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Australia's Tax News Podcast - The Podcast for Australian Tax Professionals

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110 | Multilateral Instrument

The OECD developed the so-called Multilateral Instrument to allow countries to better protect against multinational tax avoidance.

Multilateral Instrument

Multinationals use loopholes in current double tax agreements to shift profits to low-tax or no-tax countries. Often referred to as base erosion and profit shifting (BEPS).

In this episode Simon Dorevitch of A & A Legal Tax Consulting will walk you through the MLI. And since the MLI is a huge topic that would take hours, Simon will focus on the articles that affect permanent establishments. Here are our notes for this episode.

Covered Tax Agreements

The OECD's BEPS project is a concerted effort to curtail base erosion and profit shifting. To achieve this the BEPS project developed the Multilateral Instrument (MLI).

The MLI aims to stop the shifting of profits between countries with covered tax agreements.

The MLI facilitates its own implementation. It includes clear guidelines on when and how jurisdictions can adopt the MLI. The MLI refers to tax treaties that are impacted by the MLI as covered tax agreements (CTAs).

.Australia

Australia signed the MLI on 7 June 2017. And deposited its instrument of ratification with the OECD Depositary a year later on 26 September 2018. This instrument of ratification lists what MLI articles Australia implements, in what form and to what extent. Australia's covered tax agreements will begin to be impacted by the MLI from 1 January 2019.

However, the extent to which the MLI will actually modify Australia's bilateral tax treaties will also depend on what the other countries are doing. It depends on in what form and to what extent they have implemented the MLI articles.

Australia's Final Adoption

Australia's final adoption positions is available on the OECD website. Australia didn't adopt the entire MLI as such. We adopted most articles – some with and some without reservations. Completely rejected some. A few preserved existing bilateral rules.

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a) Full Rejection

Australia rejected Article 5, 10 and 12. So we didn't adopt these at all.

Article 5

Article 5 encourages the crediting of foreign tax against domestic tax. Rather than completely exempting foreign income from domestic tax. But all our treaties already apply the credit method so there is no need for Australia to adopt Article 5. So we didn't.

Article 10

Under article 10 treaty benefits are denied where an entity resident in one jurisdiction derives 'passive' income from a second jurisdiction through a permanent establishment in a third jurisdiction, if that income is both exempt in the entity's home jurisdiction and subject to reduced taxation in the third jurisdiction.

Article 12

Australia didn't adopt article 12 but will consider adopting it later. In the meantime the Multinational Anti-Avoidance Law is to safeguard Australian revenue from egregious tax avoidance arrangements that rely on a 'book offshore' model.

Article 12 rules that where an intermediary plays the principal role in concluding substantively finalised business contracts in a jurisdiction on behalf of a foreign enterprise, that arrangement will constitute a 'permanent establishment' of the foreign enterprise in that jurisdiction. Article 12 wouldn't affect genuine independent agency arrangements.

b) Full Adoption

Australia adopted Article 6, 8, 11, 15 and 16 without reservations.

Article 6

The MLI includes a new treaty preamble. This preamble states that tax treaties are not intended to create opportunities for non-taxation or reduced taxation through evasion or avoidance. This includes treaty-shopping arrangements.

Australia has adopted Article 6, including the optional text indicating a desire to further develop its economic relationships with other signatories and enhance cooperation in tax matters.

Article 8

Under Article 8 shares are required to be held for 365 days before any non-portfolio inter-corporate dividends payable in respect of those shares become eligible for reduced tax rates under tax treaties. This holding period will be added to bilateral treaties that do not already include a minimum holding period and replace existing holding periods in treaties that do.

Article 11

Article 11 stipulates that a tax treaty will not generally restrict a jurisdiction's right to tax its own residents. This rule will replace existing bilateral rules that give effect to this principle, some of which have a more limited application.

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Article 15

This article just defines who a ‘person closely related to an enterprise’ is. We need this definition to establish whether a permanent establishment exists under article 12, 13 and 14.

Article 16

New rules ensure the consistent and proper implementation of tax treaties, including the resolution of disputes regarding their interpretation or application. This will provide taxpayers with more effective tax treaty-based dispute resolution procedure.

c) Full Adoption But Preserving Existing Bilateral Rules

Australia fully adopted article 3, 9, 13, 14 and 17 but will preserve existing corresponding bilateral rules where appropriate.

