Results of the OECD BEPS Project: Impact on Tax Litigation

International Association of Tax Judges

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Panel

Chair: Philippe Martin, *Président de la section des travaux publics*, *Conseil d'État* (France)

Speakers:

- Justice John Owen, Tax Court of Canada
- Justice Tony Pagone, Federal Court of Australia
- Andrew Dawson, United Kingdom Revenue and Customs Department, Chair of OECD Working Party 1
- Jacques Sasseville, Head of the Tax Treaty Unit, OECD

Topics to be covered

Part 1 Legal issues dealing with the incorporation of BEPS results actions into various legal instruments

Part 2 Interaction between tax litigation and mutual agreement procedures, especially when arbitration is involved

Part 3 Interaction between the proposed treaty general anti-abuse rule, the domestic general anti-abuse rules and the EU anti-abuse rules (including the GAAR of the EU July 2016 Anti-avoidance Directive)

Part 1 Legal issues dealing with the incorporation of BEPS actions into various legal instruments

BEPS Project

- Focus of OECD work has historically been on
  - Model Tax Convention, which serves as the basis for over 3,000 bilateral tax treaties
  - Transfer Pricing Guidelines, which provide common standards for allocating profits among members of a multinational group
- In 2013, the OECD and G20 recognized that double non-taxation due to Base Erosion and Profit Shifting (BEPS) should also be tackled

The results of the BEPS project

- **Minimum standards** (Actions 5, 6, 13, 14)
- **Reinforced international standards** on tax treaties and TP (Actions 2, 6, 7, 8, 9, 10, 13, 14)
- **Common approaches** and **best practices** for domestic law measures (Actions 2, 3, 4, 12)
- **Analytical reports** (Action 1 and Action 15)
- Detailed **report on measuring BEPS** (Action 11)

The BEPS tax treaty changes

- Provision on transparent entities (Action 2)
- Anti-abuse rules (Action 6)
- Changes to the PE definition of Article 5 (Action 7)
- Changes to Article 25 and incorporation of Art. 9(2) in treaties where it is not found (Action 14)
- An optional provision on mandatory binding MAP arbitration (Action 14)

Example of BEPS treaty changes: Action 6

- Clear statement (in the preamble of treaties) that treaties should avoid creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including treaty shopping
- A general treaty anti-abuse rule aimed at arrangements one of the principal purposes of which is to obtain treaty benefits
- A number of specific treaty anti-abuse rules
- Clarification of the interaction of tax treaties and domestic anti-abuse rules

A minimum standard to prevent treaty shopping

- A key outcome of the work on Action 6 is agreement on a minimum level of protection against treaty shopping
- At a minimum countries should agree to include in their tax treaties:
  - The preamble's express statement that their common intention is to eliminate double taxation without creating opportunities for treaty shopping, and
  - Either
    - The general treaty anti-abuse rule
    - The LOB rule supplemented by a mechanism that would deal with conduit arrangements not already dealt with in tax treaties, or
    - Both the general treaty anti-abuse rule and the LOB rule

How to incorporate the BEPS treaty changes into treaties?

- Need to amend bilateral treaties:
  - The OECD Model will be amended in order to allow
    - Protocols to bilateral treaties that will implement these changes
    - New treaties that will also implement these changes
  - BEPS Action 15 envisages a quick modification of existing treaties through a multilateral treaty

Multilateral instrument to implement the BEPS treaty changes

- Ongoing negotiations
- Result will be a multilateral treaty that will amend bilateral treaties to take account of BEPS treaty changes (will not replace bilateral treaties)
- Effect will be different with respect to each treaty:
  - Compatibility clauses
  - Optional provisions
  - Possible reservations
- An Explanatory statement or Commentary will clarify the interpretation of the provisions

Changes to the Commentary on the OECD Model

- The BEPS work will also result in significant changes to the Commentary on the OECD Model Tax Convention:
  - To explain the new provisions included in the Reports on Actions 2, 6, 7 and 14
  - To provide additional clarification:
    - With respect to the interaction between domestic anti-abuse rules and tax treaties (e.g. departure taxes)
    - With respect to various aspects of the mutual agreement procedure (Action 14)

Questions related to the multilateral instrument

- What will be the legal status of the multilateral instrument amending bilateral treaties?
- What legal issues may arise from optional provisions and reservations?
- What will be the legal status of the Explanatory Statement or Commentary on the provisions of the Multilateral Instrument?

