



**Australian Government**

# **Australia's adoption of the BEPS Convention (Multilateral Instrument)**

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Consultation Paper  
December 2016

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## MAKING A SUBMISSION

The Government is seeking your views on the impacts of Australia signing and ratifying the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*.

### Closing date for submissions: 6 February 2017.

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## ABBREVIATIONS

BEPS	Base Erosion and Profit Shifting
CAs	Competent Authorities <ul style="list-style-type: none"><li>persons authorised by the relevant treaty to administer tax treaty provisions including treaty dispute resolution mechanisms. In Australia's case this is an authorised representative of the Commissioner of Taxation.</li></ul>
CTAs	Covered Tax Agreements <ul style="list-style-type: none"><li>tax treaties nominated to be modified by the MLI</li></ul>
MAP	Mutual Agreement Procedure
MLI	<i>The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting.</i>
MNEs	Multinational enterprises
OECD	Organisation for Economic Cooperation and Development

## INTRODUCTION

1. *The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (the Multilateral Instrument or MLI) is designed to close off tax treaty based opportunities for multinational tax avoidance. It enables jurisdictions to swiftly modify their bilateral tax treaties to give effect to the relevant recommendations contained in the OECD/G20 Base Erosion and Profit Shifting (BEPS) package.
2. BEPS is the label given to tax planning strategies used by multinational enterprises to avoid tax. The OECD has estimated that worldwide revenue losses attributable to BEPS strategies are between 4-10% of global corporate income tax revenue, i.e. USD 100-240 billion annually.
3. BEPS is a global problem that requires global solutions. The OECD/G20 BEPS project, involving over 60 jurisdictions, was established to address gaps and mismatches in international tax rules that enable multinational enterprises to avoid tax. This work culminated in late 2015 with the release, and G20 Leaders' endorsement, of the BEPS package.
4. The BEPS package sets out a range of measures (based on 15 BEPS Actions) that jurisdictions can take to limit opportunities for multinational tax avoidance. Four of these include recommended new rules for inclusion in tax treaties. BEPS Action 15 encouraged jurisdictions, including Australia, to work together to develop a multilateral treaty that would implement the BEPS treaty-related recommendations as fast as possible and in as many jurisdictions as possible.
5. On 24 November 2016, the OECD released the final text of the MLI and its accompanying Explanatory Statement. Both are available at:  
**<http://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm>**
6. The MLI provides jurisdictions with the means, if their treaty partners agree, to modify their existing bilateral tax treaties to reflect the new BEPS standards. In the absence of the MLI, jurisdictions would have to introduce the new rules treaty by treaty – a process which typically might be expected to take decades to complete.
7. The Government is strongly committed to ensuring that multinationals pay the right amount of tax. Australia has already included BEPS rules in its new tax treaty with Germany. The Government has also taken action to bolster Australia's domestic laws to prevent tax avoidance by implementing the Multinational Anti-Avoidance Law and developing the Diverted Profits Tax legislation.
8. A first group of jurisdictions is expected to sign the MLI in early June 2017. Although the Australian Government is yet to make a final decision on adopting the MLI, signing and adopting it to the widest possible extent possible would be consistent with Australia's strong track record on tackling multinational tax avoidance.
9. This public consultation paper seeks your views on the potential impacts of Australia adopting the MLI.

## OECD BEPS AGENDA AND DEVELOPMENT OF THE MLI

10. The OECD's BEPS package, endorsed by G20 Leaders in November 2015, outlines steps that jurisdictions can take to limit multinational tax avoidance strategies.
11. A number of the BEPS recommendations contain tax treaty specific measures that will be included in the 2017 update to the OECD *Model Tax Convention on Income and on Capital*, for example:
  - BEPS Action 2: Neutralise the Effects of Hybrid Mismatch Arrangements;
  - BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances;
  - BEPS Action 7: Preventing the Artificial Avoidance of Permanent Establishment Status; and,
  - BEPS Action 14: Making Dispute Resolution Mechanisms More Effective.
12. The policy intent of these measures has been incorporated into the MLI.

## ADOPTION CHOICES

13. The key focus of this consultation is to seek stakeholder input on the adoption choices that Australia should make if it becomes a Party to the MLI.
14. To encourage the widest possible uptake, the MLI incorporates flexibility features that are designed to allow countries to tailor their adoption to fit their particular national circumstances and accommodate unique aspects of their treaty network. This is achieved through the use of devices such as notifications, article choices, specific paragraph options and reservations. Each country is required to enter its set of choices at the time of signature and confirm them at the time of ratification.
15. Specifically, adopting jurisdictions will be required to identify which of their bilateral tax treaties they want the MLI to apply to and modify. By omission, jurisdictions can exclude particular treaties from the scope of the MLI. Treaties that are brought within the scope of the MLI are referred to as 'Covered Tax Agreements' or CTAs.<sup>1</sup>
16. Both bilateral treaty partners would need to identify their bilateral treaty as a CTA in order for that treaty to be modified by the MLI. In the event that only one jurisdiction (or neither jurisdiction) identifies a bilateral treaty as a CTA, the provisions of that treaty will remain un-modified.
17. While some of the MLI articles are mandatory, most are optional. Jurisdictions can, for example, choose to adopt the minimum standards only, or they can choose to also adopt some, or all, of the optional articles.
18. Where there is a bilateral match (that is, both parties agree to adopt the article in the same way or the article allows for asymmetrical adoption), the MLI will modify, but

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1. Note that the MLI is designed to apply to comprehensive tax treaties (e.g. those based on the OECD Model Tax Convention). It is not intended to apply to other types of bilateral tax agreements such as airline profits agreements or tax information exchange agreements.

not directly amend, nominated tax treaty clauses that deal with the same subject matter. Other unrelated parts of the treaties will remain unchanged.

19. The design of the MLI requires that a jurisdiction’s adoption choices (concerning the articles, parts of articles and reservations) apply across all of its CTAs. Some articles, however, do provide options that allow jurisdictions to exclude or apply the MLI rules to classes of treaties or classes of treaty provisions – that is treaties with certain objectively defined characteristics.
20. Jurisdictions that have entered reservations on adoption, can subsequently withdraw them (or replace them with more limited reservations) to expand their adoption. They cannot, however, enter new reservations after ratification that will narrow their adoption of the MLI.

### Summary of MLI adoption choices

MLI Feature	Flexibility provided	Parties need to choose
Covered Tax Agreements	The MLI modifies nominated treaties only.	Which treaties should be nominated as CTA?
Minimum standards	Some of the minimum standards include options on how to meet the standard. Alternatively, Parties can identify an alternative way to meet the standard (such as bilateral negotiation).	Whether to adopt the minimum standards through the MLI or through other mechanisms?
Optional articles	All other substantive rules are optional.	Which optional articles to adopt?
Flexible options within articles	Parties may apply alternative provisions if there are multiple ways to address the BEPS standard (e.g. Article 7 with choices involving the PPT, S-LOB or the detailed-LOB).	Which option, having reviewed all of Australia’s bilateral treaties, best meets the particular requirements of Australia’s treaty network?
Reservations	In some cases, parties can enter a reservation not to adopt provisions or parts of provisions: <ol style="list-style-type: none"> <li>1. for all nominated CTAs or</li> <li>2. for all CTAs that contain specific, detailed provisions, or objectively defined characteristics</li> <li>3. For certain CTAs (see Part VI Arbitration).</li> </ol>	Whether to adopt any of the reservations?

