BEPS and Australia’s Tax Treaty Policy

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Overview

- Australia’s tax treaties
- Treasury’s role in tax treaties
- Australia’s treaty making process
- BEPS
- BEPS and Australia’s tax treaty policy
- Future BEPS work and Australian treaty policy
Tax treaties generally

Tax treaties are bilateral agreements that aim to **eliminate double taxation & prevent fiscal evasion and avoidance**. They:

- assign taxing rights between source (of the income) country and residence (of the person/entity) country to reduce jurisdictional double taxation
- oblige the residence country to relieve double taxation where the treaty allocates shared taxing rights
- create a framework for tax authorities to cooperate administratively
- prevent tax discrimination against non-nationals
- provide a mechanism for resolving tax disputes

Tax treaties generally follow the international standard set by the OECD and the United Nations
Australia’s tax treaty network

- Australia has 44 comprehensive tax treaties (all in force)
  - 26 with OECD countries, 18 with non-OECD countries
  - By region: Africa (1), Asia (12), Europe (22), North & Central America (3), Pacific (4), South America (2)
  - Network ‘gaps’ (by region): Africa, Central Asia, Eastern Europe, Middle East, South America

- Australia has also signed:
  - 36 tax information exchange agreements
  - 9 ‘additional benefits agreements’
  - 3 airline profits agreements

- Australian treaties are incorporated into and have priority over domestic tax law (excluding Part IVA of the ITAA36)
Australia’s tax treaty network

OECD Member Countries
Treaties (2015)
Treasury’s role in tax treaties

- Advise the Government on Australia’s tax treaty policy and negotiation programme
- Negotiate and implement (i.e. legislate) treaties:
  - ATO responsible for interpretation and application
- Represent Australia in international forums:
  - OECD Committee on Fiscal Affairs – Working Party No. 1 on Tax Conventions and Related Questions (regularly)
  - UN – Committee of Experts on International Cooperation in Tax Matters (occasionally)
- Examine tax clauses in other non-tax treaties
  - e.g. diplomatic privileges & immunities and free trade agreements
Australia’s treaty making process

- Approval to negotiate
- Negotiations by officials (usually several rounds)
- Finalisation of treaty text and foreign text verification
- Approval by Ministers and then Federal Executive Council to sign treaty
- Signature (Minister/Ambassador)
- Joint Standing Committee on Treaties (national interest analysis, public hearing, tabled for 15 sitting days → JSCOT report)
- Legislation enacted *(International Tax Agreements Act 1953)*
- Other country ratifies
- Exchange of diplomatic notes or (occasionally) instruments of ratification
- Entry into force
  - Date of effect for some Articles may be different
Base erosion and profit shifting (BEPS)

Base Erosion and Profit Shifting (BEPS) refers to tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid.
BEPS timeline

**June 2012** – G20 Leaders reiterate need to prevent BEPS and endorse OECD work

**June 2013** – OECD 15 point Action Plan on BEPS released

**July 2013** – G20 Finance Ministers endorse Action Plan and establishment of OECD/G20 BEPS project

**December 2013** – Australia takes over G20 Presidency and leads efforts to combat multinational tax avoidance

**September 2014** – OECD delivers first tranche of recommendations which is endorsed by G20 Finance Ministers and subsequently by G20 Leaders (in November 2014)

**October 2015** – OECD releases final BEPS recommendations which are endorsed by G20 Finance Ministers
BEPS Action Plan

OECD Action Plan (July 2013)
1. Address the tax challenges of the digital economy
2. **Neutralise the effects of hybrid mismatch arrangements**
3. Strengthen CFC rules
4. Limit base erosion via interest deductions and other financial payments
5. Counter harmful tax practices more effectively, taking into account transparency and substance
6. **Prevent treaty abuse**
7. **Prevent the artificial avoidance of PE status**
BEPS Action Plan

OECD Action Plan (July 2013)