Questions related to the changes to the OECD Model

- What will be the impact of the changes to the provisions of the OECD Model with respect to the interpretation of existing treaties, *e.g.*
  - Is there a risk that the addition of the preamble and anti-treaty shopping rules be interpreted as suggesting that treaty-shopping is acceptable under existing treaties?
  - Will the addition of the "preparatory or auxiliary" condition in Art. 5(4) a) to d) impact the interpretation of these provisions as currently drafted?

Questions related to the changes to the Commentary

- What is currently the legal status of the OECD Commentary in treaty law and in domestic law?
- Will the BEPS Commentary changes have a different status?

The BEPS transfer pricing changes

- The results of the work on transfer pricing (BEPS Actions 8-10) is primarily additional and revised guidance as to what the arm's length principle means
- This is primarily relevant for domestic transfer pricing determination and adjustments
- The additional/revised guidance of Chapters 8-10 will be incorporated into the OECD Transfer Pricing Guidelines

Transfer pricing: treaty law or domestic law

Article 9(1) OECD Model

1. Where *[enterprises are associated]* and … conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

Transfer pricing: treaty law or domestic law

Article 9(2) OECD Model

2. Where a Contracting State includes in the profits of an enterprise of that State — and taxes accordingly — profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, …

Transfer pricing: treaty law or domestic law

Article 9(2) OECD Model (cont.)

> … then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other.

Role of the OECD Transfer Pricing Guidelines

- In treaty law
  - Art. 9(1)
  - Art. 9(2)
- In domestic law
  - Art. 9(1)
  - Art. 9(2)

Effect of the new OECD “saving clause”

- Long-standing provision of US treaties
- New Art. 1(3) will be added to the OECD Model through Report on Action 6:

> 3. This Convention shall not affect the taxation, by a Contracting State, of its residents except with respect to the benefits granted under paragraph 3 of Article 7, ***paragraph 2 of Article 9*** and Articles 19, 20, 23 A [23 B], 24 and 25 and 28.

Questions related to the Transfer Pricing Guidelines

- What is the legal status of the OECD Transfer Pricing Guidelines in treaty law and in domestic law?
- How do the Reports on Actions 8-10 impact:
  - The application of tax treaties?
  - The application of domestic transfer pricing rules?
- Will the answers to the previous question be different once the new guidance is included in the OECD Transfer Pricing Guidelines?

Part 2 Interaction between tax litigation and mutual agreement procedures, especially when arbitration is used in the context of a mutual agreement procedure

Mutual Agreement Procedure [MAP] (Art. 25(1) OECD Model)

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under of Article 24, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.

Mutual Agreement Procedure [MAP] (Art. 25(2) OECD Model)

2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.

Mutual Agreement Procedure [MAP] (Art. 25(3) OECD Model)

3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

Mutual Agreement Procedure: Arbitration (Art. 25(5) OECD Model)

5. Where … the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 within two years from the presentation of the case … any unresolved issues arising from the case shall be submitted to arbitration if the person so requests. …

Mutual Agreement Procedure Arbitration

… These unresolved issues shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State. Unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision, that decision shall be binding on both Contracting States and shall be implemented notwithstanding any time limits in the domestic laws of these States

MAP and litigation (para 7 of Art. 25 Comm.)

"… it is normally open to taxpayers to litigate in the tax court, either immediately or upon the dismissal of their objections by the taxation authorities. When taxation not in accordance with the Convention arises from an incorrect application of the Convention in both States, taxpayers are then obliged to litigate in each State, with all the disadvantages and uncertainties that such a situation entails. So paragraph 1 makes available to taxpayers affected, without depriving them of the ordinary legal remedies available, a procedure which is called the mutual agreement procedure because it is aimed … at resolving the dispute on an agreed basis, *i.e.* by agreement between competent authorities…"

MAP arbitration (para 64 of Art. 25 Comm.)

"… the arbitration process provided for by [Art. 25(5)] is not an alternative or additional recourse: where the competent authorities have reached an agreement that does not leave any unresolved issues as regards the application of the Convention, there are no unresolved issues that can be brought to arbitration even if the person who made the mutual agreement request does not consider that the agreement reached by the competent authorities provides a correct solution to the case. … Thus, under the paragraph, the resolution of the case continues to be reached through the mutual agreement procedure, whilst the resolution of a particular issue which is preventing agreement in the case is handled through an arbitration process."