## AUSTRALIA’S PROPOSED APPROACH TO ADOPTING THE MLI

21. The MLI provides Australia with a unique opportunity to safeguard Australia’s tax treaty network by adopting internationally agreed integrity rules. Given that these rules are closely aligned with Australia’s current treaty practice, Australia could adopt the MLI to the widest possible extent.
22. The initial approaches outlined in this paper have been formulated using the following principles:
  - A. **Apply the MLI to all bilateral tax treaties that do not already incorporate BEPS rules** (which would exclude the 2015 German treaty – which incorporates most of the BEPS treaty-related measures).
  - B. **Adopt the minimum standards and as many optional MLI articles as possible.** Broad adoption of the MLI articles would enable the full range of tax integrity measures recommended under the BEPS Action Plan to be applied across

Australia’s tax treaty network (subject to the agreement of the relevant treaty partner).

- C. **Make limited use of the MLI reservation system.** Australia might consider entering a reservation if Australia’s existing treaty practice already meets or exceeds the new standard, or it is necessary to avoid any significant unintended impacts. For instance, it would be appropriate to enter a reservation if adopting the MLI article could create technical difficulties or if adopting the MLI article would inadvertently override existing integrity provisions that Australia should retain.

## THE MLI EXPLAINED

23. The MLI consists of the instrument itself and its accompanying Explanatory Statement (that outlines how the MLI articles are to be interpreted and how they are intended to modify CTAs).

### HIGH LEVEL OUTLINE

Title and Preamble	
<b>Part I</b>	<p><b>Scope and Interpretation of Terms</b></p> <ul style="list-style-type: none"> <li>The MLI will modify Covered Tax Agreements (jurisdictions’ bilateral tax treaties) (Article 1)</li> <li>Parties are required to identify — via notification to the Depository — which of their bilateral treaties they want included in the scope of the MLI (Article 2)</li> </ul>
<b>Parts II to V</b>	<ul style="list-style-type: none"> <li>Substantive technical provisions (Articles 3 — 17)</li> <li>These articles typically contain the following elements: <ul style="list-style-type: none"> <li>New tax treaty integrity rule based on the relevant BEPS recommendation</li> <li>Compatibility clause defining the relationship between the integrity rule and existing bilateral treaties</li> </ul> </li> <li>Generally, a new rule will apply in place of or in the absence of corresponding bilateral provisions.</li> <li>Reservation clauses permitting Parties to opt out of the integrity rule or modify its application in some way</li> <li>Notification rule requiring the Parties to notify the Depository as to whether the article modifies their bilateral treaties (by country and by bilateral provision)</li> </ul>
<b>Part VI</b>	<p><b>Arbitration (Articles 18 — 26) (optional)</b></p> <ul style="list-style-type: none"> <li>Provides a framework for dispute resolution through independent binding arbitration</li> <li>Unlike the other MLI articles, jurisdictions may enter bespoke reservations (but these reservations are subject to acceptance by bilateral treaty partners).</li> </ul>
<b>Part VII</b>	<p><b>Final Provisions (Articles 27 — 38)</b></p> <ul style="list-style-type: none"> <li>Includes notification, entry into force and entry into effect provisions as well as amendment and ratification processes etc.</li> </ul>

### IDENTIFYING THE EFFECT OF THE MLI ON AN EXISTING TREATY

24. Unlike an amending protocol which directly amends the text of the existing bilateral treaty, the MLI sits side by side with, and modifies the existing bilateral treaty provisions to create new (modified) provisions.

25. At the time of signing and ratifying, jurisdictions will lodge their choices with the Depository (the OECD). By comparing the relevant Party's sets of choices, stakeholders will be able to identify the affected treaties and provisions and the specific MLI articles that each jurisdiction has chosen to adopt. Where these match, the MLI will modify the relevant bilateral clauses.
26. This will potentially increase the complexity of interpreting modified treaties. If adopted, the Australian Taxation Office (ATO) expects to develop guidance to help identify how the MLI modifies individual CTAs. Consistent with current practice, it is not proposed that the Government would produce consolidated versions of each modified treaty.
27. Each substantive article of the MLI comprises the relevant integrity rule(s), a compatibility clause, reservation options and notification requirements. The compatibility clauses explain how the integrity rules are intended to modify the bilateral clause. A review of all the MLI compatibility clauses, however, shows that there is significant variation between them, such that the MLI clause may:
- Be 'inserted into', 'replace' and/ or 'apply in the place of';
  - 'Sit beside'; or
  - 'Modify or override'
- the existing clauses (to the extent of inconsistency).
28. This means that the MLI text will modify the bilateral provision:
- In the manner described in the compatibility clause
  - To the extent that the two provisions deal with the same subject matter, and/or
  - To the extent that the MLI is more specific than the bilateral provision.
- All other bilateral provisions will remain unchanged.
29. The Explanatory Statement provides guidance on how the MLI provisions modify bilateral treaties. Articles 3-17 should be interpreted according to normal treaty principles, that is, in light of their ordinary contextualised meaning and in light of the treaty object and purpose (to implement the BEPS rules). The Explanatory Statement sections relating to Articles 18-26 provides detailed guidance on how the BEPS measures are intended to apply and be interpreted.
30. Further information is contained in the OECD/G20 BEPS final reports (released in October 2015), which set out the underlying BEPS rules and the proposed changes to the OECD Model Tax Convention.<sup>2</sup> (available from the OECD website).

## ENTRY INTO EFFECT

31. The MLI will enter into force after it has been ratified by five jurisdictions. This means that following signature in June 2017, five jurisdictions will need to complete their domestic treaty implementation processes before the MLI enters into force.

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<sup>2</sup> *The OECD Model Tax Convention on Income and on Capital (2014)*.

32. In Australia’s case, the MLI would need to be legislated and then formally ratified. As a result, if adopted, it is expected that the MLI 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. It is expected that some jurisdictions will take longer to complete their domestic processes than others and that as a result the date of effect for different treaties is likely to be staggered.
33. Once jurisdictions have ratified the MLI, its provisions would be binding and modify existing bilateral treaties in line with both Parties’ adoption choices. The MLI does not restrict jurisdictions’ sovereign ability to supersede the MLI changes by subsequently concluding a new bilateral agreement.

## SUMMARY OF THE MLI ARTICLES

34. The next section summarises the substantive technical articles (Articles 3-26) and Australia’s initial approach on each of these.
35. The table below maps the new MLI articles to the corresponding BEPS Actions and the underlying OECD Model articles as well as Australia’s initial approaches.

