

**DAVIS TAX COMMITTEE: SECOND INTERIM REPORT ON BASE EROSION AND PROFIT SHIFTING (BEPS) IN SOUTH AFRICA\***

**SUMMARY OF REPORT ON ACTION: 15: DEVELOP A MULTINATIONAL INSTRUMENT**

Globalisation has exacerbated the impact of gaps and frictions among different countries' tax systems. The endorsement of the 2013 OECD *Action Plan on Base Erosion and Profit Shifting* 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. Many of the principles that underpin international tax principles are imbedded in the tax treaties which 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. However, the principles in the current network of bilateral tax treaties were developed back in the 1920s when the first soft law Model Tax Convention developed by the League of Nations was developed. Although both the OECD and the UN model tax conventions have been subsequently updated over the years, some of the contents of those model tax conventions as reflected in thousands of bilateral agreements among jurisdictions, have been superseded by developments in globalisation. As a result, some features of the current bilateral tax treaty system facilitate base erosion and profit shifting (BEPS) and need to be addressed.

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.<sup>1</sup> Even where a change to the OECD 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. 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. For this reason, governments have agreed to explore the feasibility of a multilateral instrument that

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<sup>1</sup> OECD "Action Plan on Base Erosion and Profit Shifting" at 24.

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 enable countries 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 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 Report on Action 15 explored the technical feasibility of a multilateral hard law approach and its consequences on the current tax treaty system. It identified the issues arising from the development of such an instrument and provided an analysis of the international tax, public international law, and political issues that arise from such an approach. The Report also concluded that a multilateral instrument is desirable and feasible, and that negotiations for such an instrument should be convened quickly. Based on this analysis, a mandate for the formation of an ad hoc Group to develop a multilateral instrument on tax treaty measures to tackle BEPS was approved by the OECD Committee on Fiscal Affairs and endorsed by the G20 Finance Ministers and Central Bank Governors in February 2015. The ad hoc Group is open to participation from all interested countries on an equal footing and is served by the OECD Secretariat. The ad hoc Group began its work in May 2015 with the aim to conclude its work and open the multilateral instrument for signature by 31 December 2016. Participation in the development of the multilateral instrument is voluntary and does not entail any commitments to sign such instrument once it has been finalised.

## **RECOMMENDATIONS FOR SOUTH AFRICA**

As a G20 country and as a member of the OECD BEPS committee, South Africa is supportive of the OECD work developing a multilateral instrument that is intended to amend numerous bilateral treaties via a single instrument. South Africa is one of over 80 countries that form the ad hoc Group created for the development of the multilateral instrument.<sup>2</sup>

- It is in the interest of South Africa to participate in the development of the Multilateral Instrument as the country will gain experience as to how the multilateral instrument is intended to work. This experience will enable the

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<sup>2</sup> OECD “Multilateral instrument for BEPS tax treaty measures: the Ad hoc Group”. Available at <http://www.oecd.org/tax/treaties/multilateral-instrument-for-beps-tax-treaty-measures-the-ad-hoc-group.htm> accessed 4 April 2016.

country to give special consideration to which provisions in the instrument it can reservations on.

