

Treaties

30th Annual Institute on Current Issues in International Taxation

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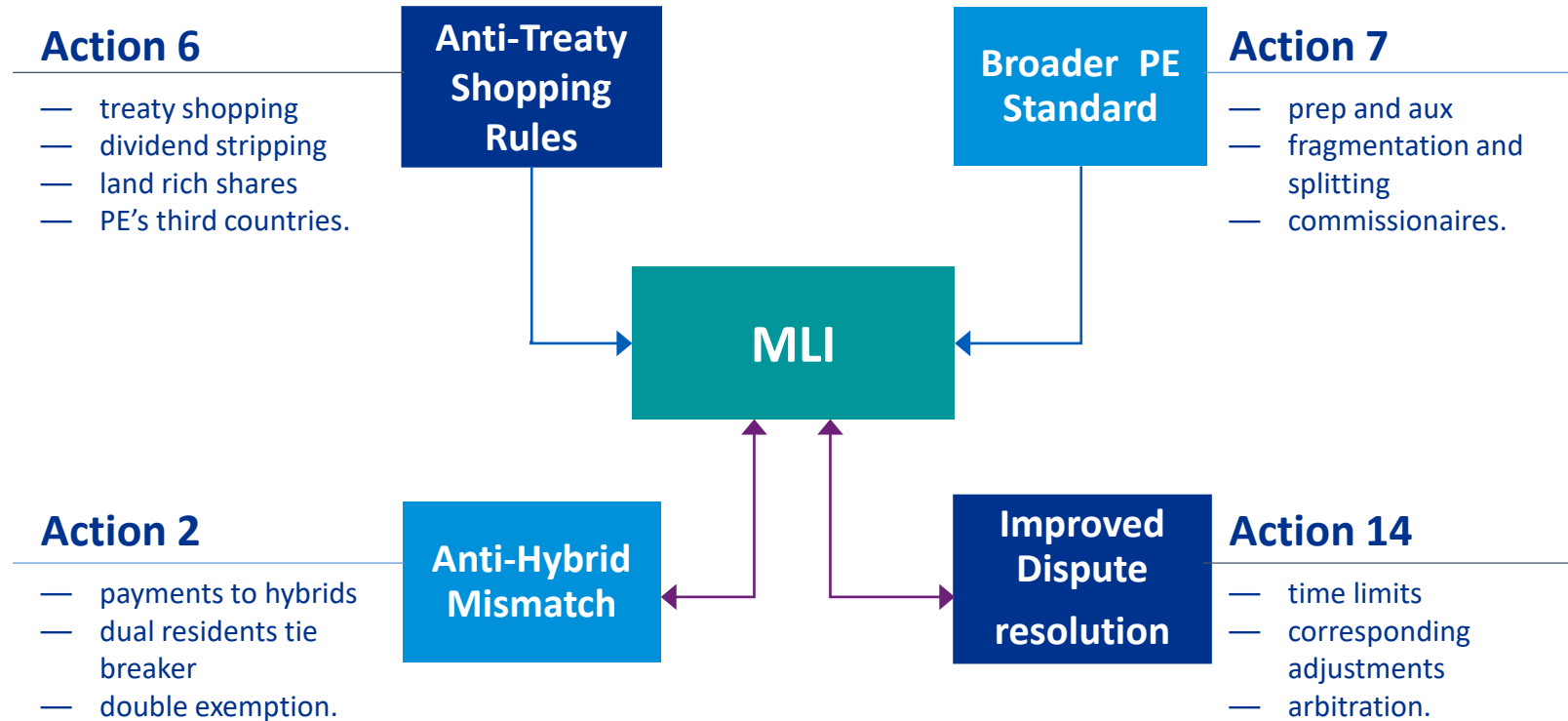
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The Multilateral Instrument: Structural and Administrative Update

