

## OECD releases second annual peer review report on BEPS Action 6 relating to prevention of treaty abuse

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### Executive Summary

On 24 March 2020, the Organisation for Economic Co-operation and Development (OECD) released the second peer review report (the [Report](#)) relating to the compliance by members of the Inclusive Framework on Base Erosion and Profit Shifting (BEPS) with the minimum standard on BEPS Action 6 for prevention of treaty abuse. The Report includes information available as of 30 June 2019 (the cut-off date) and covers 129 jurisdictions<sup>1</sup> that were members of the Inclusive Framework by the cut-off date.

Overall, the Report concludes that the majority of the Inclusive Framework members have begun to translate their commitment to prevent treaty shopping into actions and are now in the process of modifying their treaty networks. According to the Report, the peer review results show the efficiency of the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS* (MLI) in implementing the treaty-related BEPS measures. The Report also notes that the MLI is by far the preferred tool of the Inclusive Framework members for implementing the BEPS Action 6 minimum standard. By the cut-off date, 91 jurisdictions had some double tax agreements that either were already compliant with the minimum standard or were subject to a complying instrument (i.e., the MLI or a protocol/treaty). Once the complying instrument takes effect, the agreements that are subject to it will come into compliance with the minimum standard.

The minimum standard on treaty shopping requires jurisdictions to include two components in their tax agreements: (i) an express statement that their common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance; and (ii) one of three methods to address treaty shopping. The Report indicates that, of the three alternative methods, the vast majority of the jurisdictions have chosen to implement a Principal Purpose Test (PPT).

## Detailed discussion

### Background

In October 2015, the OECD released the final reports on all 15 focus areas of the BEPS Action Plan.<sup>2</sup> The recommendations made in the reports range from new minimum standards to reinforced international standards, common approaches to facilitate the convergence of national practices, and guidance on best practices. The Action 6 report, titled *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances*, contained model tax treaty provisions and related changes to the model commentary to address the inappropriate granting of treaty benefits and other potential treaty abuse scenarios.<sup>3</sup>

Minimum standards are the BEPS recommendations that all members of the Inclusive Framework have committed to implement, and they refer to some of the elements contained in: Action 5 on harmful tax practices, Action 6 on treaty abuse, Action 13 on transfer pricing documentation and Country-by-Country reporting and Action 14 on dispute resolution. The minimum standards are all subject to a peer review process. The mechanics of the peer review process were not included as part of the final reports on these Actions. Instead, the OECD indicated at the time of the release of the BEPS reports that it would, at a later stage, issue peer review documents on these Actions providing the terms of reference and the methodology by which the peer reviews would be conducted.

On 29 May 2017, the OECD released the peer review documents, (the Terms of Reference and Assessment Methodology (the Methodology)) for BEPS Action 6.<sup>4</sup> The Terms of Reference reiterate that to be in compliance with the minimum standard on treaty shopping, jurisdictions are required to include in their tax treaties: (i) an express statement that the common intention of the parties to the treaty is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty-shopping

arrangements; and (ii) an anti-abuse provision in the terms specified in paragraphs 22 and 23 of the Action 6 final report. Jurisdictions can meet the minimum standard either by renegotiating their bilateral tax treaties and protocols or through the MLI.<sup>5</sup> Partially compliant agreements – agreements that contain only one element of the minimum standard – are shown as non-compliant.

The Inclusive Framework plans to evaluate the agreed methodology for the peer review of the implementation of the minimum standard on treaty shopping in 2020 based on the experience in conducting reviews in 2018 and 2019. That evaluation will be focused on the peer review methodology and not on the minimum standard of Action 6 itself.

The first peer review was conducted in 2018 and covered the 116 jurisdictions that were members of the Inclusive Framework on 30 June 2018. The report on that review was adopted by the Inclusive Framework in January 2019 and was published on 14 February 2019.<sup>6</sup> During the course of the first peer review, all concerns raised by jurisdictions on the implementation of the minimum standard in their agreements had been resolved when the report was approved by the Inclusive Framework and therefore no recommendations came out of the first peer review.