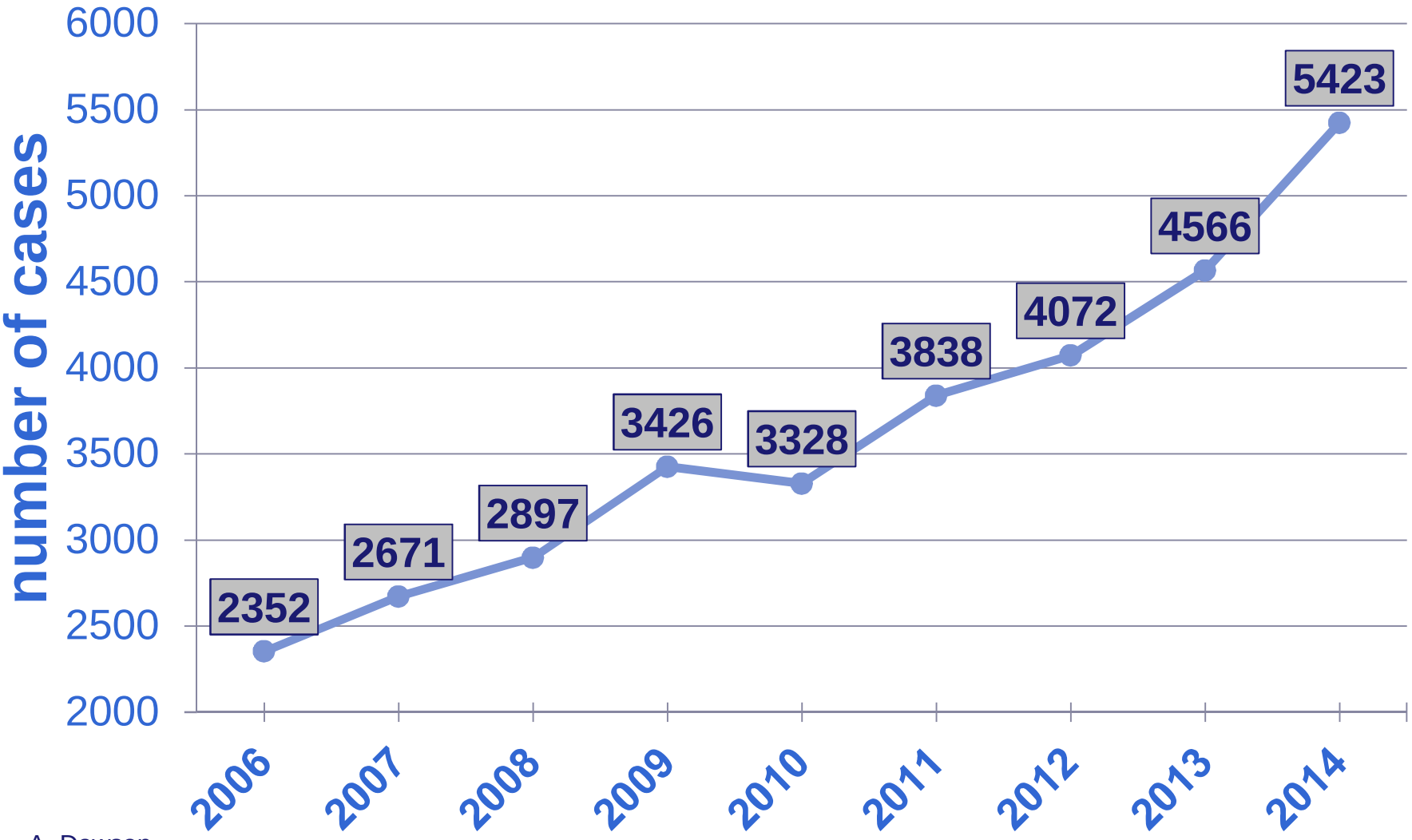
A. Dawson

MAP cases

- As shown by the OECD MAP statistics collected since 2006, the number of OECD MAP cases has increased dramatically

- OECD and UN data suggests that non-OECD countries are involved in less than 9% of all MAP cases