Tax Reforms Implemented through MLI

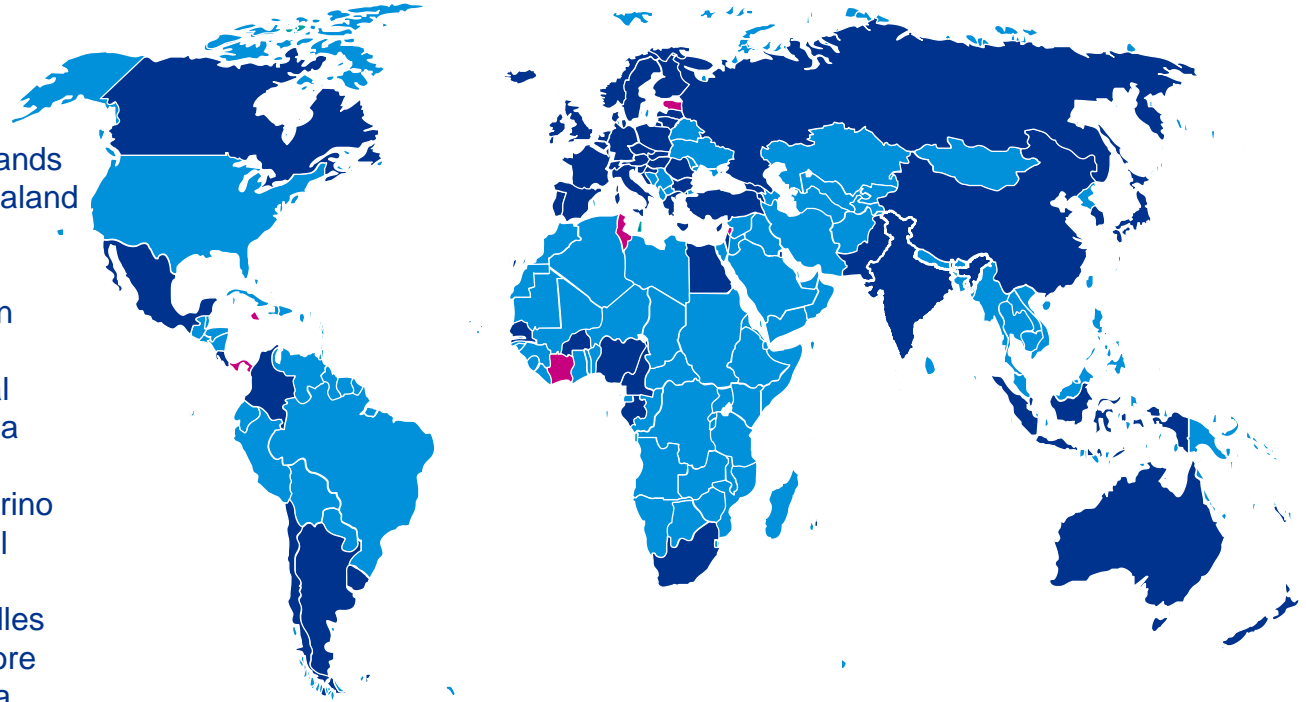


Multilateral Instrument – Signatories (as of 11/2017)

- Andorra
- Argentina
- Armenia
- Australia
- Austria
- Belgium
- Bulgaria
- Burkina Faso
- Cameroon
- Canada
- Chile
- China
- Colombia
- Costa Rica
- Croatia
- Cyprus
- Czech Republic
- Denmark
- Egypt
- Fiji
- Finland
- France
- Gabon
- Georgia
- Germany
- Greece
- Guernsey
- Hong Kong
- Hungary
- Iceland
- India
- Indonesia
- Ireland
- Isle of Man
- Israel
- Italy
- Japan
- Jersey
- Korea
- Kuwait
- Latvia
- Liechtenstein
- Lithuania
- Luxembourg
- Malta
- Mauritius
- Mexico
- Monaco
- Netherlands
- New Zealand
- Nigeria
- Norway
- Pakistan
- Poland
- Portugal
- Romania
- Russia
- San Marino
- Senegal
- Serbia
- Seychelles
- Singapore
- Slovakia
- Slovenia
- South Africa
- Spain
- Sweden
- Switzerland
- Turkey
- United Kingdom
- Uruguay

Intent to sign:

- *Cote d'Ivoire*
- *Estonia*
- *Jamaica*
- *Lebanon*
- *Panama*
- *Tunisia*



Signatories	71
Intent to Sign	6
No Development	
Ratifications Deposits	2.5

MLI Observations on key provisions

■ Minimum standard on treaty abuse

- all jurisdictions elected the PPT
- 12 signatories also chose to supplement the PPT with a simplified LOB: Argentina, Armenia, Bulgaria, Chile, Colombia, India, Indonesia, Mexico, Russia, Senegal, the Slovak Republic and Uruguay.