MLI article	Corresponding BEPS Action <sup>3</sup>	Corresponding Model article <sup>4</sup>	Initial approach
3. Transparent Entities	Action 2 (Hybrid mismatches)	1. Persons Covered 23A. Exemption Method and 23B. Credit Method	Adopt with 3(5)(d)
4. Dual resident entities	Action 2	4. Resident	Adopt with 4(3)(e)
5. Application of Methods for Elimination of Double Taxation	Action 2	23A. Exemption Method	Do not adopt (and do not adopt 5(8) or 5(9))
<b>6. Purpose of a Covered Tax Agreement*(M)</b>	<b>Action 6 (Treaty abuse)</b>	<b>Preamble</b>	<b>Adopt in full</b>
<b>7. Prevention of Treaty Abuse*(M)</b>	<b>Action 6</b>	<b>No equivalent</b>	<b>Adopt the PPT, do not adopt S-LOB</b>
8. Dividend Transfer Transactions	Action 6	10. Dividends	Adopt in full
9. Capital Gains from Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property	Action 6	13. Capital Gains	Adopt para 1 with 9(6)(e), do not adopt 9(4)
10. Anti-abuse Rules for Permanent Establishments Located in Third Jurisdictions	Action 6	No equivalent	Do not adopt

<sup>3</sup> See the 2015 final reports of the OECD/G20 Base Erosion and Profit Shifting Project.

<sup>4</sup> *The OECD Model Tax Convention on Income and on Capital (2014)*.

\* (M) denotes mandatory articles. All other articles are optional.

MLI article	Corresponding BEPS Action <sup>3</sup>	Corresponding Model article <sup>4</sup>	Initial approach
11. Application of Agreements to Restrict a Party's Right to Tax its Own Residents	Action 6	No equivalent	Adopt with 11(3)(b)
12. Artificial Avoidance of Permanent Establishment Status through Commissionnaire Arrangements and Similar Strategies	Action 7 (PE status)	5. Permanent Establishment	Adopt in full
13. Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions	Action 7	5. Permanent Establishment	Adopt with Option A, and perhaps with 13(6)(b)
14. Splitting-up of Contracts	Action 7	No equivalent	Adopt, perhaps with 14(3)(b)
15. Definition of a Person Closely Related to an Enterprise	Action 7	No equivalent	Adopt in full
<b>16. Mutual Agreement Procedure* (M)</b>	<b>Action 14 (Dispute resolution)</b>	<b>25. Mutual Agreement Procedure (MAP)</b>	<b>Adopt in full</b>
17. Corresponding Adjustments	Action 14	9. Associated Enterprises	Adopt with 17(3)(a)
18-26. Arbitration	Action 14	25. MAP	Adopt with 23(5), 28(2)(a), and perhaps 19(12)

## CONSULTATION FOCUS QUESTIONS

- Do you support Australia adopting the MLI?
- Do you agree with the proposed principles (paragraph 22) to guide the Government's adoption of MLI articles?

For each of the integrity rules in the MLI (articles 3 - 26):

- Are there any significant issues the Government should consider in its decision to adopt the rule?
- For articles that require a choice (with respect to covered tax agreements, optional articles, optional paragraphs or reservations), which choices (or combinations of choices) do you favour and why?
- What practical options are there to minimise any uncertainty and compliance costs associated with the adoption of the MLI?

## ARTICLE 3 — TRANSPARENT ENTITIES

Article 3 implements recommendations outlined in the BEPS Action 2 (Neutralising the Effects of Hybrid Mismatch Arrangements) report (see pages 139 to 143 of that report) and BEPS Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances) report (see page 86 of that report).

### How does this Article address multinational tax avoidance?

A fiscally transparent entity (FTE) is an entity or arrangement (such as a partnership or a trust) that one or both treaty partners treat as a 'flow-through' vehicle. In such a case, income derived by or through a FTE is generally treated as taxable in the hands of the participants in the entity (such as the partners or beneficiaries) rather than in the hands of the entity itself.

Article 3 will ensure that income derived by or through a FTE will be considered to be income of a resident for treaty purposes but only to the extent that at least one of the jurisdictions treats the income as income of one of its residents under its domestic law. This will help prevent double non-taxation (where income is not taxed in either country).

It will also ensure that excessive double taxation relief is not granted where both jurisdictions tax the same income in the hands of different taxpayers (for example, where one taxes the partnership and the other taxes the partner). It does this by clarifying that a jurisdiction is not required to provide relief for any tax imposed in the other jurisdiction solely on the basis that it is derived by a resident of the other jurisdiction.

Article 3 contains an optional abridged 'saving clause' that will clarify that Article 3 does not prevent a jurisdiction from taxing its own residents. This clause will only apply in relation to covered tax agreements where one or both Parties have chosen not to apply Article 11 of the MLI (Application of Tax Agreements to Restrict a Party's Right to Tax its Own Residents).

### What are the adoption options?

Adopt Article 3 without reservation

- 3(5)(a) Do not adopt Article 3 at all (i.e. no change to bilateral treaty rules)
- 3(5)(b) Adopt Article 3 but not for treaties that already have either a general or detailed FTE provision
- 3(5)(c) Adopt Article 3 but not for treaties that deny benefits to income earned through FTEs established in third jurisdictions
- 3(5)(d) Adopt Article 3 but not for treaties that already have a detailed FTE provision
- 3(5)(e) Adopt Article 3 but not for treaties that have a detailed FTE provision and deny benefits to income derived through FTEs established in third jurisdictions
- 3(5)(f) Adopt Article 3 but not paragraph 2 (double tax relief rules)
- 3(5)(g) Adopt Article 3 but only for those treaties that already have a detailed FTE provision

## **Australia's initial approach to Article 3**

Article 3 is consistent with Australia's preferred treaty practice of including provisions in its bilateral treaties to ensure that treaty benefits are available for income derived by or through FTEs (see, for example, Article 1(2) of the 2015 Australia-Germany treaty).

On this basis, Australia initial approach would be to adopt Article 3 of the MLI across all of its covered tax agreements and possibly enter the reservation permitted by Article 3(5)(d).

## ARTICLE 4 — DUAL RESIDENT ENTITIES

Article 4 implements recommendations outlined in the BEPS Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances) report (see page 72 of that report).

### How does this Article address multinational tax avoidance?

Tax treaties only apply to persons that are tax residents of one or both jurisdictions (under their respective domestic laws). Where a person is a resident of both jurisdictions (a dual resident), the treaty provides tiebreaker rules to determine a single jurisdiction of residence for the purposes of the treaty.

Consistent with the OECD Model, the key tiebreaker test that applies in most treaties to determine the residence of dual resident entities (such as companies) is the entity's place of effective management (POEM). However, in order to avoid tax, entities can manipulate their tax residence by relocating their POEM.

Article 4 will expand the criteria for determining a dual resident entity's treaty residence to include other factors (in addition to the POEM) and require the competent authorities (the two tax administrations) to attempt to agree on a single jurisdiction of residence. In the absence of such agreement, the entity will not be entitled to treaty benefits (e.g. tax reductions or exemptions) except to the extent agreed by the competent authorities.