### Second Action 6 peer review report

On 24 March 2020, the OECD released the second peer review report on BEPS Action 6 prevention of treaty abuse. The Report is divided into the following sections:

1. Executive summary
2. Background
3. The 2019 peer review
4. Difficulties in implementing the minimum standard
5. Conclusions and next steps

The Report also contains annexes with background information and data for each of the assessed jurisdictions. Each jurisdictional section contains information on the progress made by the jurisdiction in the implementation of the minimum standard, any implementation issues that may have been reported, and a summary table of the jurisdiction's response to the peer review questionnaire.

The Report reiterates that the BEPS Action 6 final report states that: (i) a jurisdiction is required to implement the minimum standard in a treaty only if asked to do so by another member of the Inclusive Framework; (ii) the decision on which of the three methods to adopt has to be agreed

by the two jurisdictions (because a particular method cannot be forced upon a jurisdiction); and (iii) reflecting treaties' bilateral nature, there is no time limit within which a jurisdiction must attain the minimum standard.

## Main findings

According to the Report, the 129 jurisdictions in the Inclusive Framework reported a total of 2,145 agreements between Inclusive Framework members, and about 1,020 agreements between Inclusive Framework members and non-members. Out of the 129 assessed jurisdictions and as of the cut-off date:

- ▶ 91 Inclusive Framework members had begun to update their bilateral treaty network and were implementing the minimum standard.
- ▶ An additional seven jurisdictions, namely Angola, the Bahamas, the Cayman Islands, the Cook Islands, Djibouti, Haiti and Turks and Caicos Islands, had no comprehensive tax agreements in force subject to the peer review.
- ▶ Six jurisdictions, namely Bahrain, Jordan, Lebanon, North Macedonia, Thailand and Vietnam, had expressed their intention to sign the MLI in the future.
- ▶ Thirty-one jurisdictions had not signed any complying instruments (i.e., the MLI or a protocol/treaty) to implement the minimum standard.

For a new tax agreement or an amending protocol to be considered compliant with the minimum standard, it should be in force by the cut-off date. Where the minimum standard has been implemented through the MLI, the relevant provisions of the MLI must have started to take effect as of 30 June 2019 for the agreement to meet the minimum standard. According to the Report, as of 30 June 2019, 86 bilateral agreements between members of the Inclusive Framework complied with the minimum standard. An additional 14 agreements not subject to this review (i.e., agreements between Inclusive Framework members and non-members) also complied with the minimum standard. In each of the 86 agreements between Inclusive Framework members that already comply with the minimum standard, the minimum standard has been implemented through the inclusion of the preamble statement and the PPT. Of these 86 agreements, 17 agreements supplement the PPT with a simplified limitation on benefits (LOB) provision.

As of the cut-off date, about 1,330 of the 2,145 bilateral agreements between Inclusive Framework members were set to become covered tax agreements under the MLI

(i.e., because both Contracting Jurisdictions had listed the agreement under the MLI and, as a result, the MLI will modify the agreement once in effect) and were thereby set to become compliant with the minimum standard. The agreements that will be modified by the MLI will comply with the minimum standard once its provisions take effect. Around another 430 of these 2,145 bilateral agreements could be modified by the MLI in the future. This is because these agreements have been listed under the MLI by only one of the treaty partners and are waiting for a match. These include 175 "waiting" agreements between Inclusive Framework members that have signed the MLI and those that have not yet signed it. As things stand, the MLI will modify around 65% of all agreements between Inclusive Framework members. The Report indicates that six additional jurisdictions have expressed interest in signing the MLI and, if they do so and list all their agreements, that figure could be as high as 85%. By 30 June 2019, the MLI had already modified around 60 bilateral agreements.

According to the agreed methodology, a jurisdiction that encounters difficulties in reaching agreement with another jurisdiction to implement the Action 6 minimum standard has the opportunity to raise its concerns in writing to the Secretariat.<sup>7</sup> In the course of the 2019 peer review, one jurisdiction raised a concern with respect to the CARICOM Agreement, which is a multilateral agreement concluded in 1994 by 11 jurisdictions,<sup>8</sup> 10 of which are members of the Inclusive Framework. Previous renegotiation attempts with respect to the CARICOM Agreement have proven to be difficult due to the fact that it contains several unusual features that are not found in the OECD Model Tax Convention or the United Nations Model Double Taxation Convention, which could lead to treaty-shopping practices. However, the Report notes that because most members of the CARICOM agreement are also members of the Inclusive Framework and have committed to implement the BEPS minimum standards, this is an opportune time to modernize the CARICOM Agreement.