■ Expand PE standard

- *dependent agent PE*
 - less than half of signatories opted in including many in LATAM
 - also, France, India, Indonesia, Japan, the Netherlands, New Zealand and Spain.
- *specific activity exemptions*
 - over a third opted to require all exemptions to be prep and aux
 - a majority of signatories elected to apply the Anti-Fragmentation Rule.

MLI – Entry into force

- Grand opening signing ceremony was held on June 7, 2017 at the headquarters of the OECD in Paris
- Ministers and high-level officials from 68 countries signed the MLI at the ceremony, covering more than 2,000 treaties. Three additional countries have signed, and six more jurisdictions have expressed their intention to sign. The United States is not a signatory to the MLI nor expected to sign.
- The MLI enters into force after five countries ratify. For specific tax treaties the MLI is effective once both or all parties to that treaty have ratified. As of October 25, 2017, only Austria and the Isle of Man have ratified.



MLI structural issues: Language

- Bilateral tax treaties are executed in all official languages of the two contracting states
- Multilateral instruments are available in a small number of official languages
- Acceding countries may provide unofficial translations that could be adopted by colingual country pairs
- Issues may arise in the interpretation of how, for example, a bilateral treaty executed in Russian and Turkish is modified by a multilateral instrument published in English and French, and unofficially translated into Spanish and German

MLI structural issues: Language (cont.)

- Members of the Ad hoc Group that developed the MLI have prepared translations into German, Italian, and Spanish, and the OECD Secretariat has prepared a translation into Arabic.
- Similar translations into Dutch, Greek, Swedish, and Russian are in process, and others are expected in the near future.
- These translations are not authentic texts of the MLI and will not become authentic texts of the MLI.
- The translated texts could be used for bilateral protocols that would implement but supersede the MLI between pairs of countries.

MLI structural issues: Layering rather than amending

- The MLI cannot insert new BEPS-approved model provisions in place of pre-existing bilateral treaty text
- New provisions are layered on top of existing provisions, superseding previous provisions to the extent inconsistent
- OECD is not expected to issue pro forma amended texts of bilateral treaties in any language
- Acceding countries may produce pro forma amended texts, and may formalize them as bilateral protocols
- Tax and legal publishers can be expected to produce unofficial pro forma amended texts of bilateral treaties

MLI structural issues: Entry into effect

- MLI will enter into force the beginning on the fourth month after five countries have ratified
- MLI will affect only “covered tax agreements” as designated by each signatory country
- Generally effective between pairs of signatory countries on the later of the dates that the two countries complete their respective ratification and notification requirements
 - With respect to taxes withheld at source – first day of the next calendar year beginning after such later date.
 - With respect to all other taxes – taxable periods beginning on or after six calendar months after such later date.
- Curious lag periods compared with bilateral tax treaties

Preamble and PPT

Competing preambles

- Minimum standard under Action 6 requires all countries to include in tax treaties an express statement that the intent of tax treaties is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance
- Article 6 of MLI implements minimum standard by allowing parties to incorporate that statement into preamble of CTAs
- Parties may opt to retain existing preamble language in specified CTAs that already contain a similar statement

Competing Preambles

- The MLI is itself a tax convention with its own preamble
- The MLI preamble includes a paragraph identical to the so-called optional preamble paragraph in Article 6
 - Noting the need to ensure that existing agreements for the avoidance of double taxation on income are interpreted to eliminate double taxation with respect to the taxes covered by those agreements 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 those agreements for the indirect benefit of residents of third jurisdictions)
- Paragraph 23 of the MLI Explanatory Statement states:
 - [t]he inclusion of this statement in the preamble to the Convention is intended to clarify the intent of the Parties to ensure that Covered Tax Agreements be interpreted in line with the preamble language foreseen in Article 6(1).

New MLI Preamble Language

- MLI Preamble language goes further than we have seen in other model preambles by including the following paragraph:

“Recognising the importance of ensuring that profits are taxed where substantive economic activities generating the profits are carried out and where value is created”
- Vienna Convention provides that “[a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.”
- Is the “purpose” and “context” reflected in the MLI preamble relevant only for interpreting provisions within the MLI itself (to the extent adopted), or does it also serve as a new backdrop for interpreting all provisions of every CTA?
- Implications for PPT?