### What are the adoption options?

Adopt Article 4 without reservation

- 4(3)(a) Do not adopt Article 4 at all (i.e. no change to bilateral treaty rules)
- 4(3)(b) Adopt Article 4 but not for treaties that already require the competent authorities (CAs) to endeavour to agree on a single jurisdiction of residence
- 4(3)(c) Adopt Article 4 but not for treaties that already deny treaty benefits without requiring the CAs to endeavour to agree on a single jurisdiction of residence
- 4(3)(d) Adopt Article 4 but not for treaties that already require the CAs to endeavour to agree on a single jurisdiction of residence and set out the treatment (of the entity) in the absence of such agreement
- 4(3)(e) Adopt Article 4 but exclude the rule that allows the CAs to allow treaty benefits in the absence of reaching an agreement on the country of residence of the entity. In such cases, treaty benefits would be denied
- 4(3)(f) Do not adopt Article 4 with countries that have chosen 4(3)(e)

### Australia's initial approach to Article 4

Australia's treaty practice has varied (with most of Australia's bilateral treaties prescribing the POEM as the determinative test) but has not previously permitted the CAs to decide on the extent of treaty benefits to be granted if the CAs are unable to agree on a single jurisdiction of residence.

As adopting the expanded criteria will generally improve the integrity of the current tie-breaker rules, Australia's initial approach would be to adopt Article 4 across all of its covered tax agreements and enter the reservation permitted by Article 4(3)(e).

## ARTICLE 5 — APPLICATION OF METHODS FOR ELIMINATION OF DOUBLE TAXATION

Article 5 implements recommendations outlined in the BEPS Action 2 (Neutralising the Effects of Hybrid Mismatch Arrangements) report (see page 146 of that report).

### How does this Article address multinational tax avoidance?

Many tax treaties alleviate double taxation by exempting prescribed foreign income from taxation in the taxpayer's jurisdiction of residence. Double non-taxation can result if the foreign income is also not taxed in the other jurisdiction.

Article 5 will modify certain existing bilateral treaty provisions that apply the 'exemption method' for relieving double taxation with the 'credit method', to guard against the income escaping tax in both jurisdictions. Parties can use one of three new provisions that would require a tax credit to be given for tax imposed in the other country on:

- income that the treaty allows the other party to exempt or tax at a reduced rate (Option A);
- dividends that are tax deductible in the other country (Option B); or
- all types of income that the treaty allows the other country to tax (Option C);

### What are the adoption options?

Do not adopt Article 5 at all (i.e. no change to bilateral treaty rules).

Adopt Article 5 and select one of the following Options:

- 5(2) **Option A:** Where the existing exemption method applies, add text that expressly allows jurisdictions to not apply the exemption method with respect to income or capital that is deductible in the payer jurisdiction
- 5(4) **Option B:** Where the existing exemption method applies, add text that expressly allows jurisdictions to not apply the exemption method with respect to dividends that are deductible in the payer jurisdiction
- 5(6) **Option C:** Replace the existing exemption method text entirely with a full credit method article based on Article 23B of the OECD Model Tax Convention
- 5(8) Where no Option chosen, Article 5 won't apply for all or specified covered tax agreements
- 5(9) Where Option C not chosen, other Party cannot apply Option C to all or specified covered tax agreements

### Australia's initial approach to Article 5

All of Australia's treaties apply the 'credit method' for relieving double taxation for Australian residents. On this basis, Australia's initial approach would be to not adopt Article 5 and also not to prevent other Parties from applying their chosen options.

## **ARTICLE 6 — PURPOSE OF A COVERED TAX AGREEMENT**

Article 6 implements recommendations outlined in the BEPS Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances) report (see page 92 of that report).

### **How does this Article address multinational tax avoidance?**

Tax treaties have been primarily developed for the purpose of avoiding double taxation. Another purpose is to prevent tax avoidance and evasion.

Article 6 will insert a new preamble into covered tax agreements which expressly states that the purpose of the tax treaty is to eliminate double taxation 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 the treaty for the indirect benefit of residents in third jurisdictions). This is important because tax treaties are required to be interpreted in their context and in light of their object and purposes (including their preamble).

Article 6 also contains optional additional preamble text stating that both jurisdictions desire to further develop their economic relationship and enhance their cooperation in tax matters.

### **What are the adoption options?**

Adopt the new preamble

- 6(3) Also adopt the additional preamble text referring to a desire to develop the bilateral economic relationship and enhance tax cooperation
- 6(4) Do not adopt the new preamble for bilateral treaties that already contain equivalent preamble language

### **Australia's initial approach to Article 6**

Article 6 is consistent with Australia's view that the object and purpose of tax treaties is to eliminate double taxation without facilitating double non-taxation or tax avoidance or evasion. The 2015 Australia-Germany treaty includes both the new and additional preamble text.

On this basis, Australia preliminary approach would be to adopt Article 6 across all of its covered tax agreements, including the additional preamble text.

## ARTICLE 7 — PREVENTION OF TREATY ABUSE

Article 7 implements recommendations outlined in the BEPS Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances) report (see paragraph 22 of that report).

### How does this Article address multinational tax avoidance?

Many tax treaties contain specific integrity rules to prevent treaty benefits from being obtained in unintended circumstances. However, some taxpayers are able to circumvent these rules using treaty-shopping and other abusive arrangements. Article 7 will modify jurisdictions' bilateral treaties to include the following:

- A general anti-avoidance rule – **the Principal Purpose Test (PPT)** – to deny treaty benefits where obtaining the benefit was one of the principal purposes of the arrangement unless granting the treaty benefits would be in accordance with the object and purpose of the relevant provisions of the treaty; and
- A supplementary (and optional) rule – **the Simplified Limitation on Benefits rule (S-LOB rule)** – to grant treaty benefits only to specified 'qualified persons' (individuals, government entities, listed companies, non-profit organisations, pension funds, entities engaged in active business or entities that meet specified ownership requirements).

### What are the adoption options?

- 7(1) Adopt the PPT (default rule)
- 7(3) Adopt an additional optional rule that requires the relevant CAs applying the PPT to consult before rejecting a taxpayer's request for treaty benefits
- 7(6) Also adopt the supplementary S-LOB rule, but as follows:
  - 7(7)(a) both jurisdictions apply the PPT and the S-LOB rule (symmetric application) or
  - 7(7)(b) one jurisdiction applies the PPT only and the other jurisdiction applies both the PPT and the S-LOB rule (asymmetric application)
- 7(15)(a) Do not adopt the PPT on the understanding that jurisdictions will take bilateral action to adopt a detailed LOB rule together with a PPT or rules to address conduit financing structures to meet the minimum standard
- 7(15)(b) Do not adopt the PPT for treaties that already contain a PPT
- 7(15)(c) Do not adopt the S-LOB rule for treaties that already contain a LOB rule
- 7(16) A jurisdiction preferring to adopt both the PPT and the S-LOB rule can choose not to apply Article 7 if the other jurisdiction will only agree to adopt the PPT, on the understanding the jurisdictions will take bilateral action to meet the minimum standard

### Australia's initial approach to Article 7

The PPT is consistent with Australia's preferred treaty practice of including provisions in its bilateral treaties that deny treaty benefits where a main purpose of a transaction or

arrangement is to obtain a treaty benefit (see, for example, Article 10(9) of the 2009 Australia-New Zealand treaty). Article 23 of the 2015 Australia-Germany treaty includes the PPT rule but not the optional PPT consultation rule.

