

OECD releases first annual peer review report on BEPS Action 6

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Executive summary

On 14 February 2019, the Organisation for Economic Co-operation and Development (OECD) released the first peer review report (the [report](#)) relating to the compliance by members of the Inclusive Framework on Base Erosion and Profit Shifting (IF on BEPS) to the minimum standard on BEPS Action 6 for prevention of treaty abuse. The report covers 116 jurisdictions and information available as of 30 June 2018 (cut-off date).

Overall, the report concludes that a large majority of the IF on BEPS members have begun to translate their commitment on treaty shopping into actions and are now in the process of modifying their treaty network. According to the report, the peer review shows the efficiency of the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS* (MLI) in implementing the treaty-related BEPS measures, and it is by far the preferred tool of the IF on BEPS members for implementing the minimum standard. By the cut-off date, 82 jurisdictions had some agreements that were already compliant with the minimum standard or were subject to a complying instrument. Once the complying instrument (i.e., the MLI or a protocol/treaty) takes effect, the agreements will come into compliance with the minimum standard.

The minimum standard on treaty shopping requires jurisdictions to include two components in their tax agreements: 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 one of three methods of addressing treaty shopping. Of the three 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.¹ 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.²

Minimum standards are the BEPS recommendations that all members of the IF on BEPS have committed to implement, and 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 6.³ The terms of reference reiterated 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.⁴

According to the Methodology, the review would be carried out by the OECD's Working Party 1 (WP1) and all jurisdictions that are members of the IF on BEPS would participate in that work on an equal footing. The process would begin in 2018 and the first step of the review would consist in completing an overview of existing treaties by each jurisdiction of the IF on BEPS before 30 June 2018. Each member of the IF on BEPS shall list the tax treaties that it has signed, separating those signed with other members of the IF on BEPS from those signed with non-members. Further, they should indicate which of those treaties meet the minimum standard, the date of signature of the complying instrument (i.e., MLI or protocol/treaty) and whether the complying instrument has entered into force and effect. The OECD then would analyze the lists prepared by all jurisdictions to reconcile divergent information that could be provided by the parties to the same treaty, and lastly the WP1 would review a consolidated version of the list.

Any jurisdiction could raise questions related to the implementation of the minimum standard that have not been previously addressed by the OECD or the IF on BEPS. Questions are to be submitted before 31 August of the year preceding the presentation of the report (e.g., by 31 August 2018 for the first peer review report).

Further, the Methodology also addressed the issue of countries facing difficulties in getting agreement from another country to amend an existing treaty in order to implement the minimum standard. In that respect, the document clarified that given that the application of the minimum standard to an existing bilateral treaty would involve two jurisdictions, it is important to distinguish cases where jurisdictions do not agree to modify a treaty in order to implement the minimum standard from cases where:

- (a) A jurisdiction does not agree on the anti-treaty shopping provision to be included in a treaty (i.e., detailed Limitation on Benefits (LOB) and anti-conduit mechanism, Principal Purpose Test (PPT) only or LOB plus PPT).
- (b) A jurisdiction does not agree to enter into a new treaty with a jurisdiction.

- (c) A jurisdiction agrees to amend an existing treaty to incorporate the minimum standard but is unable to ensure a quick conclusion and ratification of the necessary protocol.

The three cases listed above would not be considered a case where a jurisdiction is not willing to implement the minimum standard.

The Methodology will be used for the reviews that will take place in the subsequent years and will be reviewed in 2020 in light of the experience in conducting that review.

First Action 6 peer review report

On 14 February 2019, the OECD released the first peer review report on BEPS Action 6 prevention of treaty abuse. The report is divided into four chapters:

1. Context of the Action 6 Minimum Standard
2. Conducting the Action 6 Peer Review on Treaty Shopping
3. Aggregate results of the Peer Review
4. Conclusions and next steps

The report also contains an annex with data for each of the assessed jurisdictions. Each jurisdictional section contains information on the progress made 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.

Main findings

According to the report, as of the cut-off date almost none of the reported agreements had met the minimum standard; mainly because the MLI entered into force only on 1 July 2018. However, the report shows that a large majority of IF on BEPS members have begun to translate their commitment to preventing treaty shopping into actions and are now in the process of modifying their treaty network.