## Selected<sup>9</sup> peer review country reports

- ▶ **Australia:** Australia has 44 tax agreements in force, as reported in its response to the peer review questionnaire. Seven of those agreements comply with the minimum standard. Australia is implementing the minimum standard through the inclusion of the preamble statement and the PPT. Australia signed the MLI in 2017.

- ▶ **Japan:** Japan has 71 tax agreements in force, as reported in its response to the peer review questionnaire. Eighteen of those agreements comply with the minimum standard. Japan is implementing the minimum standard through the inclusion of the preamble statement and the PPT for five of its compliant agreements and is implementing the minimum standard through the inclusion of the preamble statement and the PPT combined with the LOB for the rest of its compliant agreements. Japan signed the MLI in 2017 and signed a bilateral complying instrument with respect to its agreement with Spain.
- ▶ **Luxembourg:** Luxembourg has 82 tax agreements in force, as reported in its response to the peer review questionnaire. Two of those agreements comply with the minimum standard. Luxembourg is implementing the minimum standard through the inclusion of the preamble statement and the PPT. Luxembourg signed the MLI in 2017.
- ▶ **Netherlands:** The Netherlands has 95 tax agreements in force, as reported in its response to the peer review questionnaire. Three of those agreements comply with the minimum standard. The Netherlands is implementing the minimum standard through the inclusion of the preamble statement and the PPT. The Netherlands signed the MLI in 2017 and signed a bilateral complying instrument with respect to five of its agreements (Algeria, Denmark, Ghana, Ukraine and Uzbekistan). The Netherlands also indicated that bilateral negotiations would be used with respect to its agreements with Belgium, Brazil, Bulgaria, Ireland, Poland, and Spain.
- ▶ **Singapore:** Singapore has 86 tax agreements in force, as reported in its response to the peer review questionnaire. None of those agreements comply with the minimum standard. Singapore is implementing the minimum standard in its tax agreements through the inclusion of the preamble statement and the PPT. Singapore signed the MLI in 2017.
- ▶ **Switzerland:** Switzerland has 106 tax agreements in force, as reported in its response to the peer review questionnaire. Three of those agreements comply with the minimum standard. Switzerland is implementing the minimum standard through the inclusion of the preamble statement and the PPT. Switzerland signed the MLI in 2017 and also signed a bilateral complying instrument with respect to its agreements with Iran, Ireland, Korea, the Netherlands, Norway, Sweden, Ukraine and the United Kingdom. Switzerland further indicated in its response to

the peer review questionnaire that it has entered or intends to enter into bilateral negotiations with more than 45 of its treaty partners.

- ▶ **United Kingdom (UK):** The UK has 129 tax agreements in force, as reported in its response to the peer review questionnaire. 16 of those agreements comply with the minimum standard. The UK is implementing the minimum standard through the inclusion of the preamble statement and the PPT. The UK signed the MLI in 2017 and signed bilateral complying instruments with Israel, Switzerland and Ukraine. The UK also indicated that bilateral negotiations would be used with respect to its agreement with Germany.
- ▶ **United States (US):** The US has 66 tax agreements in force, as reported in its response to the peer review questionnaire. The US has implemented LOB clauses in most of its agreements. The US expects to comply with the minimum standard through a detailed LOB which is not available through the MLI. Therefore, the US did not sign the MLI and will implement the minimum standard bilaterally.

## Next steps

The progress of the assessed jurisdictions will be reflected in peer review reports for the subsequent year. The next peer review exercise will be launched in the first half of 2020 and will also include the review of the new members of the Inclusive Framework.

The methodology used to conduct the review for subsequent years after 2020 will be evaluated in 2020.

## Implications

The purpose of the peer reviews is to ensure the effective implementation of the agreed minimum standard on BEPS Action 6. However, the commitment to the minimum standard of BEPS Action 6 should not be interpreted as a commitment to conclude new treaties or amend existing treaties within a specific period of time. The peer review process will likely result in more countries renegotiating their tax treaties bilaterally and/or signing the MLI to meet the minimum standard.