On this basis, Australia's initial approach would be to adopt the PPT, but not the optional PPT consultation rule, in Article 7 across all of its covered tax agreements. In addition, Australia would not wish to adopt the S-LOB in relation to treaties that already contain a detailed LOB rule (for example, the 2008 Australia-Japan treaty). However, Australia would not need to enter the reservation permitted by Article 7(15)(c) unless Australia chooses to apply Article 7(7)(a) or (b).

## ARTICLE 8 — DIVIDEND TRANSFER TRANSACTIONS

Article 8 implements recommendations outlined in the BEPS Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances) report (see page 70 of that report).

### How does this Article address multinational tax avoidance?

To encourage foreign investment, tax treaties generally provide concessional tax rates on non-portfolio intercorporate dividends<sup>5</sup> paid to non-resident shareholders. Non-resident shareholders can abuse these concessions by increasing their shareholdings just before dividends are paid in order to obtain the concessional tax rates.

Article 8 will insert a 365-day holding period before taxpayers become eligible for the reduced tax treaty rate. This will limit opportunistic access to reduced source country taxation and help foster genuine longer term direct investment.

### What are the adoption options?

Adopt Article 8 without reservation

8(3)(a) Do not adopt Article 8 at all (i.e. no change to bilateral treaty rules)

Adopt Article 8 but not in relation to treaties that already prescribe:

8(3)(b)(i) a minimum holding period

8(3)(b)(ii) a minimum holding period shorter than 365 days, or

8(3)(b)(iii) a minimum holding period longer than 365 days.

### Australia's initial approach to Article 8

A number of Australia's tax treaties already include holding periods to access the concessional rates (see the 2015 Australia-Germany treaty which includes a 12 month holding period for the nil rate for non-portfolio intercorporate dividends and a 6month holding period for the 5 per cent rate for non-portfolio intercorporate dividends). The existing 12 month holding period provisions require that the period be satisfied at the time the dividend is declared whereas the MLI provides that the 365 day period includes the day of the payment of the dividends (and therefore the holding period does not have to be in advance of the dividend payment date).

Australia's initial approach would be to adopt Article 8 without reservation across all of its covered tax agreements. This would standardise the holding period rules for non-portfolio intercorporate dividends in Australia's treaties.

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<sup>5</sup> Although some of Australia's tax treaties include split definitions of what constitutes a 'non-portfolio' dividend interest, typically the rules for Australian dividends apply where the receiving company has 10% or more of the voting interest in the paying company.

## **ARTICLE 9 — CAPITAL GAINS FROM ALIENATION OF SHARES OR INTERESTS OF ENTITIES DERIVING THEIR VALUE PRINCIPALLY FROM IMMOVABLE PROPERTY**

Article 9 implements recommendations outlined in the BEPS Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances) report (see page 71 of that report).

### **How does this Article address multinational tax avoidance?**

Tax treaties typically preserve a jurisdiction's right to tax capital gains attributable to real property (primarily land) located in that jurisdiction. This applies not only to directly held real property (e.g. where an investor owns property in their own right) but also to real property held indirectly through interposed entities, the assets of which derive more than 50 per cent of their value from real property ('land-rich entities').

Foreign residents can attempt to avoid taxation of capital gains by contributing other assets to a land rich entity, so that it is no longer land-rich, shortly before disposing of their interests in the entity.

Article 9 will introduce a 365 day period for testing whether the relevant entity was land-rich. It will also ensure – through the insertion of references to 'comparable interests' - that a wider range of interests in land-rich entities (e.g. units in trusts) are brought within the scope of the article, as well as shares.

### **What are the options?**

Adopt Article 9 without reservation

- 9(6)(a) Do not adopt Article 9 at all (i.e. no change to bilateral treaty rules)
- 9(6)(b) Adopt Article 9 but do not apply the 365 day test period
- 9(6)(c) Adopt Article 9 but do not include comparable interests
- 9(6)(d) Adopt Article 9 but not in relation to treaties that already include a test period
- 9(6)(e) Adopt Article 9 but not in relation to treaties that already include comparable interests
- 9(4) Adopt the optional clause that would modify bilateral treaties to include a full replacement provision containing both the 365 day test and the reference to comparable interests
- 9(6)(f) Adopt the optional clause referred to immediately above but not in relation to treaties that already contain an equivalent provision

### **Australia's initial approach to Article 9**

Article 9 is consistent with Australia's preferred treaty practice of including both the 365 day test and a reference to comparable interests in its bilateral treaties (see Article 13(4) of the 2015 Australia-Germany treaty). However, a large number of Australia's treaties already include either a general or detailed reference to comparable interests.

On this basis, Australia's initial approach would be to adopt Article 9 across all of its covered tax agreements and enter the reservation permitted by Article 9(6)(e). Australia would not adopt the optional full replacement provision in Article 9(4,) which would leave existing references to comparable interests undisturbed.

## **ARTICLE 10 — ANTI-ABUSE RULE FOR PERMANENT ESTABLISHMENTS SITUATED IN THIRD JURISDICTIONS**

Article 10 implements recommendations outlined in the BEPS Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances) report (see page 75 of that report).

### **How does this Article address multinational tax avoidance?**

Tax treaty rules often limit the amount of tax that can be imposed on income derived from one treaty jurisdiction by residents of the other treaty jurisdiction. However, an entity which is a resident of a treaty jurisdiction can establish a presence (permanent establishment) in a third, low-tax jurisdiction. Where the income is considered to be attributable to that permanent establishment and the treaty jurisdiction where the entity is resident exempts profits of permanent establishments situated in the third jurisdiction, this will result in low or no tax on the income.

Article 10 will insert a new rule that allows a treaty jurisdiction to instead impose its domestic rate of tax (rather than any treaty concessional rates) where:

- the relevant income is attributable to a permanent establishment in a third jurisdiction;
- the profits of that permanent establishment are exempt from tax in the other treaty jurisdiction;
- the tax on that income in the third jurisdiction is less than 60 per cent of the tax that would have been payable on that same income in the other treaty jurisdiction if the permanent establishment was instead situated in that other treaty jurisdiction; and
- the income is not derived in connection with, or incidental to, the active conduct of a business through that permanent establishment in that third jurisdiction.

Article 10 would also permit the competent authority of the relevant tax administration of the country from which the income is derived to nevertheless agree to grant treaty benefits if considered justified.

### **What are the options?**

Adopt Article 10 without reservation

- 10(5)(a) Do not adopt Article 10 at all (i.e. no change to bilateral treaty rules)
- 10(5)(b) Adopt Article 10 but not for treaties that already contain an equivalent rule
- 10(5)(c) Adopt Article 10 but only for treaties that already deny or limit treaty benefits for income attributable to permanent establishments situated in third jurisdictions

### **Australia's initial approach to Article 10**

None of Australia's existing treaties include this rule.

Australia's initial approach would be to not adopt this article pending further analysis of its potential impacts in the Australian context.