- Before South Africa signs the multilateral instrument, it should take cognisance of its economic and socio-geopolitical special circumstances. Cognisance should also be taken of the fact that South Africa has signed treaties with some countries that are based on the OECD MTC and others based on the UN MTC. The OECD MTC embodies rules and proposals by developed capital exporting countries so it favours capital exporting countries over capital importing countries. Treaties based on the OECD MTC normally eliminate double taxation by requiring the source country to give up some or all of its tax on certain categories of income earned by residents of the other treaty country.<sup>3</sup> The UN MTC favours capital importing countries over capital exporting countries and it generally imposes fewer restrictions on the tax jurisdiction of source countries.<sup>4</sup> It is not clear how these diverging interests will be protected in a multilateral instrument (despite the op-in/opt-out proposals); and whether the interests of developing countries will be addressed in the multinational instrument. It would therefore be worthwhile for South Africa to adopt a “wait and see” approach as it gauges how other developing and emerging economies are proceeding on the matter. The UN is currently working on a revised MTC to be released in 2017 that would take into perspective the BEPS implications. It will be worthwhile for South Africa to first consider the UN recommendations as to how developing countries should respond to the changes.
- The OECD notes that countries have gained some experience in the working of multilateral instruments through the Multilateral Convention on Mutual Administrative Assistance in Tax Matters,<sup>5</sup> which was open to developing countries in 2011.<sup>6</sup> Although there has been an increase in the number of countries that have signed the Multilateral Convention, significant work in administrative capacity building is still required for many developing countries, before they can be admitted as parties to the Convention.
- Administrative capacity will once again be a major hindrance for many developing countries to be part of the BEPS Action 15 multilateral instrument. On 3 November 2011, South Africa signed, but has not yet ratified the Multilateral Convention on Mutual Administrative Assistance in Tax Matters.<sup>7</sup> South Africa has therefore not gained experience from this

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<sup>3</sup> BJ Arnold and M.J. McIntyre, *International Tax Primer* (Kluwer Law International, 2002), p. 109.

<sup>4</sup> Ibid.

<sup>5</sup> OECD ‘Convention on Mutual Administrative Assistance in Tax Matters’. Available at <http://www.oecd.org/tax/exchange-of-tax-information/conventiononmutualadministrativeassistanceintaxmatters.htm> (accessed on 9 May 2013).

<sup>6</sup> Ibid.

<sup>7</sup> Croome op cit note 220 at 1.

multilateral instrument. There are however other regional multilateral instruments South Africa has signed. South Africa is a member of the African Tax Administration Forum (ATAF) which promotes and facilitates mutual cooperation among African tax administrators. ATAF has come up with an African Agreement on Mutual Assistance in Tax Matters - a legal instrument to allow African Tax Administrations to assist each other in tax matters.<sup>8</sup>

- South Africa is also a party to the SADC Agreement on Assistance in Tax Matters signed in 2012 and dealing exclusively tax administration matters. It is important that South Africa gauges its experience from its involvement in these regional instruments to determine whether it is ready to sign the multilateral instrument. As much as it is important for South Africa as a member of G20 and OECD BEPS Sub-committee to be associated with the BEPS initiatives, protection of South Africa's economic interests in light of its special circumstances as developing country is of paramount importance.

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<sup>8</sup> ATAF "Twenty one African Countries finalise Mutual Assistance Agreement in collecting taxes" (2 August 2012). Available at <http://content.ataftax.org/Ataf/KodiKaticontentWeb.nsf/0/B4357C40821E9FDA42257AC9004DBE61?OpenDocument> accessed 14 March 2014.

# DTC REPORT ON ACTION 15: DEVELOP A MULTINATIONAL INSTRUMENT

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## 1 BACKGROUND

The OECD notes that 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 base erosion and profit shifting (BEPS) and need to be addressed. 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 the Commentary to the OECD Model Tax Convention (OECD MTC);
- changes to Transfer Pricing Guidelines; and
- changes to the OECD MTC. Such as:
  - the introduction of an anti-treaty abuse provision;
  - changes to the definition of permanent establishment;
  - changes to transfer pricing provisions; and
  - introduction of treaty provisions in relation to hybrid mismatch arrangements.<sup>1</sup>

The OECD explains that changes to the OECD MTC are not directly effective without amendments to bilateral tax treaties.<sup>2</sup> 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 OECD MTC is consensual (after having been agreed upon multilaterally), it takes a substantial amount of time and resources to introduce that change into most bilateral tax treaties. Indeed, renegotiating a country's treaty network takes decades. As a result, the current network is not well-synchronised with the model tax conventions. Since the actual treaties are many years behind the models on which they are based, any multilaterally-agreed changes to the models take a generation to be implemented<sup>3</sup> and issues that arise over time cannot be addressed swiftly.<sup>4</sup> Furthermore, the version of the commentary and convention that applied when the treaty was signed is generally viewed as being the one that applies (i.e. as agreed) and, thus, many treaties are not suitable for the prevailing business environment.