Year-end inventory of MAP cases



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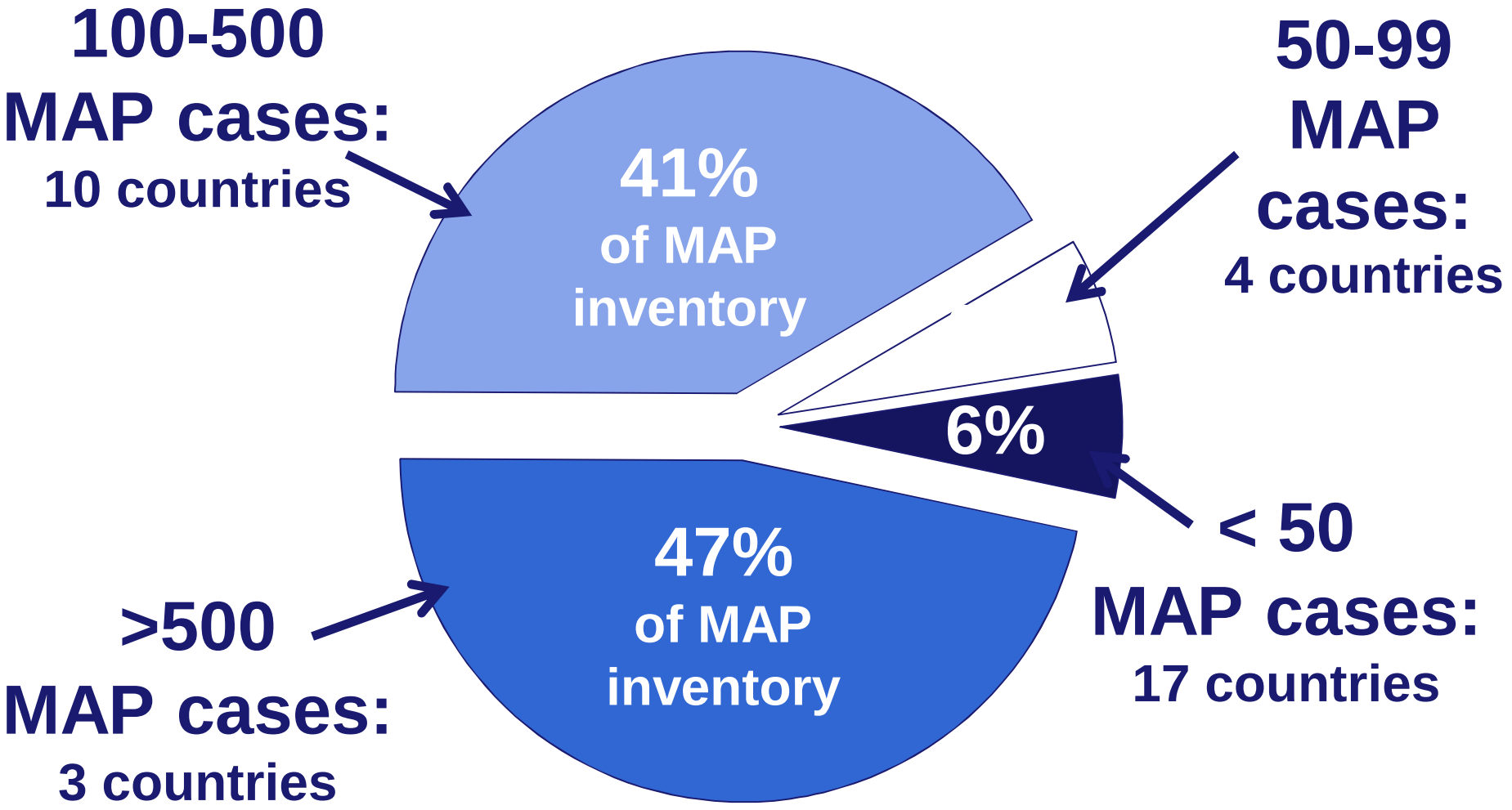
Number of MAP cases by OECD country



13 countries = 88% of MAP cases

More than 500 cases	**3 countries** (47% of 2014 ending inventory)	France, Germany, U.S.
100-500 cases	**10 countries** (41% of 2014 ending inventory)	Austria, Belgium, Canada, Finland, Italy, Luxembourg, Netherlands, Sweden, Switzerland, U.K.
50-99 cases	**4 countries** (6% of 2014 ending inventory)	Denmark, Japan, Korea, Spain
Fewer than 50 cases	**17 countries** (6% of 2014 ending inventory)	Australia, Chile, Czech Republic, Estonia, Greece, Hungary, Iceland, Ireland, Israel, Mexico, New Zealand, Norway, Poland, Portugal, Slovak Republic, Slovenia, Turkey

Action 14 of the BEPS Action Plan

"Develop solutions to address obstacles that prevent countries from [re]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."

