**ADDRESSING BASE EROSION AND PROFIT SHITTING IN SOUTH AFRICA**
**DAVIS TAX COMMITTEE INTERIM REPORT**

**ACTION 15: DEVELOP A MULTINATIONAL INSTRUMENT**

## 1 BACKGROUND

The OECD 2013 report on Base Erosion and Profit Shifting (BEPS)[1] notes that there is a need to consider innovative ways to implement the measures resulting from the work on the BEPS Action Plan.[2] The delivery of the actions included in the BEPS Action Plan will result in a number of outputs. Some actions will result in:

- Recommendations regarding domestic law provisions
- Changes to Transfer Pricing Guidelines
- Changes to the OECD Model Tax Convention and its Commentary. Such as:
  - the introduction of anti-treaty abuse provisions;
  - changes to the definition of a permanent establishment;
  - changes to transfer pricing provisions;
  - Introduction of treaty provisions in relation to hybrid mismatch arrangements. [3]

The OECD explains that changes to the OECD Model Tax Convention are not directly effective without amendments to bilateral tax treaties.[4] If undertaken on a purely treaty-by-treaty basis, the sheer number of treaties may make the process very lengthy, the more so where countries embark on comprehensive renegotiations of their bilateral tax treaties. A multilateral instrument to amend bilateral treaties is a promising way forward in this respect. [5]

The OECD undertook to analyse the tax and public international law issues related to the development of a multilateral instrument so as to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties. On the basis of this analysis, interested parties will develop a multilateral instrument designed to: provide an innovative approach to international tax matters that reflects the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution. [6]

## 2 OECD SEPTEMBER 2014 REPORT ON ACTION 15: DEVELOPING A MULTINATIONAL INSTRUMENT TO MODIFY BILATERAL TAX TREATIES

[1] OECD "Action Plan on Base Erosion and Profit Shifting" (2013) at 24.
[2] OECD "Action Plan on Base Erosion and Profit Shifting" (2013) at 24.
[3] OECD "Action Plan on Base Erosion and Profit Shifting" at 24.
[4] OECD "Action Plan on Base Erosion and Profit Shifting" at 23.
[5] OECD "Action Plan on Base Erosion and Profit Shifting" at 24.
[6] OECD "Action Plan on Base Erosion and Profit Shifting" at 24.

In terms of the timeline the OECD set to deliver on the Action Plans, Action Plan 15 was one of the September 2014 deliverables. In the September 2014 report on Action 15,[7] the OECD noted that the endorsement of its 2013 BEPS Action Plan by the Leaders of the G20 in Saint-Petersburg in September 2013 shows unprecedented political support to adapt the current international tax system to the challenges of globalisation. The OECD notes that:

- Tax treaties are based on a set of common principles designed to eliminate double taxation that may occur in the case of cross-border trade and investments. The current network of bilateral tax treaties dates back to the 1920s and the first soft law Model Tax Convention developed by the League of Nations. The OECD and the United Nations have subsequently updated model tax conventions based on that work. The contents of those model tax conventions are reflected in thousands of bilateral agreements among jurisdictions.[8] However globalisation has exacerbated the impact of gaps and frictions among different countries' tax systems. As a result, some features of the current bilateral tax treaty system facilitate BEPS and need to be addressed.[9]
- Beyond the challenges faced by the current tax treaty system on substance, the sheer number of bilateral treaties makes updating the current tax treaty network highly burdensome. Even where a change to the Model Tax Convention is consensual, it takes a substantial amount of time and resources to introduce it into most bilateral tax treaties. As a result, the current network is not well-synchronised with the model tax conventions, and issues that arise over time cannot be addressed swiftly.[10]
- Without a mechanism to swiftly implement them, changes to Models only make the gap between the content of the Models and the content of actual tax treaties wider. This clearly contradicts the political objective to strengthen the current system by putting an end to BEPS, in part by modifying the bilateral treaty network. Doing so is necessary not only to tackle BEPS, but also to ensure the sustainability of the consensual framework to eliminate double taxation.[11]
- For this reason, governments have agreed to explore the feasibility of a multilateral instrument that would have the same effects as a simultaneous renegotiation of thousands of bilateral tax treaties.