Without a mechanism to swiftly implement them, changes to model treaties only make the gap between the content of the model treaties and the content of actual tax

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<sup>1</sup> OECD "Action Plan on Base Erosion and Profit Shifting" at 24.

<sup>2</sup> OECD "Action Plan on Base Erosion and Profit Shifting" at 23.

<sup>3</sup> OECD/G20 2015 Final Report on Action 15 in para 5.

<sup>4</sup> OECD/G20 2015 Final Report on Action 15 in the Executive Summary.

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.<sup>5</sup>

The OECD BEPS report notes that there is a need to consider innovative ways to implement the measures resulting from the work on the BEPS Action Plan.<sup>6</sup> The OECD recommends that a multilateral instrument to amend bilateral treaties is a promising way forward in this respect.<sup>7</sup> In terms of Action 15, a “multilateral instrument” is a treaty concluded between more than two parties. The OECD makes reference to the Vienna Convention on the Law of Treaties (VCLT), which defines a treaty in article 2(1)(a) as:

“an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation.”<sup>8</sup>

It is proposed that the “multilateral instrument” would have the same effect as a simultaneous renegotiation of thousands of bilateral tax treaties.

The OECD is of the view that such a multilateral instrument would not be a far-fetched idea as countries have gained some experience through the Multilateral Convention on Mutual Administrative Assistance in Tax Matters,<sup>9</sup> which was initially only open to members of the OECD and through the Council of Europe in 1998. In 2009, the G20 called for action to make it easier for developing countries to secure the benefits of transnational tax administrative co-operation.<sup>10</sup> In 2011, the OECD and the Council of Europe developed a Protocol that amended the Multilateral Convention on Mutual Administrative Assistance in Tax Matters thereby opening it up to developing countries.<sup>11</sup> Since then there has been increase in the number of countries that have signed the Multilateral Convention.

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.<sup>12</sup> On the basis of this analysis, interested countries will develop a multilateral instrument designed to provide an innovative approach to

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<sup>5</sup> OECD/G20 2015 Final Report on Action 15 in the Executive Summary.

<sup>6</sup> OECD “Action Plan on Base Erosion and Profit Shifting” (2013) at 24.

<sup>7</sup> OECD “Action Plan on Base Erosion and Profit Shifting” at 24.

<sup>8</sup> OECD/G20 2015 Final Report on Action 15 in para 6 of Annexure A.

<sup>9</sup> OECD “Convention on Mutual Administrative Assistance in Tax Matters”. Available at <http://www.oecd.org/tax/exchange-of-tax-information/conventiononmutualadministrativeassistanceintaxmatters.htm> (accessed on 9 May 2013).

<sup>10</sup> Ibid.

<sup>11</sup> Ibid.

<sup>12</sup> OECD/G20 2015 Final Report on Action 15 in the Executive Summary.

international tax matters, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution.<sup>13</sup>

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.<sup>14</sup> Drawing on the expertise of public international law and tax experts, the OECD explored the technical feasibility of a multilateral hard law approach and its consequences on the current tax treaty system. It identified the issues arising from the development of such an instrument and provided an analysis of the international tax, public international law, and political issues that arise from such an approach.<sup>15</sup>

In 2014 the OECD issued a report in which it also concluded that a multilateral instrument is desirable and feasible, and that negotiations for such an instrument should be convened quickly. Based on the analysis in the 2014 report, a mandate for the formation of an ad hoc Group (“the Group”) to develop a multilateral instrument on tax treaty measures to tackle BEPS was approved by the OECD Committee on Fiscal Affairs and endorsed by the G20 Finance Ministers and Central Bank Governors in February 2015. The Group is open to participation from all interested countries on an equal footing and is served by the OECD Secretariat. The Group began its work in May 2015 with the aim to conclude its work and open the multilateral instrument for signature by 31 December 2016. Participation in the development of the multilateral instrument is voluntary and does not entail any commitments to sign such an instrument once it has been finalised.<sup>16</sup> In 2015, the OECD issued its Final Report on report on Action 15. Below is a summary of the Report.