The two BEPS minimum standards on treaties are: (i) provisions dealing with treaty shopping (BEPS Action 6); and (ii) more effective dispute resolution mechanisms through the Mutual Agreement Procedure (MAP) (BEPS Action 14).

Some treaty changes to implement the minimum standard under BEPS Action 6 will be effective in 2020 and thus any conflicts that may occur from these treaty changes will have to be resolved through MAP. As of 24 March 2020, 94 jurisdictions have signed the MLI, 43 jurisdictions have deposited the instrument of ratification<sup>10</sup> and the MLI has entered into effect for around 290 covered tax agreements. The two key impacts are:

i. Structures developed before the widespread introduction of substantive anti-treaty-shopping measures should be reevaluated in light of the new developments in order to determine continued qualification for treaty benefits.

ii. Many multinational enterprises have favored domestic dispute resolution processes for international tax matters because of the absence and/or unenforceability of effective bilateral MAP processes. As a consequence of BEPS Action 6 in the context of treaty-protected trade, MAP can be expected to improve, shifting the balance in controversy management from unilateral single-country approaches towards bilateral approaches such as MAP and/or arbitration.

Businesses may want to review their structures and should continue to monitor tax treaty developments with respect to BEPS Action 6 and the MLI.

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## Endnotes

1. Andorra, Anguilla, Antigua and Barbuda, Argentina, Armenia, Aruba, Australia, Austria, Bahrain, Barbados, Belgium, Belize, Benin, Bermuda, Botswana, Brazil, British Virgin Islands, Brunei Darussalam, Bulgaria, Burkina Faso, Cabo Verde, Cameroon, Canada, Chile, China, Colombia, Congo, Costa Rica, Cote d'Ivoire, Croatia, Curacao, Czech Republic, Democratic Republic of the Congo, Denmark, Dominica, Dominican Republic, Egypt, Estonia, Faroe Islands, Finland, France, Gabon, Georgia, Germany, Greece, Greenland, Grenada, Guernsey, Hong Kong (China), Hungary, Iceland, India, Indonesia, Ireland, Isle of Man, Israel, Italy, Jamaica, Japan, Jersey, Kazakhstan, Kenya, Korea, Latvia, Liberia, Liechtenstein, Lithuania, Luxembourg, Macau (China), Malaysia, Maldives, Malta, Mauritius, Mexico, Monaco, Mongolia, Montserrat, Morocco, Netherlands, New Zealand, Nigeria, The Republic of North Macedonia, Norway, Oman, Pakistan, Panama, Papua New Guinea, Paraguay, Peru, Poland, Portugal, Qatar, Romania, Russian Federation, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, San Marino, Saudi Arabia, Senegal, Serbia, Seychelles, Sierra Leone, Singapore, Slovak Republic, Slovenia, South Africa, Spain, Sri Lanka, Sweden, Switzerland, Thailand, Trinidad and Tobago, Tunisia, Turkey, Ukraine, United Arab Emirates, United Kingdom, United States, Uruguay, Vietnam, Zambia.
2. See EY Global Tax Alert, [OECD releases final reports on BEPS Action Plan](#), dated 6 October 2015.
3. See EY Global Tax Alert, [OECD releases final report under BEPS Action 6 on preventing treaty abuse](#), dated 20 October 2015.
4. See EY Global Tax Alert, [OECD releases peer review document on BEPS Action 6 on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances](#), dated 30 May 2017.
5. See EY Global Tax Alert, [OECD releases multilateral instrument to implement treaty related BEPS measures on hybrid mismatch arrangements, treaty abuse, permanent establishment status and dispute resolution](#), dated 2 December 2016 and EY Global Tax Alert, [Mandatory Binding Treaty Arbitration under OECD's Multilateral Instrument](#), dated 2 December 2016.
6. See EY Global Tax Alert, [OECD releases first annual peer review report on BEPS Action 6](#), dated 15 February 2019.
7. The OECD Secretariat carries out the work of the OECD and it is led by the Secretary-General and composed of directorates and divisions that work with policy makers and shapers in each country.
8. Antigua and Barbuda, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, and Trinidad and Tobago. All members of the Inclusive Framework except for Guyana.
9. The selection is random among peer reviewed jurisdictions from different geographies and both signatories not signatories of the MLI.
10. The full list of the signatories and parties to the MLI can be accessed at the [OECD website](#).

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