Article 3

Under article 3 treaty benefits are granted for income derived through fiscally transparent entities, such as partnership or trusts, but only if one of the two jurisdictions treats the income as income of one of its residents under its domestic law. These rules will not prevent either jurisdiction from taxing its own residents.

Article 9

Under article 9 jurisdictions can tax capital gains derived by foreign residents from the disposal of shares or other interests in ‘land-rich’ entities (where the underlying property is located in that jurisdiction) if the entity was land-rich at any time during the 365 days preceding the disposal. Australia has adopted Article 9 but will preserve existing bilateral rules that apply to the disposal of comparable interests (non-share interests) in land-rich entities.

Article 13

Most tax treaties include a list of exceptions to the definition of permanent establishment if a place of business is used solely for specifically listed activities such as warehousing or purchasing goods. Under article 13 only genuine preparatory or auxiliary activities will be excluded from the definition of permanent establishment. In addition, article 13 prevents related entities from fragmenting their activities to qualify for exclusion.

Article 14

Most tax treaties include rules that deem building or construction projects that exceed a specified time period (for example 12 months) to constitute a permanent establishment. Under article 14 related entities will be prevented from avoiding the application of specified time period by splitting building or construction-related contracts into several parts. Australia will preserve existing bilateral rules that deem a permanent establishment to exist for offshore natural resource activities.

Article 17

Transfer pricing adjustments can result in double taxation when one jurisdiction makes an adjustments to an entity’s profits and the other jurisdiction does not make a compensating adjustment to the profits of the relevant related entity.

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A jurisdiction will be required to make a download adjustment to the profits of a resident entity, as a result of an upward adjustment by the other jurisdiction to the profits of an associated entity which is a resident of that other jurisdiction (provided both jurisdictions agree that the upward adjustment is justified).

d) Adoption with Reservations

Australia adopted the article 4 and 7 in general but excluded certain parts.

Article 4

Most treaties use an entity's place of effective management as the key tiebreaker test to determine a dual resident's jurisdiction of tax residence for treaty purposes. Article 4 expands this rule to include other factors and authorise the two tax administrations to agree on a single jurisdiction of residence. Australia didn't adopt the rule in article 4 that would allow the two tax administration to grant treaty benefits in the absence of such an agreement.

Article 7

Article 7 introduces new anti-abuse rules. It enables tax administrations to deny treaty benefits using either the Principal Purpose Test (PPT) or the Simplified Limitation on Benefits Rule (S-LOB). The PPT is the default option to satisfy the BEPS minimum standard. Australia has adopted the PPT including the discretion not to apply the PPT in certain circumstances. The S-LOB is a supplementary and optional rule and Australia didn't adopt the S-LOB rule.

e) Arbitration rules

Articles 18 to 26 cover arbitration rules and are optional.

Australia has adopted independent and binding arbitration. However, these arbitration rules are subject to some conditions.

When a dispute is subject to a decision by a court or administrative tribunal, it is not eligible for arbitration. An existing arbitration process will terminate.

A taxpayer or their advisers breaching confidentiality will terminate the arbitration process.

Anything within the scope of Part IV A ITAA36 or s67 of the FBTA 86 will be excluded from the arbiration process.

Bilateral Treaties

Australia nominated all of its existing bilateral tax treaties as being within the scope of MLI. The only exception is Australia's 2015 treaty with Germany as this treaty already includes BEPS minimum standards.

Based on other jurisdictions' known adoption positions, the MLI is likely to modify (to varying degrees) 31 of Australia's 44 bilateral tax treaties.

Nine countries decided not to sign the MLI at all. Four countries – Austria, Korea, Swden and Switzerland – decided not to nominate their DTA with Australia as a covered tax agreeemnt. So the MLI won't affect Australia's DTA with these 13 countries.

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The following DTAs are covered tax agreements: Argentina, Belgium, Canada, Chile, China, the Czech Republic, Denmark, Fiji, Finland, France, Hungary, India, Indonesia, Ireland, Italy, Japan, Malaysia, Malta, Mexico, the Netherlands, New Zealand, Norway, Poland, Romania, Russia, Singapore, the Slovak Republic, South Africa, Spain, Turkey and the United Kingdom.

The number of affected treaties could change if more of Australia's bilateral tax treaty partners sign and ratify the MLI and nominate their treaty with Australia.

The extent to which MLI will modify these treaties will depend on the final adoption positions, in relation to the MLI articles, taken by each jurisdictions.

All this is just our brief take on the issue, but please listen to the episode above. Simon Dorevitch explains all this in a much better way than we ever could.

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