## **2 FINAL REPORT ON ACTION 15: DEVELOPING A MULTILATERAL INSTRUMENT TO MODIFY BILATERAL TAX TREATIES - 2015**

### **2.1 SUMMARY OF THE OECD’S VIEWS ON A MULTILATERAL INSTRUMENT**

- a) The OECD notes that there is strong political support to eliminate BEPS.<sup>17</sup>
- b) The current system of bilateral tax treaties focuses on the elimination of double taxation.<sup>18</sup>
- c) Some features of the current tax treaty system facilitate BEPS.<sup>19</sup>

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<sup>13</sup> Ibid.

<sup>14</sup> Ibid.

<sup>15</sup> Ibid.

<sup>16</sup> Ibid.

<sup>17</sup> OECD/G20 2015 Final Report on Action 15 in para 1.

<sup>18</sup> OECD/G20 2015 Final Report on Action 15 in para 2.

<sup>19</sup> OECD/G20 2015 Final Report on Action 15 in para 3.



- d) Change is needed to eliminate the opportunities the current tax treaty system creates for double non-taxation.<sup>20</sup>
- e) The sheer number of bilateral treaties makes updates to the treaty network, burdensome and time-consuming, limiting the efficiency of multilateral efforts.
- f) The need for change is urgent, and this is both a challenge and a unique opportunity. To address BEPS in a reasonable timeframe, a mechanism to facilitate swifter implementation is hence required.<sup>21</sup>
- g) A multilateral instrument can address treaty-based BEPS issues while respecting sovereign autonomy in tax matters.
  - o As BEPS results from the interactions of multiple countries' laws and treaties, governments need to collaborate more intensively through a hard law multilateral instrument both to prevent the tax treaty network from facilitating BEPS and to protect their tax sovereignty. Recognising the tax sovereignty concern, the report focuses on implementing treaty measures, even though a multilateral instrument could in principle also be used to express commitments to implement certain domestic law measures.<sup>22</sup>
- h) A multilateral instrument facilitates speedy action and innovation. It will implement agreed treaty measures over a reasonably short period and at the same time it would preserve the bilateral nature of tax treaties. This innovative approach has at least three important advantages:
  - o It would help ensure that the multilateral instrument is highly targeted;
  - o It would allow all existing bilateral tax treaties to be modified in a synchronised way with respect to BEPS issues, without a need to individually address each treaty within the 3000+ treaty network; and
  - o It responds to the political imperatives driving the BEPS Project in that it allows BEPS abuses to be curtailed and governments to swiftly achieve their international tax policy goals without creating the risk of violating existing bilateral treaties that would derive from the use of unilateral and uncoordinated measures.<sup>23</sup>
- i) Overcoming traditional obstacles to swiftly implement agreed tax treaty measures requires political willingness to act.<sup>24</sup>
- j) The OECD report on Action 15 concludes that a multilateral instrument is desirable and feasible, and that negotiations should be convened quickly. Negotiations would be convened through an International Conference open to G20 countries, OECD members and other interested countries under the aegis of the OECD and the G20.<sup>25</sup>

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<sup>20</sup> OECD/G20 2015 Final Report on Action 15 in para 4.  
<sup>21</sup> OECD/G20 2015 Final Report on Action 15 in para 6.  
<sup>22</sup> OECD/G20 2015 Final Report on Action 15 in para 7.  
<sup>23</sup> OECD/G20 2015 Final Report on Action 15 in para 8.  
<sup>24</sup> OECD/G20 2015 Final Report on Action 15 in para 9.  
<sup>25</sup> OECD/G20 2015 Final Report on Action 15 in para 10.

