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BEPS Action 6: Preventing the granting of treaty benefits in inappropriate circumstances

Introduction

The OECD released a discussion draft on 14 March 2014 as part of its work on Base Erosion and Profit Shifting (BEPS). The discussion draft includes proposals for Action 6 (Prevent Treaty Abuse) of the BEPS Action Plan. The Action Plan identifies treaty abuse, and in particular treaty shopping, as one of the most important sources of BEPS concern.

The draft proposals set out in the document do not represent the consensus views of either the Committee of Fiscal Affairs or its subsidiary bodies, but are intended to provide stakeholders with substantive proposals for comment.

Proposals

(A) Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances

Limitation on benefits clause: A specific anti-abuse rule is proposed based on the limitation on benefits provision already included in many US treaties. The rule is designed to limit treaty benefits to companies (and individuals, not for profits, pension funds and government bodies) with sufficient presence in the relevant country. The rule operates based on the legal nature, ownership in, and general activities of, residents of a treaty country. One of the matters discussed is whether the rule should include a "derivative benefits" clause to allow a treaty country to look through to the shareholders where they would also be entitled to benefits under a treaty.

Purpose rule: In addition to the limitation on benefits clause, the Discussion Draft proposes a broadly drafted general purpose rule aimed at removing treaty benefits from income where one of the main purposes of the arrangements or transaction was to obtain treaty benefits.

Determining treaty residence: The Discussion Draft proposes removing the place of effective management tie-breaker clause for determining treaty residence (where different domestic rules would treat an entity as resident in two countries). This will be replaced by a requirement that the competent authorities of the two countries endeavour to determine residence, by reference to place of effective management, place of incorporation/constitution and any other relevant factors.

Minimum shareholding period re dividends: It is proposed that the reduced rates of withholding tax applicable to non-portfolio dividends are restricted to shareholdings that are owned throughout a period of months that includes the dividend payment. Comments are sought on what the number of months should be.

Withholding taxes on payments to permanent establishments (PE): A new clause is proposed to restrict relief from withholding taxes on payments to a third country PE, to apply where the combined rate of tax paid by the recipient in the PE and residence countries is less than 60% of the tax rate of the residence country.

(B) Clarification that tax treaties are not intended to be used to generate double non-taxation

The title and preamble to the OECD Model Tax Convention will be amended to clarify that the prevention of tax evasion and avoidance, specifically including but not limited to treaty shopping, is a purpose of tax treaties; countries that enter into a treaty intend to eliminate double taxation without creating opportunities for tax avoidance and evasion. This title and preamble will be relevant to the treaty's interpretation.

(C) Tax policy considerations that countries should consider before deciding to enter into a tax treaty with another country

It is proposed that the model tax treaty include key points for countries to consider in relation to the conclusion, modification (or termination) of a tax treaty. The avoidance of double taxation remains a main objective of tax treaties in order to reduce tax obstacles to cross-border services, trade and investment. However, other considerations include the ability to eliminate double taxation domestically, increased risk of non-taxation, excessive taxation from high withholding tax rates, increased certainty and cross-border dispute resolution for taxpayers and the ability of prospective treaty partners to provide assistance in the collection of taxes and exchange of information.

Timetable and Next Steps

Comments are requested by 9 April 2014 given the extremely tight timetable for the BEPS project. A public consultation event was held in Paris on 14/15 April 2014 before the proposals are finalised in September 2014. Adoption of the final proposals will need to await the multilateral convention (Action 15 – due December 2015), as individual negotiation will be time-consuming.

Deloitte Comments

One of the concerns with the proposals, which are wide-ranging, is the degree of uncertainty that will exist in applying a purpose test. It will also likely be difficult to apply, such a test, on a consistent basis. This uncertainty will create practical issues for businesses seeking to understand whether the benefits of a treaty will apply to their transactions.

Tax Analysis is published for the clients and professionals of the Hong Kong and Chinese Mainland offices of Deloitte China. The contents are of a general nature only. Readers are advised to consult their tax advisors before acting on any information contained in this newsletter. For more information or advice on the above subject or analysis of other tax issues, please contact:

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