PE and Attribution of Profits

BEPS Actions 7 and 15: Revised PE threshold Countries to introduce via MLI





BEPS Action 7: PE Profit Attribution

- Latest Discussion Draft on Profit Attribution published in June, with public consultation in November.
- Key Points:
 - Clarifies that while the changes made to Article 5(5) and 5(6) of the OECD Model Tax Convention by the report on Action 7 have modified the threshold for the existence of a deemed PE under Article 5(5), they have not modified the nature of the deemed PE.
 - Any approach on how to attribute profits to a PE that is deemed to exist under the pre-BEPS version of Article 5(5) should therefore be applicable to a PE that is deemed to exist under the post-BEPS version of Article 5(5).
 - Seeks to take into account the work performed in relation to transfer pricing under BEPS Actions 8-10.
 - Four non-numerical examples, which illustrate the attribution of profits to PEs resulting from either the changed definition of a dependent agent PE or the anti-fragmentation rule.



BEPS Action 7: PE Profit Attribution

- Key themes arising from the public consultation on 7 November were:
 - The changes to Article 5 have narrowed the differences between Article 7 and Article 9, and that if BEPS 8-10 has achieved its objectives, then there should not be significant profit allocable under Article 7 (except in extreme examples)
 - Article 9 analysis should come before Article 7 analysis
 - More should be done centrally (i.e. by the OECD) on administrative simplification
- Final guidance expected in Spring 2018; may be limited in scope given lack of consensus among countries

OECD Model Treaty Developments External to MLI

Withholding procedures / TRACE

- US funds (mutual funds, pension funds, etc.) facing increasing difficulties in obtaining foreign treaty benefits – issues include:
 - Transparent vs. opaque treatment
 - Beneficial ownership questions
 - Procedures for establishing US ownership under LOB
- OECD work in 2009-2013 called for improvements in countries' withholding practices:
 - 2009 CIV report called for treaty / CA agreements on treatment of CIVs
 - 2013 TRACE (Treaty Relief and Compliance Enhancement) called for harmonized procedures

Withholding procedures / TRACE

- Basic elements of TRACE proposal:
 - Relief at source
 - Investors do self-certification (no certificates of residence)
 - Authorized intermediaries make pooled claims on behalf of investors
 - Authorized intermediaries report investor-specific information to tax authorities, followed by intergovernmental info exchange
- OECD now preparing to relaunch work on TRACE proposal:
 - FATCA and CRS implementation makes governments more comfortable with information flow from financial intermediaries, exchange of information aspects
 - Some governments' experience with fraudulent refund schemes improves willingness to use relief at source mechanism
 - OECD to work on direct investments, CIVs, other pooling vehicles

2017 OECD Model Update – Non-BEPS Changes

- 2017 update includes:
 - Article 5 Commentary changes
 - Article 4 Commentary re “permanent home”
 - Article 4 Commentary re “habitual abode”
- Work had started prior to BEPS to clarify aspects of the Commentary on pre-existing Article 5
- Discussion drafts were issued in October 2011 and October 2012, then work was suspended during BEPS
- Issues addressed include:
 - Whether premises are “at the disposal” of the taxpayer
 - Whether a place of business is “fixed”
 - Whether a home office could be a PE
 - What the PE time requirement is

Article 5 Commentary (cont'd)

- Meaning of “at the disposal of”
 - “will depend on [the] enterprise having the **effective power to use** that location as well as the extent of the presence of the enterprise at that location and the activities that it performs there.”
 - Includes situation where “an enterprise is **allowed to use** a specific location that belongs to another enterprise or that is used by a number of enterprises **and performs its business activities at that location on a continuous basis during an extended period of time**”
 - But cf: “it cannot be considered that a **plant that is owned and used exclusively by a supplier or contract-manufacturer** is at the disposal of an enterprise that will receive the goods produced at that plant merely because all these goods will be used in the business of that enterprise”

Article 5 Commentary (cont'd)

- Home office as a PE
 - Cannot automatically conclude that such a location is at the disposal of the enterprise simply because it is used by an individual (e.g. an employee) who works for the enterprise
 - “Where, however, a home office is ***used on a regular and continuous basis for carrying on business activities for an enterprise*** and it is clear from the facts and circumstances that ***the enterprise has required the individual to use that location to carry on the enterprise’s business*** (e.g. by not providing an office to an employee in circumstances where the nature of the employment clearly requires an office), the home office ***may*** be considered to be at the disposal of the enterprise.”