## 2.2 THE OECD'S VIEWS AS TO WHY A MULTILATERAL INSTRUMENT IS DESIRABLE

The OECD is of the view that the multinational instrument is desirable because: the benefits are numerous, while burdens can be addressed or avoided:

- a) Changes to the OECD MTC are intended to ultimately produce changes to the network of bilateral tax treaties that form a key component of the broader international tax architecture:<sup>26</sup>
- b) A multilateral negotiation can overcome the hurdle of cumbersome bilateral negotiations and produce important efficiency gains:<sup>27</sup>
  - Given the decades-long process for bilateral treaty negotiations, a multilateral instrument represents the only way to address treaty-based BEPS concerns in a swift and co-ordinated manner;
  - The current network of bilateral treaties involves substantial complexity because each treaty is a legally distinct instrument, and its relationship to other bilateral treaties is undefined. As a result, lawyers, tax administrators, and courts spend a lot of energy interpreting each individual treaty, especially when treaties differ in small ways;
  - This problem would become more severe if varied anti-BEPS measures were included in thousands of new bilateral protocols to existing treaties;
  - The multilateral instrument will instead produce synchronised results that would save resources and improve the clarity of BEPS-related international tax treaty rules; and
  - Only a multilateral instrument can overcome the practical difficulties associated with trying to rapidly modify the 3000+ bilateral treaty network.<sup>28</sup>
- c) The multilateral instrument can provide developing countries with the opportunity to fully benefit from the BEPS Project:<sup>29</sup>
  - Developing countries find it more difficult than developed countries to conclude double tax treaties, and to get the interest of other countries in tax treaty re-negotiation. This is because their tax treaty negotiation expertise is often more limited than that of developed economies.
  - A multilateral instrument therefore offers the best opportunity to ensure that developing countries reap the benefits of multilateral efforts to tackle BEPS.
  - In a multilateral negotiation, similarly-minded developing governments may co-operate, pooling their expertise to be efficacious in the negotiating process.<sup>30</sup>

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<sup>26</sup> OECD/G20 2015 Final Report on Action 15 in para 11.

<sup>27</sup> OECD/G20 2015 Final Report on Action 15 in para 12.

<sup>28</sup> OECD/G20 2015 Final Report on Action 15 in para 12.

<sup>29</sup> OECD/G20 2015 Final Report on Action 15 in para 13.

<sup>30</sup> OECD/G20 2015 Final Report on Action 15 in para 13.

- d) Some issues are much easier to address multilaterally than in bilateral instruments:
- The bilateral treaty architecture was not originally designed to address high levels of factor mobility and global value chains brought about by globalisation, this substantially increases the need to resolve resultant multi-country tax disputes.
  - Although the multilateral mutual agreement procedure (MAP) can be used to resolve such multi-country disputes, some countries foresee legal constraints in the absence of a hard law instrument authorising multilateral MAP. Other countries do not believe they can use MAP to resolve cases that touch on issues not explicitly addressed in their existing bilateral tax treaties in the absence of an international law instrument that provides that authority.
  - These and other legal obstacles that arise in implementing multilateral MAP can easily be addressed in the context of the multilateral instrument.<sup>31</sup>
- e) A multilateral instrument can increase the consistency and help ensure the continued reliability of the international tax treaty network, providing additional certainty for business:
- Having a single text, instead of thousands of similar but slightly varying texts would be more likely to produce consistent interpretation across jurisdictional boundaries.
  - A common international understanding would develop about the meaning of the text of the provisions of the multilateral instrument.
  - By addressing a number of contested questions surrounding international tax rules in a definitive way, a multilateral instrument can restore clarity and ensure future certainty for the status of a variety of important rules that business relies upon to be able to invest with confidence cross-border.<sup>32</sup>
- f) Flexibility, respect for bilateral relations, and a targeted scope are key to success:
- The multinational instrument provides benefits of swift implementation, improved consistency, certainty, and efficiency. These benefits can only be achieved if bilateral specificities and tax sovereignty are fully respected.
  - Countries can be allowed to tailor their commitment under the instrument in pre-defined cases to help address these concerns.
  - Parties could commit to a core set of provisions as part of a multilateral instrument, but then have the possibility to opt-out, opt-in or choose between alternative – and clearly delineated – provisions with respect to other issues covered by the instrument.

