DANON & SALOMÉ

Publication on the BEPS Multilateral Instrument

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Prof. Robert J. Danon and Mr. Hugues Salomé published a scientific contribution on "The BEPS Multilateral Instrument – General overview and focus on treaty abuse", in IFF Forum für Steuerrecht, 2017/3, pp. 197-247.

This study explores in details the practical impact of the so-called Principal Purpose Test (PPT rule) with which MNE groups will have to comply to claim tax treaty benefits. From a more global perspective, the contribution also contains an analysis of the positions taken by the 71 signing jurisdictions to the MLI. In that context, it identifies possible areas of disputes at the global level and addresses future challenges such as, for instance, the revised permanent establishment threshold under BEPS Action 7 and the controversial issue of profit attribution currently still pending at the OECD level.

I. Summary

7 June 2017 witnessed an historical turning point in the area of international taxation with the signature of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI). The signing ceremony brought together 68 jurisdictions (including Switzerland) which agreed to introduce the tax treaty measures of the OECD/G20 Base Erosion and Profit Shifting initiative (BEPS) into their international tax policy.

Our contribution looks first of all at the nature, functioning and effect of the MLI which is designed to apply alongside existing bilateral tax treaties. We then focus on treaty abuse and more specifically on the Principal Purpose Test (PPT rule) which the instrument aims at introducing as a minimum standard pursuant to BEPS Action 6.

We conclude that states may not give to the PPT rule an interpretation that exceeds its proposed commentaries which represent binding context under the Vienna Convention on the Law of Treaties. Accordingly, the PPT rule should in essence be construed as a business reality test which applies to both abusive restructurings and conduit situations. We show that when the PPT rule is applicable a jurisdiction is not prevented from granting treaty benefits on the basis of a re-characterized fact pattern (i.e. for example treaty benefits available before a restructuring) even if such jurisdiction has not opted for the right not to include the discretionary relief mechanism provided by art. 7 (4) MLI. Further, we find that despite the language "Notwithstanding any provisions of a Covered Tax Agreement", the PPT rule may only come into play to the extent that the relevant factual situation is not covered by a specific treaty anti-avoidance rule (SAAR).

Finally, it is remarkable that BEPS Action 6 addresses conduit structures exclusively on the basis of the PPT rule (or an anti-conduit mechanism producing similar results) and makes no reference to the beneficial ownership concept in art. 10-12 OECD MC. In our opinion, this is yet another confirmation that beneficial ownership is not an appropriate test to deal with conduit situations and should be construed restrictively pursuant to the 2014 OECD Commentary.

For this reason, we argue that the broad and substance oriented interpretation favored by the Swiss Federal Tribunal since the famous Total Return Swap Case decided in 2015 should be revisited and fully aligned with the 2014 OECD Commentary and possible conduit situations assessed pursuant to the PPT rule. The Swiss case law, which does not take into consideration the intention of the taxpayer and focuses primarily on the criterion of economic interdependence, does not fully coincide with the analysis under the PPT rule. The PPT rule will indeed not simply apply because there is some sort of interdependence but rather because the purpose of the transaction is abusive. Hence, for example, the PPT rule will not apply, where despite the existence of an interdependence, the transaction is conforming to the standard commercial organization and behavior of the group.

II. Take away

From a policy perspective, it is unfortunate that the PPT rule is drafted in broad terms as its meaning becomes potentially very far reaching as soon as it is detached from its proposed commentaries. This may indeed lead to uncertainties and increased tax treaty disputes around the globe. We show however that the PPT rule is merely a business reality test which should not affect genuine transactions. We believe that our arguments will be useful to taxpayers in the framework of audits and disputes concerning tax treaty benefits and to national policy makers as well.

Overall, the MLI entails the need for MNE groups to review their business models and to ensure that the approach taken by the countries in which they operate coincides indeed with the OECD interpretation.

This study reflects the practice and involvement of our Firm in the implementation of the BEPS project around the globe. We may also act alongside local advisers in foreign jurisdictions to provide expert opinions on BEPS related matters and, more broadly, on international tax law issues.

The table of content may be consulted and the contribution ordered online.

III. Prior coverage of the Firm on the MLI

News Alert of 14 June 2017

Summary table of the position taken by the 71 signing jurisdictions (updated 17 August 2017)

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