OECD releases final report on developing a multilateral instrument to modify bilateral tax treaties under BEPS Action 15

Executive summary

On 5 October 2015, the Organisation for Economic Co-operation and Development (OECD) released its final report on developing a multilateral instrument to modify bilateral tax treaties (Action 15) under its Action Plan on Base Erosion and Profit Shifting (BEPS). This report was released in a package that included final reports on all 15 BEPS Actions.

The Action 15 report, Developing a Multilateral Instrument to Modify Bilateral Tax Treaties (the Multilateral Instrument Report or Final Report), provides an overview of the current status of the multilateral instrument, which aims to swiftly and consistently implement the tax treaty-based measures developed during the course of the BEPS project. This Final Report is mainly a reproduction of the previously published deliverables under Action 15, specifically the September 2014 report on developing a multilateral instrument to modify bilateral tax treaties and the subsequent mandate issued in February 2015 authorizing the establishment of an ad hoc group to conduct further work on the multilateral instrument. This group is open to all interested countries, including non-OECD or G20 members, with all participating on an equal basis. The group began its work in May 2015 with the aim of finalizing the multilateral instrument and to open it for signature by 31 December 2016. So far, approximately 90 countries are participating. The Final Report indicates that participation in the development of the multilateral instrument is voluntary and does not entail any commitments to sign such instrument once it has been finalized.
Detailed discussion

Overview
On 5 October 2015, the OECD released final reports on all 15 focus areas in its Action Plan on BEPS, including the final report on Action 15: Developing a Multilateral instrument to Modify Bilateral Tax Treaties (the Multilateral Instrument or Final Report). Action 15 called for a report to “Analyze 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.” The Final Report reproduces the report issued in September 2014 Developing a Multilateral Instrument to Modify Bilateral Tax Treaties (the 2014 Report). Drawing on the expertise of public international law and tax experts, the 2014 Report explored the technical feasibility and desirability of a multilateral instrument and its consequences on the current tax system. It concluded that a multilateral instrument is considered both desirable and feasible, and that negotiations for such an instrument should be convened as soon as possible.

On the basis of the outcome of the analysis in the 2014 Report, a mandate was subsequently approved by the OECD and G20 countries in February, which authorized the formation of an ad hoc group (the Group) to develop a multilateral instrument that would implement the treaty-based measures developed as part of the BEPS Project. This mandate also is included in the Final Report. The following is a brief overview of these previously published deliverables under Action 15, as reproduced in the Final Report.

2014 Report
The Introduction to the 2014 Report stated that the current network of over 3,000 bilateral tax treaties ensures broad consistency in cross-border tax rules, but that “gaps and frictions” have grown over time resulting for instance in amounts of income not being taxed in any jurisdiction. Due to the time required to renegotiate each treaty, the treaty network is not well-synchronized with treaty models, so that a change in treaty models would not satisfy the political imperative to address BEPS in a reasonable time frame. A multilateral instrument would however implement agreed treaty measures in a reasonably short time frame and at the same time would preserve the bilateral nature of tax treaties.

Desirability and feasibility of a multilateral instrument
The 2014 Report began with an examination of the desirability and feasibility of a multilateral instrument. It noted that a multilateral instrument facilitates swift implementation of the treaty-related BEPS outputs by avoiding the need to individually negotiate existing bilateral tax treaties. Furthermore, the 2014 Report indicated that such an instrument would allow developing countries that could otherwise have difficulties concluding or renegotiating treaties to fully benefit from the BEPS project. In addition, it outlined that a multilateral instrument can be an easier way to address multilateral issues, such as multilateral mutual agreement procedures (MAPs), than bilateral treaties. Finally, the 2014 Report stated that a multilateral instrument can increase the consistency and clarity of the tax treaty network, and it also could allow countries to provide assurance to each other regarding their determination to address BEPS simultaneously so that each of them would “feel comfortable moving ahead in tackling BEPS.” For all these reasons, the 2014 Report considered that such an instrument is desirable but that, in order to create a level playing field, broad participation in the multilateral instrument needs to be achieved.

The 2014 Report goes on to identify obstacles to a multilateral instrument from technical (public international law and international tax law) and political perspectives and the solutions to address those obstacles.

First, in the choice between (i) a “self-standing instrument” that would wholly supersede existing treaties; (ii) an instrument that would merely operate as a set of protocols amending each of the existing bilateral treaties specifically; and (iii) an instrument that would coexist with bilateral treaties, only the third option appeared to preserve tax sovereignty and achieve an efficient outcome. Under that latter option, the instrument would amend a limited number of provisions commonly found in
bilateral tax treaties and, where not already included in those treaties, would add new anti-BEPS measures. The instrument would be legally binding on the contracting parties, but would only govern the relationship between those that already have a bilateral tax treaty in place among themselves. However, the 2014 Report suggested that a multilateral dispute resolution mechanism could operate among all parties to the multilateral agreement. The instrument would be subject to standard domestic ratification procedures.

Second, on the more technical challenges around, for example, the interaction with bilateral tax treaties, the 2014 Report derived solutions from numerous examples of multilateral treaties in areas other than tax. For instance, “compatibility” clauses to resolve a conflict with similar provisions in existing or even future bilateral treaties (giving priority to the multilateral instrument); an explanatory report providing interpretative guidance; different dates of entry into force for different provisions; mechanisms for expeditious amendment procedures in the future; and the use of official languages and unofficial translations. More importantly, the 2014 Report suggested that flexibility could be provided to tailor the extent of rights and obligations created by the multilateral treaty by the recourse to opt-out or opt-in mechanisms or leaving parties a choice between alternative provisions.