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<sup>31</sup> OECD/G20 2015 Final Report on Action 15 in para 14.

<sup>32</sup> OECD/G20 2015 Final Report on Action 15 in para 15.

- Negotiations would thereby accommodate bilateral specificities, reinforce governmental policy goals, and reassert tax sovereignty in the face of globalisation.<sup>33</sup>
- g) A level playing field will require broad participation:
  - Some provisions of the treaty-based portion of the BEPS Project require broad participation in order to successfully address BEPS concerns.
  - To ensure a level playing field and fairly shared tax burdens; flexibility and respect for bilateral relations will need to be balanced against core commitments that reflect new international standards that countries are urged to meet and for which the multilateral instrument is a facilitative tool.<sup>34</sup>

## 2.3 OTHER ADVANTAGES OF THE MULTINATIONAL INSTRUMENT

- a) The multilateral instrument provides an innovative approach to address the rapidly evolving nature of the global economy and the need to adapt international rules quickly.<sup>35</sup>
- b) Some of the measures developed in the BEPS Project are multilateral in nature (such as those below) and would be much more effective if implemented through a multilateral instrument. These include:
  - Multilateral MAP;
  - Addressing dual-residence structures;
  - Addressing transparent entities in the context of hybrid mismatch arrangements;
  - Addressing “triangular” cases involving PEs in third states: where income of a tax treaty resident is attributed by the country of residence to a PE in a third State and exempt from tax in the residence State, often together with low taxation in the State of the PE; and
  - Addressing treaty abuse.<sup>36</sup>
- c) Some tax treaty provisions that may implicate BEPS concerns are bilateral in nature, and for these provisions flexibility can be provided within certain boundaries. For instance, a multilaterally agreed provision which introduces changes to the definition of PE may need to provide for some flexibility to tailor the level of commitment towards all the other parties depending on the partner country.
- d) Flexibility has to be within certain boundaries to ensure consistency and administrative feasibility.<sup>37</sup>

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<sup>33</sup> OECD/G20 2015 Final Report on Action 15 in para 16.

<sup>34</sup> OECD/G20 2015 Final Report on Action 15 in para 17.

<sup>35</sup> OECD/G20 2015 Final Report on Action 15 in para 30.

<sup>36</sup> OECD/G20 2015 Final Report on Action 15 in para 33.

<sup>37</sup> OECD/G20 2015 Final Report on Action 15 in para 32.

- e) The precise content of a multilateral instrument is yet to be defined but the sense of direction is clear.<sup>38</sup> OECD and G20 governments are working towards agreement on substantive treaty-based measures to counter BEPS.
- f) A multilateral instrument to implement BEPS outputs is an effective and innovative solution. This feasibility study concludes that despite potential challenges, a multilateral instrument is a promising way to quickly implement treaty-related BEPS measures.<sup>39</sup>
- g) A multilateral instrument should be conceived in a dynamic way.<sup>40</sup>

## **2.4 THE OECD'S VIEWS AS TO WHY A MULTILATERAL INSTRUMENT IS FEASIBLE**

The OECD is of the view that the multilateral instrument is feasible because legal mechanisms are available to achieve a balanced instrument that addresses the technical and political challenges.

- a) The technical legal challenges that arise in modifying the international tax treaty architecture by means of a multilateral instrument will require careful attention. Nevertheless, an analysis of precedents in other areas of international law and the specifics of various proposed changes to the model tax conventions illustrate that developing a multilateral instrument to rapidly implement agreed changes is completely feasible from a legal point of view.<sup>41</sup>
- b) The multilateral instrument would coexist with the existing bilateral tax treaty network:
  - Like existing tax treaties, this instrument would be governed by international law and would be legally binding on the parties.
  - A multilateral instrument will modify a limited number of provisions common to most existing bilateral treaties, and would, for those treaties that do not already have such provisions, add new provisions specifically designed to counter BEPS.
  - It could also clarify the compatibility with tax treaties of other anti-BEPS measures developed in the course of the BEPS Project.
  - The multilateral instrument could be accompanied by an explanatory report to facilitate the implementation of the provisions contained therein.<sup>42</sup>
- c) The approach of a multilateral instrument is highly targeted and efficient:
  - The OECD considered other options, but a multilateral instrument that coexists with bilateral tax treaties was identified to be more appropriate

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<sup>38</sup> OECD/G20 2015 Final Report on Action 15 in para 33.