Action 14 work on MAP Mandatory binding arbitration

- Ongoing negotiation of Part VI of the multilateral agreement
- Part VI will add MAP arbitration to the existing treaties of countries that will agree to it
- Main features of the proposed MAP arbitration provision (i.e. arbitration that is binding on the competent authorities)

MAP and litigation

- Taxpayers will often initiate MAP and tax litigation in parallel
- To avoid conflicting results, one procedure will typically be suspended
- Pros and cons:
  - Suspension of MAP pending litigation results
  - Suspension of litigation pending MAP results

Questions on interaction between MAP and tax litigation

- Is it possible to suspend litigation pending a MAP process?
- Would the litigation process be terminated if a MAP agreement were reached and the taxpayer agreed with it? How?
- If MAP goes first but the proposed MAP agreement is rejected by taxpayer who then pursues litigation (or refuses to renounce to litigation rights), would a court take the proposed MAP agreement into account?

Question on the possibility that MAP could override a court decision

- If litigation goes first and the courts of one State reach a final decision, would the competent authority of that State be able to reach a different interpretation of the treaty in the context of the MAP?

Question on the legal status of a MAP

- What weight would a court give to a mutually agreed interpretation of the treaty reached by the Competent authorities under Art. 25(3)?

Question on MAP arbitration

- Does the fact that arbitration is used to reach a MAP agreement change anything to the previous answers? For instance, if MAP agreement is reached through arbitration but the agreement is rejected by taxpayer who then pursues litigation, would a court take the arbitration decision into account?
- (For European countries) To what extent does the EU arbitration Convention prevent the application of MAP Arbitration under a tax treaty?

Part 3 Interaction between the proposed treaty general anti-abuse rule, the domestic general anti-abuse rules and the EU anti-abuse rules

How the Report on BEPS Action 6 deals with treaty abuse

- Inclusion of the following in the preamble of tax treaties: “[State X] and [State Y] Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States), have agreed as follows:”

How the Report on BEPS Action 6 deals with treaty abuse

Inclusion of a general treaty anti-abuse rule aimed at arrangements one of the principal purposes of which is to obtain treaty benefits

> Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.

How the Report on BEPS Action 6 deals with treaty abuse

- A number of specific treaty anti-abuse rules
  - Limitation-on-benefits (LOB) rule to address a large number of treaty shopping situations
  - Minimum shareholding period to prevent dividend transfer transactions
  - Changes to Article 13(4) to prevent transactions that circumvent the application of that rule
  - Changes to the tie-breaker rule for determining the treaty residence of dual-resident entities
  - Anti-abuse rule for permanent establishments situated in third States
- Clarification of the interaction of tax treaties and domestic anti-abuse rules

Questions on the BEPS Action 6 changes

- What will be the legal effect of the new preamble of tax treaties?
- Do you see significant substantive differences between the new treaty anti-abuse rule and your domestic general anti-abuse rule?
- If there are any such differences, what is their potential legal impact?

EU law approach to tax abuse

- ECJ decisions (*e.g*. *Cadbury Schweppes*)
- Changes to the Parent-Subsidiary Directive (EU) 2015/121 of 27 January 2015
- Tax avoidance directive of 12 July 2016 (EU) 2016/1164 of 12 July 2016

Cadbury Schweppes (Case C-196/04; 12 September 2006)

"It follows that, in order for a restriction on the freedom of establishment to be justified on the ground of prevention of abusive practices, the specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory." [paragraph 55]

Changes to Parent–Subsidiary Directive (EU) 2015/121 of 27 January 2016

2. Member States shall not grant the benefits of this Directive to an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances.

An arrangement may comprise more than one step or part.

3. For the purposes of paragraph 2, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.

4. This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of tax evasion, tax fraud or abuse.

Directive on Tax Avoidance (EU) 2016/1164 of 12 July 2016

1. For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part.
2. For the purposes of paragraph 1, an arrangement or a series thereof shall be regarded as nongenuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.
3. Where arrangements or a series thereof are ignored in accordance with paragraph 1, the tax liability shall be calculated in accordance with national law

Questions on the EU anti-abuse rule

- [For European countries] To what extent does EU anti-abuse law affect the approach of tax courts towards other anti-abuse rules?
- [For European countries] What is the impact of the new EU anti-abuse rule on abuse of tax treaties in the case of treaties
  - that do not include the BEPS anti-abuse rule
  - that will include the BEPS anti-abuse rule?