Article 5 Commentary (cont'd)

- Time requirement for the existence of a PE
 - Illustration of ***recurrent short visit PE***: “An enterprise of State R carries on drilling operations at a remote arctic location in State S. The seasonal conditions at that location prevent such operations from going on for more than three months each year but the operations are expected to last for 5 years.”



Article 5 Commentary (cont'd)

- Time requirement for the existence of a PE
 - Illustration of ***short duration business*** carried on exclusively in host country: one-time film location 4-month cafeteria, versus State R catering company that opens cafeteria for 4-month filming of documentary



Article 5 Commentary (cont'd)

- Presence of foreign enterprise's personnel in the host country
 - Seconded employee who becomes de facto employee of host enterprise – no PE for foreign enterprise
 - Employee sent into host country to carry on business of sending company – PE possibility
 - Analysis under Article 15 Commentary will be relevant



Article 5 Commentary (cont'd)

- Main contractor who subcontracts all aspects of a contract
 - An enterprise may carry on its business through subcontractors
 - “in the absence of employees of the enterprise, however, it will be necessary to show that such a place is at the disposal of the enterprise on the basis of ***other factors showing that the enterprise clearly has the effective power to use that site***, e.g. because the enterprise owns or has legal possession of that site and controls access to and use of the site.”
 - E.g., construction site example, where general contractor subcontracts out 100% of project but “has legal possession of the site, controls access to and use of the site and has overall responsibility for what happens at that location”



Article 5 Commentary (cont'd)

- Whether Article 5(4) activities must be of a preparatory or auxiliary nature -- 2012 discussion draft had said:
 - “Where the only activities carried on at a fixed place of business are activities to which one of subparagraphs a) to d) apply, the place is **deemed not to constitute a permanent establishment.**”
 - That view did not survive into 2017 Commentary

Article 4 Commentary re “permanent home” and “habitual abode”

- For “permanent home”, new Commentary says: *“a house owned by an individual cannot be considered to be available to that individual during a period when the house has been rented out and effectively handed over to an unrelated party so that the individual no longer has the possession of the house and the possibility to stay there”*
- For “habitual abode” concept, new Commentary says it’s: *“a notion that refers to the frequency, duration and regularity of stays that are part of the settled routine of an individual’s life and are therefore more than transient”* – doesn’t depend exclusively on length of time spent