## **ARTICLE 11 — APPLICATION OF TAX AGREEMENTS TO RESTRICT A PARTY’S RIGHT TO TAX ITS OWN RESIDENTS**

Article 11 implements recommendations outlined in the BEPS Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances) report (see page 86 of that report).

### **How does this Article address multinational tax avoidance?**

Most tax treaty rules are intended to restrict a country’s right to tax income derived (from within that country) by foreign residents. It has been argued, however, that some treaty rules limit a country’s right to tax its own residents.

Article 11 contains a ‘saving clause’ that clarifies that the treaty does not restrict a country’s right to tax its own residents, except with respect to certain treaty provisions (listed in Article 11(1)(a) to (j)).

### **What are the options?**

Adopt Article 11 without reservation

- 11(3)(a) Do not adopt Article 11 at all (i.e. no change to bilateral treaty rules)
- 11(3)(b) Do not adopt Article 11 for treaties that already include a saving clause

### **Australia’s initial approach to Article 11**

Article 11 codifies a widely accepted principle that is already understood to apply to Australia’s treaties. A saving clause is included in Articles 1(3) and (4) of the 1982 Australia-US treaty.

Australia’s initial approach is to adopt Article 11 across all of its covered tax agreements and enter the reservation permitted by Article 11(3)(b).

## **ARTICLE 12 — ARTIFICIAL AVOIDANCE OF PERMANENT ESTABLISHMENT STATUS THROUGH COMMISSIONNAIRE ARRANGEMENTS AND SIMILAR STRATEGIES**

Article 12 implements recommendations outlined in the BEPS Action 7 (Preventing the Artificial Avoidance of Permanent Establishment Status) report (see page 15 of that report).

### **How does this Article address multinational tax avoidance?**

A Permanent Establishment (PE) is a taxable presence threshold for determining whether or not a country can tax local business profits derived by a foreign resident. Under tax treaties, a jurisdiction can only tax such profits to the extent they are attributable to a PE of the foreign resident located in that jurisdiction. PE is a defined term in all tax treaties.

Foreign residents can interpose agency arrangements to artificially avoid creating a PE, thus preventing the host country from taxing those business profits.

Article 12 will ensure that where an intermediary habitually concludes contracts or habitually plays the principal role in concluding substantially finalised business contracts in the host country on behalf of a foreign enterprise, that arrangement will be deemed to constitute a PE. The article applies to contracts:

- in the name of the foreign resident enterprise,
- for the transfer of ownership or granting the right to use property owned by the foreign resident enterprise or which the enterprise has the right to use, or
- for services provided by that enterprise.

Article 12 will also ensure that genuine independent agents operating in the normal course of their business will not constitute a PE, provided that the intermediary is not acting exclusively or almost exclusively for a closely related foreign resident enterprise.

### **What are the options?**

Adopt Article 12 without reservation

- 12(4) Do not adopt Article 12 at all (i.e. no change to bilateral treaty rules).

### **Australia's initial approach to Article 12**

Article 12 is consistent with both Australia's preferred treaty practice of including provisions in its bilateral treaties to ensure that foreign resident enterprises do not artificially avoid creating a PE in Australia and Australia's Multinational Anti-Avoidance Law (MAAL). Articles 5(8) and (9) of the 2015 Australia-Germany treaty include the Article 12 provisions.

On this basis, Australia's initial approach is to adopt Article 12 without reservation across its covered tax agreements.

## ARTICLE 13 — ARTIFICIAL AVOIDANCE OF PERMANENT ESTABLISHMENT STATUS THROUGH THE SPECIFIC ACTIVITY EXEMPTIONS

Article 13 implements recommendations outlined in the BEPS Action 7 (Preventing the Artificial Avoidance of Permanent Establishment Status) report (see page 28 of that report).

### How does this Article address multinational tax avoidance?

A Permanent Establishment (PE) is a taxable presence threshold for determining whether or not a country can tax local business profits derived by a foreign resident. Under tax treaties, a jurisdiction can only tax such profits to the extent they are attributable to a PE of the foreign resident located in that jurisdiction. PE is a defined term in all tax treaties.

Most tax treaties include a list of exceptions to the PE definition where a place of business is used solely for the specifically listed activities (the specific activity exemptions), such as warehousing or purchasing goods. Enterprises can avoid PE status by miscategorising or fragmenting activities to fall within the listed exceptions.

Article 13 will ensure that the specifically activity exemptions will only apply where the activities are genuinely preparatory or auxiliary in nature.

Article 13 will also insert a rule to prevent fragmentation of activities by a foreign resident enterprise itself or with related entities. The rule will apply where the business activities constitute complementary functions that are part of a cohesive business operation.

### What are the options?

Adopt Article 13 and choose whether to adopt Option A or B for specific activity exemptions

- 13(6)(a) Do not adopt Article 13 at all (i.e. no change to bilateral treaty rules)
- 13(1) Adopt either Option A or B or neither option
- 13(2) **Option A:** Inserts the requirement that all the specific activity exemptions must be of a preparatory or auxiliary character
- 13(3) **Option B:** Inserts the requirement that some but not all the specific activity exemptions must be of a preparatory or auxiliary character
- 13(6)(b) Choose Option A but not for treaties that already explicitly require that each specific activity exemption is 'preparatory or auxiliary'
- 13(6)(c) Do not adopt the anti-fragmentation rule.

### Australia's initial approach to Article 13

Option A in Article 13 is consistent with Australia's preferred treaty practice of requiring that all the specific activity exemptions are preparatory or auxiliary in nature and that foreign resident enterprises should not fragment their activities to avoid creating a PE. Australia's recent treaties include the preparatory and auxiliary requirement for all the specific activity exemptions. Articles 5(6) and (7) of the 2015 Australia-Germany treaty include the Article 13 Option A and anti-fragmentation provisions.

On this basis, Australia's initial approach is to adopt Option A of Article 13 (and possibly enter the reservation permitted by Article 13(6)(b)), together with the anti-fragmentation rule, across its covered tax agreements.

## ARTICLE 14 — SPLITTING-UP OF CONTRACTS

Article 14 implements recommendations outlined in the BEPS Action 7 (Preventing the Artificial Avoidance of Permanent Establishment Status) report (see page 42 of that report).

### How does this Article address multinational tax avoidance?

A Permanent Establishment (PE) is a taxable presence threshold for determining whether or not a country can tax local business profits derived by a foreign resident. Under tax treaties, a jurisdiction can only tax such profits to the extent they are attributable to a PE of the foreign resident located in that jurisdiction. PE is a defined term in all tax treaties.

Most tax treaties deem a PE to exist in the case of building or construction projects that exceed a specified time period (e.g. 12 months). This rule can be circumvented by dividing contracts into several parts (typically among related parties), with each contract not exceeding the specified time period.

Article 14 will insert a new anti-contract splitting rule which will apply to deemed PE provisions for building sites, construction or installation projects, or supervisory or consultancy activities in connection with such sites or projects. For the purposes of assessing whether the specified time period to constitute a deemed PE has been exceeded, connected activities which are carried on by closely related persons at the same site or project during different periods of time that each exceed 30 days must be added to the aggregate period of time that a foreign resident enterprise has also carried on activities at that site or project.