Around 1,940 agreements are in place between members of the IF on BEPS and over 1,150 additional agreements exist between IF on BEPS members and non-members. In addition to the 1,940 bilateral agreements, 5 multilateral tax agreements were also reported.⁵ Out of the 116 assessed jurisdictions and as of the cut-off date:

- ▶ 82 jurisdictions of the IF on BEPS had some agreements that already complied with the minimum standard or were subject to a complying instrument. Once the complying instrument (i.e., the MLI or a protocol/treaty) takes effect, the agreements will come into compliance with the minimum standard.

- ▶ 7 jurisdictions (Angola, Bahamas, Cayman Islands, Djibouti, Haiti, Maldives, Turks and Caicos Islands) did not have comprehensive tax agreements in force subject to the peer review.

- ▶ 27 jurisdictions had not yet signed any complying instruments to implement the minimum standard.

Moreover, the report mentions that on the cut-off date 13 bilateral agreements, subject to the peer review, already complied with the minimum standard. In all of these 13 agreements, the minimum standard is met through the inclusion of the new preamble language and a PPT, and 5 of these agreements supplement the PPT with a LOB clause. About 1,260 of the 1,940 bilateral agreements between the IF on BEPS members would be covered tax agreements under the MLI (i.e. both Contracting Jurisdictions listed the agreement under the MLI). The agreements that will be modified by the MLI will comply with the minimum standard once its provisions take effect. As things stand, the MLI is expected to modify around 65% of all agreements between the IF on BEPS members. Some 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 90%, as per the report.

Next steps

The progress of the jurisdictions assessed will be reflected in peer review reports for subsequent years. The next peer review exercise will be launched in the first half of 2019 and it will also include the review of the new members of the IF on BEPS. The methodology used to conduct the review will be reviewed in 2020.

According to the report, the ultimate aim of the BEPS work on Action 6 is not simply to see anti-treaty shopping provisions inserted into tax treaties but to put an end to treaty shopping itself. In this respect, the report mentions the work on Action 11 will help in the monitoring of the impact of the implementation of the minimum standard on treaty shopping and in the interpretation of the aggregate and jurisdictional data in future peer review reports.

Implications

The purpose of the peer reviews is to ensure the effective implementation of the agreed minimum standard on BEPS Action 6 although 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 bilaterally their tax treaties and/or signing the MLI to meet the minimum standard.

Most treaty changes to implement the minimum standard under BEPS Action 6 will be effective from 2020 and any conflicts that may occur from these treaty changes will have to be resolved through Mutual Agreement Procedures (MAPs). The two key impacts are:

- (i) Many structures developed before the introduction of widespread substantive anti-treaty-shopping measures will no longer qualify for treaty benefits so that additional taxation will arise and/or common trading and investment structures will need to change.
- (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 become more widespread and more enforceable shifting the balance in controversy management from unilateral single-country approaches towards bilateral approaches such as MAP and/or arbitration.

Businesses should continue to monitor tax treaty developments with respect to BEPS Action 6 and the MLI. We believe that 2019 is a key year for impact assessments related to BEPS Action 6 and the MLI because restructuring to best access treaty benefits following the BEPS Action 6 changes is likely to be a 6-12 month exercise.

Endnotes

1. See EY Global Tax Alert, [OECD releases final reports on BEPS Action Plan](#), dated 6 October 2015.
2. See EY Global Tax Alert, [OECD releases final report under BEPS Action 6 on preventing treaty abuse](#), dated 20 October 2015.
3. 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.
4. 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.
5. Namely, (i) the Arab Maghreb Union Income Agreement; (ii) the agreement among the members of the CARICOM; (iii) the Regulation 08/2008/COM adopting the rules for the avoidance of double taxation within the West African Economic and Monetary Union and the rule for assistance in tax matters; (iv) the Decision 578 of the Andean Community Commission which establishes a regime for the avoidance of double taxation and the prevention of fiscal evasion; and (v) the Nordic Convention.

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