Experts should also consider for itself whether and how to incorporate these changes into the UN model.

5. The MLI should however be drawn up as a self-standing convention, with its own commentary. It is not intended to provide a **model** text, but a set of **actual treaty provisions** for states to accept and ratify as they wish. This will be easiest for the proposals which involve new treaty articles, such as the article on Entitlement to Benefits in Action 6, with its related Commentary (although this will have three alternative versions). It will be more difficult for proposals which have in the BEPS reports been formulated as amendments to particular parts of the OECD model articles, such as the more specific anti-abuse rules proposed in the Action 6 report to amend various articles. Nevertheless, for inclusion in the MLI these proposals must be reformulated as self-standing actual treaty provisions, with an appropriate related commentary. We agree with the statement in the DD that it is important to ensure, as far as possible, consistency and certainty in the interpretation and application of these provisions, and hence that the MLI should be accompanied by its own Commentary. It would not be appropriate for interpretation to rely indirectly on the Commentary to be included in the revised OECD model following implementation of the BEPS reports. This is a treaty and should have its own commentary to enable clarity and consistency in the interpretation and application of its provisions.

Amending Existing Bilateral Treaties: Country Schedules

6. The next key question is how to handle the relationship between the provisions of the multilateral instrument and the existing tax treaty network. The DD suggests that this could be done through 'compatibility clauses', which would 'describe in detail under what circumstances the new provision is intended to be added to or replace the provisions of an existing tax treaty'. In our view this would create unnecessary complications due to the significant differences in the provisions of existing tax treaties that the MLI is expected to modify or supersede. We suggest instead that each jurisdiction's adherence to the MLI should be on the basis of a Country Schedule, which would list the actual treaties and specific provisions which it intends to amend with the amending language. This would require each state to review all its existing treaties, and determine which specific changes and additions it intends to make to each treaty. These lists would also need to be discussed with each treaty partner to agree those changes, so that the Schedules would be aligned. The process would be similar to that of drawing up national schedules in multilateral trade agreements specifying each country's commitments to bind tariffs, although in this case each country's schedule would need to correlate with those of its treaty partners. This would be the best way to ensure clarity about which treaties have been changed and how. Indeed, without such specificity the relationship of these new treaty provisions to those of existing treaties would remain unsure. Lack of clarity about which treaties have been amended and how would be very damaging.

7. This 'Country Schedule' procedure would also mean that the MLI would simply provide a multilateral framework agreement, allowing states to choose which provisions they wish to apply to each of their existing treaties. The choices of each state would need to match with those of their treaty partners to create reciprocal binding obligations. Although this procedure would be somewhat complex, it would be far easier than actual separate country-by-country treaty negotiations. Since relevant officials from many countries will be attending the MLI meetings, it is likely that mutual decisions could be reached for a significant percentage of the more important bilateral treaties. While this would require more time and effort of officials to attempt to reach agreement with their treaty partners at the MLI meetings, it should significantly ease the domestic ratification process for many countries since the bilateral agreements on terms of specific treaties reflected in each Country Schedule would be ratified at the same time that the MLI itself is ratified by each participating country. In view of the benefits of reaching as many agreements as possible between bilateral treaty parties, we

suggest that additional days be scheduled in future MLI meetings to allow for such discussions and agreements.

8. The mandate for Action 15 in 2014 referred to the need to ensure balance between 'need for flexibility in order to ensure broad adoption against the need to develop an instrument that will be effective in preventing BEPS outcomes among signatories' (para. 12). However, the Action 15 report in 2015 also stressed that 'The benefits of swift implementation, improved consistency, certainty, and efficiency, can only be achieved if bilateral specificities and tax sovereignty are fully respected'. It is certainly important to ensure that the MLI achieves its aim of rapidly repairing some of the most glaring loopholes in tax treaties. However, it is clear that this cannot be done in a uniform way. Firstly, this is because of the diverse nature of existing bilateral treaties. Many of the proposed new provisions add new sub-clauses to particular articles or paragraphs, identified by their numbering in the OECD model treaty. Actual treaties may have different numbering and even different wording, so it would be unclear what was being added or changed and where. Secondly, the BEPS proposals do not put forward a basic package of uniform changes, but in a number of cases offer alternative versions. This is even the case for the proposals in Action 6 to prevent abuse of treaties, which might be considered core provisions. The draft articles which comprise the minimum standard for preventing treaty abuse propose three alternatives, between which each jurisdiction must choose.

9. The 'Country Schedule' procedure we suggest should also resolve the first technical question posed in para.10 of the DD, the decision on which existing bilateral treaty provisions that serve a similar purpose to those to be included in the MLI should be retained, and which replaced. This is surely a matter for each jurisdiction to decide for itself, in conjunction with its treaty partners. It may be appropriate for the MLI to be accompanied by a set of expected standards or recommendations, but ultimately each jurisdiction must decide for itself.