Article 14 will not affect existing treaty anti-contract splitting rules for other types of deemed PE activities.

### What are the options?

Adopt Article 14 without reservation

- 14(3)(a) Do not adopt Article 14 at all (i.e. no change to bilateral treaty rules).
- 14(3)(b) Adopt Article 14 but exclude bilateral treaty rules that deem a PE to exist in relation to exploration for or exploitation of natural resources

### Australia's initial approach to Article 14

Article 14 is consistent with Australia's preferred treaty practice of including anti-contract splitting provisions in its bilateral treaties to prevent foreign resident enterprises circumventing deemed PE time thresholds. Australia's recent treaties include anti-contract rules (see, for example, Article 5(6) of the 2009 Australia-New Zealand treaty and Article 5(5) of the 2015 Australia-Germany treaty) but these rules also apply to other types of deemed PEs with time thresholds (such as natural resource and substantial equipment activities). The Offshore Activities Articles of the 2006 Australia-Norway treaty includes an anti-contract splitting rule – see Article 20(3).

On this basis, Australia's initial approach is to adopt Article 14 (and possibly enter the reservation permitted by Article 14(3)(b)) across its covered tax agreements.

## **ARTICLE 15 — DEFINITION OF A PERSON CLOSELY RELATED TO AN ENTERPRISE**

Article 15 implements recommendations outlined in the BEPS Action 7 (Preventing the Artificial Avoidance of Permanent Establishment Status) report (see page 16 of that report).

### **How does this Article address multinational tax avoidance?**

Article 15 will define when a person is closely related to an enterprise for the purposes of Articles 12, 13 and 14 of the MLI. A person is considered to be closely related to an enterprise if, based on all the relevant facts and circumstances:

- one has control of the other,
- both are under the control of the same persons or enterprise,
- one person possesses directly or indirectly more than 50 per cent of the beneficial interest in the other (or, in the case of a company, the aggregate vote and value of the company's shares or of the beneficial equity in the company), or
- if another person possesses directly or indirectly more than 50 per cent of the beneficial interest (or, in the case of a company, the aggregate vote and value of the company's shares or of the beneficial equity in the company) in the person and the enterprise.

### **What are the options?**

Adopt Article 15 without reservation

- 15(2) Do not adopt Article 15 at all if the Party has entered reservations under Articles 12(4), 13(6)(a) or (c) and 14(3)(a) (and the definition is therefore not needed)

### **Australia's initial approach to Article 15**

Article 15 is necessary for the coherent operation of Articles 12, 13 and 14. Article 5(10) of the 2015 Australia-Germany treaty includes this definition.

On this basis, Australia's initial approach is to adopt Article 15 without reservation across its covered tax agreements if Articles 12, 13 or 14 are also adopted.

## ARTICLE 16 — MUTUAL AGREEMENT PROCEDURE

Article 16 implements recommendations outlined in the BEPS Action 14 (Making Dispute Resolution Mechanisms More Effective) report (see page 13 of that report).

### How will this Article make dispute resolution mechanisms more effective?

Article 16 is broadly designed to provide business with a more effective tax-treaty based dispute resolution procedure so that actions to counter BEPS do not inadvertently lead to double taxation. The article aims to ensure the consistent and proper implementation of tax treaties, including the effective and timely resolution of disputes regarding their interpretation or application through the mutual agreement procedure (MAP).

Specifically, Article 16 will modify MAP rules in existing treaties to:

- allow taxpayers the option to present a case to the competent authority (CA) of either treaty jurisdiction if the taxpayer believes they are not/will not be taxed in accordance with terms of the treaty, irrespective of any domestic law remedies (Article 16(1));
- require taxpayers to request MAP assistance within three years from the first notification of the action resulting in taxation not in accordance with the treaty (Article 16(1));
- require the respective CAs (if the objection appears to be justified and the CA to which the case was presented is unable to arrive at a satisfactory solution itself) to endeavour to resolve the case by mutual agreement and to implement any resulting agreement notwithstanding any time limits in the domestic law (Article 16(2)); and
- require the respective CAs to endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the treaty and allow the CAs to consult for the elimination of double taxation in cases not provided for in the treaty (Article 16(3)).

### What are the options?

Adopt Article 16 without reservation

- 16(5)(a) Adopt Article 16 but not the rule allowing a case to be presented to either CA (on the condition that the jurisdiction instead implements a bilateral notification or consultation process)
- 16(5)(b) Adopt Article 16 but not the rule requiring that the case be presented within 3 years from the first notification in treaties that don't already specify a time period (on the condition that the jurisdiction will nevertheless allow a taxpayer to present the case within a period of at least 3 years)
- 16(5)(c) Adopt Article 16 but not the rule requiring any mutual agreement be implemented notwithstanding any domestic law time limits (on the condition that the treaty jurisdiction will nevertheless implement the mutual agreement notwithstanding any domestic law time limits or by accepting in its bilateral treaty negotiations a time limit for initiating transfer pricing adjustments).

## **Australia's initial approach to Article 16**

Article 16 is consistent with Australia's preferred treaty practice for the MAP rules. Articles 25(1), (2) and (3) of the 2015 Australia-Germany treaty include the Article 16 provisions. Australia's initial approach is to adopt Article 16 without reservation across its covered tax agreements.

## ARTICLE 17 — CORRESPONDING ADJUSTMENTS

Article 17 implements recommendations in the BEPS Action 14 (Making Dispute Resolution Mechanisms More Effective) report (see pages 13 and 29 of that report).

### How will this Article make dispute resolution mechanisms more effective?

Transfer pricing adjustments to an enterprise's profits made by the jurisdiction where that enterprise is a resident can result in double taxation if the other jurisdiction does not make a corresponding adjustment to the profits of the other associated enterprise involved in the relevant transaction.

Article 17 will modify treaties to require the tax administration of a jurisdiction to make a downward adjustment to the profits of a resident enterprise, to reflect a corresponding upward adjustment by the tax administration of the other jurisdiction to the profits of the other party (the associated enterprise) involved in the relevant transaction. This obligation only applies, however, where the upward adjustment reflects a true allocation of profits between the two enterprises in accordance with the arm's-length principle.

### What are the options?

Adopt Article 17 without reservation

- 17(3)(a) Adopt Article 17 but not for treaties that already contain an equivalent provision
- 17(3)(b) Do not adopt Article 17 on the condition that in the absence of a treaty corresponding adjustment provision, either the jurisdiction will make an appropriate corresponding adjustment or its CA will endeavour to resolve a transfer pricing case under the MAP rules
- 17(3)(c) Do not adopt Article 17 if the jurisdiction has made a reservation under MAP Article 16(5)(c)(ii) (on the basis that the jurisdiction will accept in its bilateral treaty negotiations a corresponding adjustment provision if the two jurisdictions can also agree on a time limit for initiating transfer pricing adjustments)

### Australia's initial approach to Article 17

Article 17 is consistent with Australia's preferred treaty practice of including corresponding adjustment provisions in its bilateral treaties to alleviate potential double taxation. Australia's treaties all contain a corresponding adjustment provision with the exception of the 1982 Australia-Italy treaty.