Will Tax Treaties Survive a World of Unraveling Consensus

- US Tax Reform
- Proposals for taxation of the Digital Economy
- DPT

US Tax Reform: House/Senate Anti-Base Erosion Proposals

House Bill

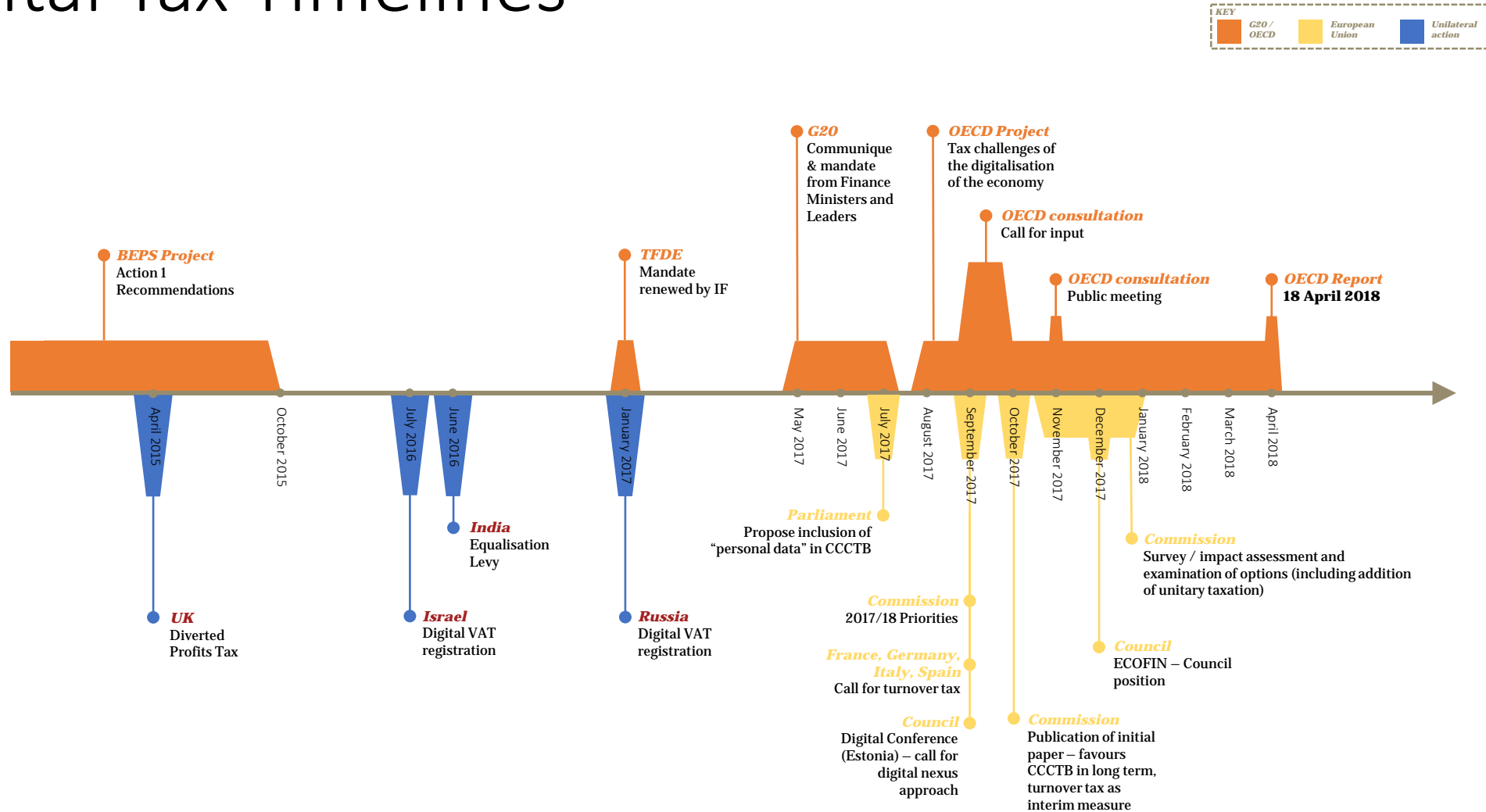
- Creates a new 20% tax on certain deductible payments made by a U.S. corporation to a related foreign corporation
- Applies to nearly all payments (includes COGS) other than interest and services charged at cost
- Tax does not apply if foreign recipient elects to treat the payment as ECI
 - ECI election is subject to special rules that determine deemed deductions based on financial statement net income ratios for the product line
- Allows a limited 80% section 906 credit
- Applies to US corporate taxpayers that are part of a group makes at least \$100,000,000 of such outbound related party payments on average per year over three years.
- Apply to amounts paid or accrued after December 31, 2018.

Senate Bill

- Like H.R. 1's tax, focus is on deductible payments made to foreign related persons (different scope and methodology)
- Compares normal tax liability to an alternative tax liability computed at 10% rate and without deductible payments to foreign related persons
- Applies to US corporate taxpayers (other than S Corps, RICs, or REITs) that are part of a group with:
at least \$500 million of gross receipts (3 yr. average) and
a "base erosion percentage" of 4% or higher for the taxable year
- Applies to payments paid or accrued in tax years beginning on or after December 31, 2017

OECD/EU Proposals to Tax the Digital Economy

Digital Tax Timelines



UK Diverted Profits Tax

Diverted profits tax

- UK DPT, in effect since April 1, 2015, can cause a non-UK company to have a “deemed” PE in the UK – e.g., applies where:
 - a. persons are carrying on activities in the UK in connection with supplies of goods, services or property by that foreign principal company to UK or overseas customers, but the foreign principal does not have a taxable presence in the UK and is therefore not subject to UK corporation tax;
 - b. it is reasonable to assume that the activity of the foreign principal, and the person(s) carrying on the activity in the UK, are designed to ensure that the principal does not have a taxable presence in the UK for UK corporation tax purposes (whether or not the arrangements are also designed to secure any other commercial or other objective); and