8. Transfer pricing – intangibles
9. Transfer pricing – Risks and capital
10. Transfer pricing – other high-risk transactions
11. Methodologies to collect and analyse data on BEPS and the actions to address it
12. Require taxpayers to disclose aggressive tax planning arrangements
13. Re-examine transfer pricing documentation
14. More effective dispute resolution mechanisms
15. Develop a multilateral instrument to implement changes
Australia’s BEPS treaty responses to date

• Federal Budget 2015-16:
  – Australia will act now to incorporate the OECD’s recommendations on treaty abuse into our treaty practice

• The Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill 2015 passed on 3 December 2015
  – includes multinational anti-avoidance law (MAAL) that targets multinationals artificially avoiding a taxable presence in Australia
Australia’s BEPS treaty responses to date

- Treasurer’s Media Release No. 3 of 2015 on 6 October 2015
  - Prevention of treaty shopping to be adopted in new/updated treaties
  - OECD PE recommendations are in line with Australia’s treaty practice and MAAL consistent
  - Australia committed to binding arbitration
  - Australia working with other countries on multilateral instrument to quickly update bilateral treaties with BEPS outcomes

- New Australia-Germany tax treaty signed 12 November 2015
  - Gives effect to BEPS treaty recommendations
BEPS process

CFA

Working Party No 1

Focus Groups
BEPS process

- OECD and G20 members, as well as other interested countries, invited to participate in BEPS work
- Extraordinary meetings, as well as large volume of work via correspondence, to meet 2015 deadline
- Focus groups explored issues and developed proposals for each tax treaty

BEPS Action

- WP1 considered proposals and discussion drafts
- CFA approved release of public discussion drafts and responsible for ultimate policy decisions on BEPS recommendations
- Public consultation meetings
- Focus groups and/or WP1 revised recommendations in light of public comments
- CFA approved BEPS recommendations for OECD Ministerial approval
BEPS Action 2

Action 2 – Neutralise the effects of hybrid mismatch arrangements

‘Develop model treaty provisions and recommendations regarding the design of domestic rules to neutralise the effect (e.g. double non-taxation, double deduction, long-term deferral) of hybrid instruments and entities. This may include: (i) changes to the OECD Model Tax Convention to ensure that hybrid instruments and entities (as well as dual resident entities) are not used to obtain the benefits of treaties unduly; ... Special attention should be given to the interaction between possible changes to domestic law and the provisions of the OECD Model Tax Convention. ...’...
BEPS Action 2

Action 2 – Neutralise the effects of hybrid mismatch arrangements

2015 report on Action 2:

- New treaty tie-breaker rule for dual-resident entities
- New treaty provision on transparent entities
- Discussion of interaction between recommendations for design of domestic rules to neutralise hybrid mismatch arrangements and tax treaties
BEPS – Australian treaty policy

Action 2 and Germany treaty

- Article 1(2) and Protocol paragraphs 2 and 3
- Article 4(3)
BEPS Action 6

Action 6 – Prevent treaty abuse

‘Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. Work will also be done to clarify that tax treaties are not intended to be used to generate double non-taxation and to identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country. The work will be co-ordinated with the work on hybrids.’
BEPS Action 6

Action 6 – Prevent treaty abuse

Final report on Action 6:

• Minimum standard that treaties will include express statement that eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements

• Also include either PPT rule, PPT rule + LOB rule, or LOB rule supplemented by mechanism to address conduit arrangements
BEPS Action 6

Action 6 – Prevent treaty abuse

Final report on Action 6:

• New treaty integrity rules for:
  – dividend transfer transactions (new holding period)
  – alienations of interests in land-rich entities (new holding period)
  – tie-breaker test for dual-resident entities
  – permanent establishments in third countries

• Tax policy considerations before entering into, or whether to maintain, a treaty with another country
BEPS Action 6

Action 6 – Prevent treaty abuse

Final report on Action 6:

• Additional work to be done on:
  – LOB and other anti-abuse rules reflected in the US Model (given concurrent US Model review)
  – treaty entitlement of non-CIV funds
  – treaty entitlement of pension funds (special residence rule)
BEPS – Australian treaty policy