The 2014 Report thus concluded that a multilateral instrument also appears to be feasible.

**Scope of the multilateral instrument**

The 2014 Report listed some of the treaty-related measures to be developed in the BEPS project that are multilateral in nature and would be more effective if implemented by a multilateral instrument. These treaty-related measures include addressing multilateral mutual agreement procedures, dual resident structures, hybrid mismatch arrangements, triangular cases involving a permanent establishment (PE) in third states, and treaty abuse. The mandate for negotiation of a multilateral instrument and progress made in 2015

Considering the feasibility and desirability of the multilateral instrument, the 2014 Report concluded with and recommended the convening of an international conference to develop and negotiate the content of such multilateral instrument. Such mandate was approved by the OECD and G20 countries on 6 February 2015, which authorized the formation of the Group to develop a multilateral instrument that would initially be limited to the tax treaty measures as developed during the BEPS Project, in line with the recommendations of the 2014 Report. Although the Mandate does not provide for a list of the treaty-based measures to be included, the explanations to the Mandate indicate that the negotiations should include the tax treaty provisions as developed under Action 2 (hybrid mismatch arrangements), Action 6 (treaty abuse), Action 7 (permanent establishment), and Action 14 (dispute resolution). The mandate furthermore provided that participation in the development
of the multilateral instrument will be open to all interested countries, including non-OECD or G20 members, with all countries participating on an equal basis. Participation in the development of the multilateral instrument is voluntary and does not entail any commitments to sign such instrument, once it has been finalized.

The Group began its work in May 2015 with the aim of finalizing the multilateral instrument and to open it for signature no later than 31 December 2016. During the OECD webcast held on 5 October 2015, it was confirmed that the first working meeting of the Group will take place in November 2015 and that future consultations will be held with stakeholders on the different aspects of the multilateral instrument. So far, approximately 90 countries are participating in the discussion. Worth noting is that on 2 October 2015, Robert Stack, US Deputy Assistant Treasury Secretary for International Tax Affairs, confirmed that the United States will participate in the discussions, but emphasized that this decision does not imply that the United States ultimately will join in signing the instrument.

Implications

The multilateral instrument of Action 15 is a key part of the OECD’s effort toward implementation of the recommended measures as quickly and consistently as possible. Although the precise content of the multilateral instrument is not yet defined, the sense of direction is clear, as the mandate indicates that the negotiations on the development of the multilateral instrument will focus on the tax treaty provisions on hybrid mismatch arrangements, treaty abuse, permanent establishment status and dispute resolution as developed under Action 2, Action 6, Action 7 and Action 14 respectively.

With respect to the treaty provisions related to dispute resolution in particular, the final report on Action 14 states that a provision on mandatory binding arbitration will be developed in the negotiations of the multilateral instrument.5 While not all OECD and G20 countries agree on arbitration as a mechanism for improving the resolution of the mutual agreement procedure, the Action 14 final report indicates that a group that includes 20 countries have committed to mandatory binding arbitration.6

The success of Action 15 will depend on the outcome of the negotiations between the participating countries and the appetite of such countries to sign the multilateral instrument and then advance it through their normal domestic ratification procedures applicable to tax treaties. This instrument could result in some key BEPS recommendations taking effect as early as 2017 through significant changes to bilateral tax treaties, including new limitations on access to treaty benefits, lower thresholds for permanent establishment status and, in some cases, new arbitration mechanisms for dispute resolution. Global businesses therefore should monitor the developments with respect to Action 15, with a particular focus on the participation of the countries where they operate.

Webcasts

EY is hosting a series of eight tax webcasts that will provide a comprehensive review of the final BEPS reports and the outlook for country action:

- OECD BEPS Project Outcomes: Highlights and Next Steps – 15 October, 10am EDT
- New Reporting under BEPS Action 13 - 20 October, 10am EDT
- Digital Economy Developments and BEPS Action 1 – 27 October, 12 noon EDT
- Permanent Establishment Developments and BEPS Action 7 – 5 November, 10am EST
- Transfer Pricing and BEPS Actions 8-10 – 12 November, 10am EST
- Anti-abuse Measures under BEPS Actions 3, 5, 6 and 12 – 19 November, 10am EST
- Financial Payments and BEPS Actions 2 and 4 – 3 December, 10am EST
- Dispute Resolution and BEPS Action 14 – 10 December, 10am EST

For more information and to register for the webcast series, click here.
Endnotes


3. The Report contains a technical annex called *A toolbox for a multilateral instrument for the swift implementation of BEPS measures based on input by a group of experts in tax and public international law*.

4. A proposal for allocation of interest expenses that was considered under Action 4 (Interest Deductions and Other Financial Payments) was not included in the final report on Action 4. However, the 2014 Report, as reproduced in the Final Report, still refers to the example of a multilateral interest expense allocation agreement.


6. The identified countries are Australia, Austria, Belgium, Canada, France, Germany, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Slovenia, Spain, Sweden, Switzerland, the United Kingdom and the United States.

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