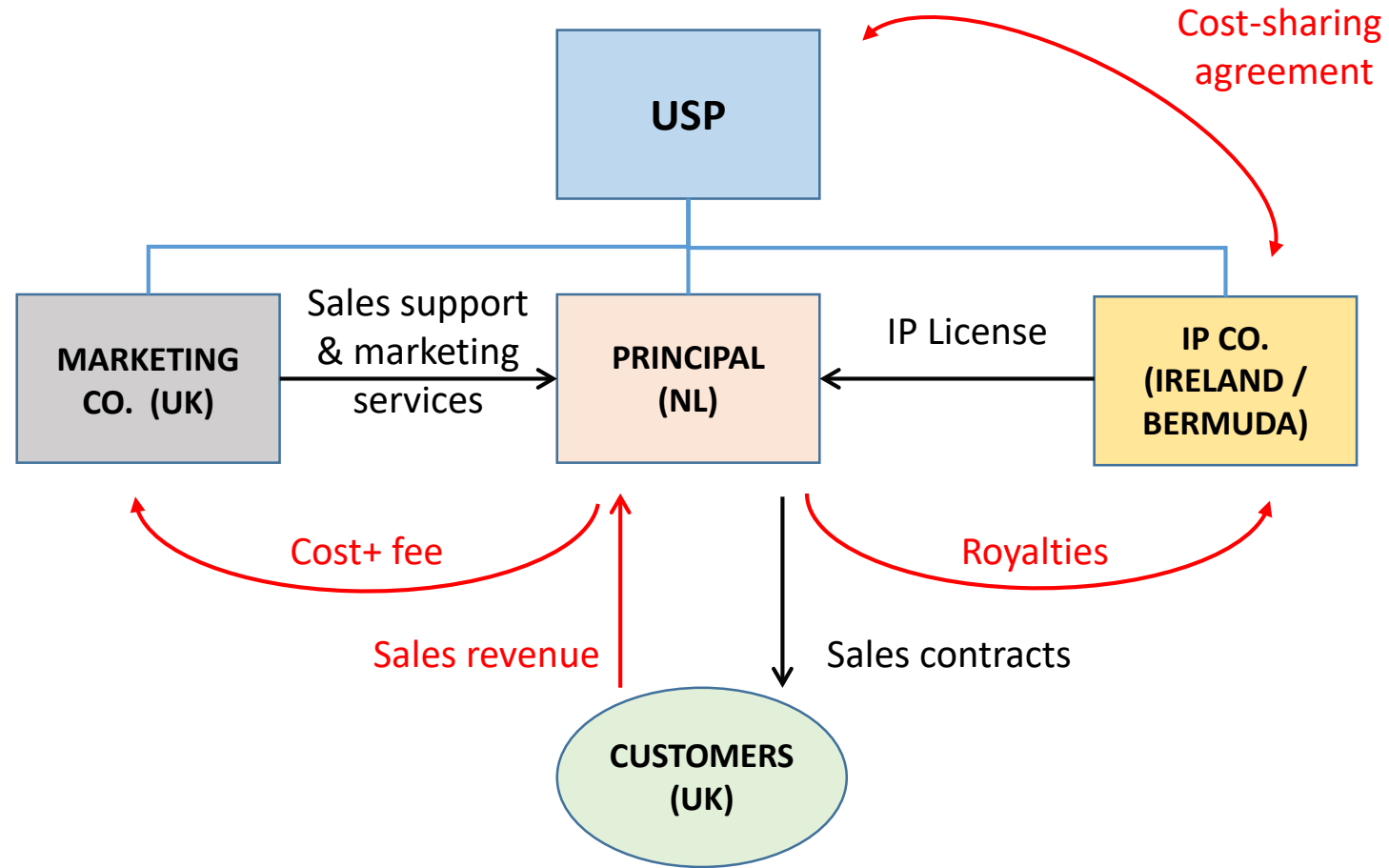
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Diverted profits tax (cont'd)

c. either:

- in connection with the supplies of goods, services or property made by the foreign principal, the principal makes payments (directly or indirectly) to an affiliate which both lacks economic substance and is subject to a lower rate of tax on that income than the foreign principal; or
 - arrangements are in place in connection with the supplies made by the foreign principal (or those and other supplies) which have a main purpose of avoiding or reducing a charge to UK corporation tax.
-
- Where DPT applies, “deemed” PE taxable (at 25%) on profits attributable to PE under AOA principles

Diverted profits tax (cont'd)



Diverted profits tax (cont'd)

- UK position:
 - DPT is not a “covered” tax under UK treaties (on theory that it’s not expressly covered and is not an “identical or substantially similar” tax)
 - DPT is an allowable targeted anti-avoidance measure
- Raises questions about:
 - Availability of PE protection
 - Availability of double tax relief
 - Availability of MAP
 - Availability of nondiscrimination protection