On this basis, Australia's initial approach is to adopt Article 17 across all of its covered tax agreements and enter the reservation permitted by Article 17(3)(a).

## ARTICLES 18-26 — ARBITRATION

Articles 18 to 26 implement binding MAP arbitration, reflecting the commitment by some countries to provide for this in their bilateral tax treaties, as was noted in the BEPS Action 14 (Making Dispute Resolution Mechanisms More Effective) report (see page 10 of that report).

### How will this article make dispute resolution mechanisms more effective?

The MAP rules in tax treaties provide taxpayers with a mechanism to seek the assistance of the CAs (of the two tax administrations) in resolving treaty-related disputes. The majority of disputes involve economic double taxation, i.e. where both countries seek to tax the same income in the hands of different, associated taxpayers. However, the MAP rules do not oblige the CAs to finally resolve disputes, only to endeavour to resolve them, which can mean that disputes remain unresolved indefinitely.

Articles 18 to 26 will permit taxpayers to refer disputes that have not been resolved through the MAP process within two years to independent and binding arbitration. The rules cover:

- Eligibility for arbitration, relevant timelines and other operational rules
- The appointment of arbitrators
- The confidentiality of arbitration proceedings
- The resolution of cases prior to the conclusion of arbitration
- Types of arbitration processes
- Agreement (by the CAs) on a different resolution
- Costs of arbitration proceedings

Part VI is intended to apply only between jurisdictions that expressly choose to apply Part VI with respect to their covered tax agreements.

### Choice to apply Part VI

Article 18: allows jurisdictions to choose to apply the arbitration provisions in Part VI of the MLI

### Mandatory binding arbitration

Article 19(1): permits the taxpayer to request that any unresolved issues be submitted to arbitration after a period of 2 years (or an alternative time period agreed between the CAs)

Article 19(2): extends the specified period for any periods that the MAP process is suspended

Article 19(3): extends the specified period for any periods that the taxpayer has failed to provide material information requested by the CA

- Article 19(4): provides that the arbitration decision is final and will be implemented through the MAP, and will be binding on both jurisdictions except in specified circumstances
- Article 19(5): prescribes when the CA who received the request must notify the taxpayer and the other CA
- Article 19(6): prescribes when each CA must either confirm it has the necessary information to substantively consider the request or request additional information
- Article 19(7): prescribes when a CA that has requested additional information must either confirm it has the necessary information or that some information is still missing
- Article 19(8): prescribes the start date where no additional information was requested
- Article 19(9): prescribes the start date where additional information was requested
- Article 19(10): prescribes the CAs will settle the mode of application of the arbitration provisions (including the minimum information necessary to undertake substantive consideration of a case) prior to the date a case is first eligible to be submitted to arbitration

### **Appointment of arbitrators**

- Article 20(1): prescribes rules for the appointment of arbitrators unless the CAs mutually agree on different rules
- Article 20(2): specifies the appointment of 3 impartial and independent individuals and how they are to be selected
- Article 20(3): prescribes a default rule where a CA fails to appoint an arbitrator
- Article 20(3): prescribes a default rule where the first 2 arbitrators fail to appoint a Chair

### **Confidentiality of arbitration proceedings**

- Article 21(1): permits disclosure of information to the arbitrators and their staff
- Article 21(2): requires written confidentiality agreement

### **Resolution of a case prior to the conclusion of arbitration**

- Article 22: prescribes that the MAP and arbitration proceeding terminate if the CAs reach a mutual agreement to resolve the case or the taxpayer withdraws the request prior to delivery of the arbitration decision

### **Type of arbitration process**

- Article 23(1): provides for the 'final offer' arbitration process as the default type of arbitration process unless the CAs mutually agree on different rules and specifies that both CAs must submit a proposed resolution, may also submit a supporting position paper and the arbitration panel will select as its decision one of the proposed resolutions

## Agreement on a different solution

- Article 24(1): allows jurisdictions to choose to allow the CAs to agree on a different resolution after the arbitration decision has been delivered
- Article 24(2): prescribes the arbitration decision is not binding on the jurisdictions or implemented if the CAs agree on a different resolution within 3 months of the arbitration decision being delivered

## Costs of arbitration proceedings

- Article 25: prescribes how the costs of arbitration will be shared between the two jurisdictions

## What are the options?

### Adopt Part VI without reservation

- 18 Do not adopt Part VI at all (i.e. no change to bilateral treaty rules)
- 19(11) Adopt Article 19 but apply a three year period (instead of two years) for the referral of unresolved disputes to arbitration
- 19(12)(a) Adopt Article 19 but exclude disputes in respect of which a court or administrative tribunal has rendered a decision from the scope of arbitration
- 19(12)(b) Adopt Article 19 but include a rule that would terminate the arbitration proceedings if a court or administrative tribunal renders a decision on the dispute
- 23(2) Adopt Article 23 but instead adopt the 'independent opinion' arbitration process
- 23(3) Do not adopt Article 23 where the other jurisdiction has reserved the right to instead adopt the 'independent opinion' arbitration process and leave it to the CAs to endeavour to agree on the type of arbitration process
- 23(5) Adopt Article 23 but include a rule to ensure the confidentiality of the arbitration proceedings, including the possibility of terminating proceedings if the taxpayer or its representatives breach confidentiality
- 23(6) Adopt Article 23 but where the jurisdiction has not reserved the right to require confidentiality under Article 23(5), the jurisdiction can elect for Article 23(5) not to apply to selected covered tax agreements
- 23(6) Adopt Article 23 but where the jurisdiction has reserved the right to require confidentiality under Article 23(5), the jurisdiction can elect for Part VI not to apply at all to any covered tax agreements for which the other jurisdiction has reserved its position under Article 23(5)
- 24(3) Adopt Article 24 but only where the 'independent opinion' arbitration process applies
- 26(4) Do not adopt Part VI for one or more treaties that already provide for mandatory binding arbitration

- 28(2)(a) Adopt Part VI but exclude particular issues from the scope of arbitration
- 28(2)(b) Do not adopt Part VI where a jurisdiction objects to a reservation made by the other jurisdiction under Article 28(2)(b)

### **Australia's initial approach to Part VI**

Part VI is consistent with Australia's commitment to implement binding MAP arbitration in its bilateral tax treaties. Australia has included binding MAP arbitration provisions (with some variations) in its bilateral tax treaties with New Zealand (2009), Switzerland (2013) and Germany (2015). Each of those treaties prevents an unresolved issue from being submitted to arbitration if a court or administrative tribunal of either jurisdiction has already a decision on the issue. However, Australia's general anti-avoidance rule (Part IVA of the *Income Tax Assessment Act 1936*) prevails over Australia's bilateral treaties.

On this basis, Australia's initial approach is to adopt Part VI of the MLI across its covered tax agreements, including the option requiring taxpayers (and their advisers) to maintain the confidentiality of information obtained during the course of arbitration proceedings. Australia's initial approach is to also enter a reservation to exclude Australia's general anti-avoidance rule from the scope of arbitration and possibly enter the reservations permitted by Article 19(12).