Action 6 and Germany treaty

- Title and preamble
- Article 10(2)(a) and (3)
- Article 13(4)
- Article 23(2) and (3) and Protocol paragraph 7
BEPS Action 7

Action 7 – Prevent the artificial avoidance of PE status

‘Develop changes to the definition of PE to prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions. Work on these issues will also address related profit attribution issues.’
BEPS Action 7

Action 7 – Prevent the artificial avoidance of PE status

Final report on Action 7:
• Changes to PE definition:
  – new agency PE rule
  – specific activity exemptions must only be preparatory or auxiliary
  – new anti-fragmentation rule
  – anti-contract splitting rule
• No specific rule for insurance enterprises
• Further work to be done on attribution of profits to new PEs (ongoing but to be completed in 2016)
BEPS – Australian treaty policy

Action 7 and Germany treaty

- Article 5(5), (6), (7), (8), (9) and (10)
- Article 7(6)
BEPS Action 14

Action 14 – Make dispute resolution mechanisms more effective

‘Develop solutions to address obstacles that prevent countries from solving treaty-related disputes under MAP, including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases.’
BEPS Action 14

Action 14 – Make dispute resolution mechanisms more effective

Final report on Action 14:

• minimum standard re resolution of treaty-related disputes
  – treaty obligations re the Mutual Agreement Procedure (MAP) fully implemented in good faith and MAP cases resolved in timely manner
  – administrative processes promote prevention and timely resolution of treaty-related disputes
  – taxpayers can access MAP when eligible

• complemented by set of best practices, as well as monitoring

• 20 countries (including Australia) committed to mandatory binding MAP arbitration
BEPS Action 14

Action 14 – More effective resolution mechanisms

• Business anticipates a spike in disputes following the implementation of other BEPS recommendations
• Business therefore wants the certainty of mandatory binding arbitration
• Some countries (including Australia) advocate arbitration
• Some other countries view mandatory arbitration as a challenge to state sovereignty over tax affairs
BEPS – Australian treaty policy

Action 14 and Germany treaty

- Article 7(8)
- Article 9(2) and (3)
- Article 25(1), (2), (3) and (5)
Action 15 – Develop a multilateral instrument

‘Analyse the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties. On the basis of this analysis, interested Parties will develop a multilateral instrument designed to provide an innovative approach to international tax matters, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution.’
BEPS Action 15

Action 15 – Develop a multilateral instrument to implement changes

- September 2014 report on Action 15 found multilateral instrument desirable and feasible, and could be expanded beyond BEPS at later date
- Mandate for development of instrument released May 2015
- Australia participating in the Ad Hoc Group to develop the instrument
  - Australia also contributing to further work on arbitration
- Instrument will allow for efficient update of specific clauses in the bilateral tax treaties between signatories to the instrument
- Instrument will be open for signature by the end of 2016
Future Australian tax treaty policy

• Australia’s modern tax treaties include a range of integrity rules
  – including rules to prevent non-taxation of income derived by temporary residents and certain capital gains

• BEPS treaty recommendations are broadly consistent with Australia’s established treaty practice and will further supplement or strengthen the existing treaty rules
Future Australian tax treaty policy

• Continue to engage with the OECD on treaty issues arising from BEPS
  – Better treaty entitlement for pension funds
  – Possible revisions in light of US Model review
  – Revised commentary on Article 5 incorporating recommendations in October 11 discussion draft on interpretation and application of Article 5

• Continue to review Australia’s departures from the OECD Model and update for new developments
  – E.g. whether Australia should adopt new Article 7 (adopted in the OECD Model in 2010)
Final messages

• Having tax treaties with the right countries is important
  – with appropriate integrity rules
• Treaties are the outcome of negotiations
  – similar but not identical
• Australian treaties reflect the global economic environment and Australia’s position in it
• Tax treaty policy is dynamic
  – though changes often slow and incremental