Action 15 of the BEPS Action Plan provides for an analysis of the tax and public international law issues related to the development of a multilateral instrument to

7 OECD "OECD/20 BEPS Project: Developing A Multinational Instrument To Modify Bilateral Tax Treaties – Action 15: 2014 Deliverable (2014). (OECD/G20 2014 Report on Action 15).
8 OECD/G20 2014 Report on Action 15 at 11.
9 OECD/G20 2014 Report on Action 15 at 11.
10 OECD/G20 2014 Report on Action 15 at 11.
11 OECD/G20 2014 Report on Action 15 at 12.

enable countries that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties.[12]

- On the basis of this analysis, interested countries will develop a multilateral instrument designed to provide an innovative approach to international tax matters, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution.
- The goal of Action 15 is to streamline the implementation of the tax treaty-related BEPS measures.
- This is an innovative approach with no exact precedent in the tax world, but precedents for modifying bilateral treaties with a multilateral instrument exist in various other areas of public international law.
- Drawing on the expertise of public international law and tax experts, the OECD is exploring the technical feasibility of a multilateral hard law approach and its consequences on the current tax treaty system. [13]
- The OECD will identify the issues arising from the development of such an instrument and provide an analysis of the international tax, public international law, and political issues that arise from such an approach.
- The OECD concludes that a multilateral instrument is desirable and feasible, and that negotiations for such an instrument should be convened quickly. [14]

## 3 COMMENTS ON THE ENVISAGED MULTINATIONAL INSTRUMENT

The current OECD Model Convention requires that changes to the Model treaty and its commentary be made by member consensus. Some of the changes do not become effective because of the slow pace of renegotiation and the reluctance of many courts to adopt changes to commentary.[15] Getting a multinational agreement going implies recognition that good ideas for reform need commitment. Then there are concerns of countries terminating treaties as a result of this multinational treaty [16]

The signing of the multilateral agreement seems to be the pinnacle upon which one could judge if the OECD BEPS project will succeed or fail.[17]

- The legal framework is there in the Multilateral Convention on Administrative Assistance.[18]
- Tax administrations need to move beyond the cooperation in exchange of information to towards better coordination between tax administrations. The

12 OECD/G20 2014 Report on Action 15 at 12.
13 OECD/G20 2014 Report on Action 15 at 13.
14 OECD/G20 2014 Report on Action 15 at 14.
15 L Shepperd "What should the OECD do about Base Erosion?" Copenhagen Precise of 2013 International Fiscal Association annual Congress" (9 September 2013).
16 Ibid.
17 Ibid.
18 OECD "Multilateral Convention on Administrative Assistance". It was developed jointly by the OECD and the Council of Europe in 1988 and amended by Protocol in 2010. Available at http://conventions.coe.int/Treaty/en/Treaties/Html/127.htm accessed 16 May 2014.

OECD Forum on Tax Administration[19] has been the main mover on the issue of moving from cooperation to coordination. It now brings together commissioners from 43 countries, including all the G-20 countries. The Forum is pushing the idea of joint audits, sharing of risk assessments, and using tax treaties to achieve a more coordinated approach to compliance by MNEs. [20]

- Considering the range of issues handed, in the BEPS project, the use of a single multilateral treaty to adapt existing bilateral treaties could potentially be managed by a range of agreements.

## 4 CONCLUDING REMARKS AND RECOMMENDATIONS FOR SOUTH AFRICA

- South Africa has so far signed the following multilateral agreements:
  - African Tax Administration Forum Agreement on Mutual Assistance in Tax Matters (singed 17 January 2014);
  - OECD Multilateral Convention on Mutual Administrative Assistance on Tax Matters (in operation from 1 March 2014);
  - Southern African Development Community Agreement on Assistance in Tax Matters (signed 17 August 2013).
- Existing multilateral agreements should be updated in accordance with BEPS proposals, once finalised.
- South Africa should wait for OECD BEPS proposals before signing further multilateral agreements;
- The proposed OECD multilateral instrument to amend numerous bilateral treaties via a single instrument should be supported as a general principle, subject to such amendments being appropriate in the context of South Africa's treaties.

[19] OECD Forum on Tax Administration "About the Forum". The vision of the Forum is to create a forum through which tax administrators can identify, discuss and influence relevant global trends and develop new ideas to enhance tax administration around the world. See http://www.oecd.org/site/ctpfta/abouttheforum.htm accessed 16 may 2014.

[20] J Owens "What is Meant by a Competitive Tax Environment?" Presentation Before Davis Tax Committee (19 September 2013).