Core Provisions

10. The central purpose of the MLI is to amend existing treaties to ensure that they are interpreted and applied unambiguously to prevent not only double taxation but also double non-taxation. It is therefore appropriate that the MLI should have as its core the basic provisions for preventing abuse of tax treaties in the BEPS reports. The key provisions are therefore those in the Action 6 report on preventing treaty abuse: the changes to the Title and Preamble, and the new article on Entitlement to Treaty Benefits. Three alternatives are proposed in the Action 6 report, and it is essential that the MLI should offer at least one version which is suitable for developing countries. Other provisions may also be regarded as core, if they are clearly aimed at preventing double non-taxation, such as the specific anti-abuse provisions in the Action 6 report, and the anti-hybrid provisions in the Action 2 report. The revisions formulated in the Action 7 report to the article 5 provisions on Permanent Establishment (PE) are directed at treaties based on the OECD model. The UN model's article 5 does not include the word "delivery" in (a) and (b) of paragraph 4. The changes to be introduced by the MLI should be drafted in a way which leaves those sub-paragraphs unaffected, or an alternative should be offered, in consultation with the UN Committee of Tax Experts, which allows countries to retain the UN model language.

11. The aim of ensuring that the MLI is effective should not be achieved by attempting to impose excessive uniformity on bilateral treaties which are in fact diverse, since this could create legal complexity and uncertainty. Other procedures and pressures are available to ensure that all jurisdictions comply with the minimum standards and amend their treaties appropriately, including not only the peer-review process, but the pressures of public opinion.

Dispute Resolution, the MAP and Arbitration

12. In our view, it is not appropriate to include as core provisions in the MLI any of the proposals in the Action 14 report on Making Dispute Resolution Procedures More Effective, especially those directed at the Mutual Agreement Procedure (MAP), including the introduction of Mandatory Binding Arbitration. The evidence is clear that the growth of disputes resulting from divergent interpretations and application of tax treaties has been almost entirely among the main OECD countries. It also seems that the bulk of such disputes concern transfer pricing or profit attribution issues, although little is publicly known about the nature of these disputes, due to the total secrecy of the MAP. We understand the fears of business that there may be a further increase in these disputes following implementation of the BEPS proposals. The underlying reason for this, as we have repeatedly stressed in our submissions, is the faulty approach adopted towards revision of the Transfer Pricing Guidelines (TPGs). This approach has retained the requirement that all analysis is based on the fictions of 'independent entity' and the contracts and arrangements between related parties devised by tax planners, while strengthening the powers of tax authorities to recharacterise those arrangements. The subjective and indeed arbitrary nature of the judgments involved in this process will inevitably continue to produce conflicts. However, it is entirely inappropriate to seek to resolve these conflicts in an administrative process held behind closed doors.

13. The attempt to coerce tax authorities to abandon their own judgments and interpretations by compelling them to reach agreement through the threat of mandatory binding arbitration is even more inappropriate. MNEs have the same remedies open to them as do all taxpayers in relation to a disputed tax assessment, of referring the issue to domestic tribunals and courts. Indeed, they have the special advantage that tax treaty provisions are generally automatically applied in domestic law, creating a special legal regime for cross-border business on which they can rely. This includes not only the treaty provisions, but also their related Commentaries, and even the Transfer Pricing Guidelines and other reports. Domestic tax courts can and do very commonly refer to and apply these rules. Tax advisers sometimes complain that domestic tribunals always side with national tax administrations, but this is far from uniformly true.

14. The MAP is an 'amicable procedure', and it is not appropriate to try to convert it into a supranational dispute settlement procedure. It is contrary to the due process of law, and indeed in many countries regarded as unconstitutional, for contentious interpretations of legal provisions to be made by secret and unaccountable administrative procedures, rather than by courts or tribunals in an open legal process, and subject to a requirement of exhaustion of local remedies. MNEs may well complain of delays and other difficulties with court procedures, but all citizens suffer from such defects in public administration, the causes of which include pressures on government revenues. Mandatory Binding Arbitration is also likely to exploit the imbalance between the capacity of OECD countries' tax authorities and developing countries' tax authorities, solely to the benefit of OECD resident taxpayers.

15. We therefore remain opposed to the adoption of Mandatory Binding Arbitration as proposed in Action 14. In our view it is not appropriate to include even a 'voluntary' procedure for Mandatory Binding Arbitration in the MLI, which should be aimed at ending double non-taxation. The effect of making it mandatory for competent authorities to resolve all conflicting interpretations through the MAP is to provide a guarantee that aggressive tax planning would be riskless. It would therefore create an incentive to continue BEPS behavior. We regard the commitment of the 20 OECD states to this as a mistake. There is an overwhelming demand from public opinion for greater transparency in international tax

matters. It will not be regarded as acceptable for decisions involving often hundreds of millions of dollars in taxes to be taken behind closed doors, and by applying criteria which can only be described as discretionary. The leading OECD countries which seem determined to adopt this approach should now think again. They certainly should cease to attempt to bully or persuade others to follow them along this very questionable path.