<sup>39</sup> OECD/G20 2015 Final Report on Action 15 in para 34.

<sup>40</sup> OECD/G20 2015 Final Report on Action 15 in para 35

<sup>41</sup> OECD/G20 2015 Final Report on Action 15 in para 18.

<sup>42</sup> OECD/G20 2015 Final Report on Action 15 in para 19.

than other approaches because it is more efficient and more targeted. Other options evaluated included:

- The use of a “self-standing instrument” that would wholly supersede bilateral tax treaties, governing the relationship between all the parties, whether or not they have concluded bilateral tax treaties amongst themselves. A “self-standing instrument” was however viewed to be overbroad given the importance of bilateral relations in international tax affairs and the importance of preserving tax sovereignty.
  - An instrument whose sole purpose would be to operate like a bundle of “amending protocols”, precisely amending the varying language of each of the 3000+ tax treaties. However the use of a bundle of “amending protocols” was viewed as less appealing than a coexisting multilateral instrument because it would be both more technically complex and less efficient. This approach was viewed as being too cumbersome and time consuming to satisfy the central purpose of the multilateral instrument, which is to implement treaty-related responses to BEPS quickly.<sup>43</sup>
- d) A multilateral instrument would follow established negotiating processes, and ratification would require conventional domestic procedures, pursuant to national laws:
- The intent of this multilateral instrument would be to ensure the effective and efficient implementation of the outputs of the BEPS Project that bear a relationship to the operation of tax treaties.
  - Once the implications of this innovative solution have been fully considered and addressed, an International Conference would negotiate the content and actual text of the multilateral instrument, which would then be subject to the regular ratification procedures by each party.
  - Therefore, this multilateral instrument would follow traditional negotiating processes, and ratification would take place according to national laws.<sup>44</sup>
- e) The relationship between parties to a multilateral instrument that are not parties to a bilateral tax treaty between themselves generally would not be affected:
- In some instances, parties to a multilateral instrument would not yet have concluded a bilateral tax treaty between themselves.
  - The multilateral instrument would only govern the relationship between parties that have concluded bilateral tax treaties amongst themselves.
  - One exception to this general rule could be a multilateral dispute resolution mechanism which operates among all parties to the multilateral instrument, including in cases where certain parties to the instrument lack bilateral treaty relationships with one another.

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<sup>43</sup> OECD/G20 2015 Final Report on Action 15 in para 20.

<sup>44</sup> OECD/G20 2015 Final Report on Action 15 in para 21.

- A separate question to be examined by the treaty negotiators at the International Conference is whether this multilateral instrument would impose any obligation on the parties to the instrument with respect to a situation in which two States conclude a bilateral tax treaty covering the same issue for the first time at a date after they each become parties to the instrument. In this regard, the OECD recommends that from a legal point of view the relevant provisions could be crafted to apply in such a case, and therefore a decision will have to be taken at the political level.<sup>45</sup>
- f) Technical challenges arising from the interaction between a multilateral instrument and bilateral tax treaties can be addressed:
- Variations in scope between similar provisions of existing bilateral treaties can be successfully resolved.
  - Variations in the wording of similar provisions of existing bilateral treaties can be addressed through superseding language in a multilateral instrument.
  - Addressing variations in the numbering of provisions simply requires careful drafting.
  - The timelines for signature and entry into force can be calibrated for flexibility.
  - Solutions for other technical issues, such as questions of language and translation, are readily available.<sup>46</sup>
- g) In general, a flexible approach will be paramount for the multilateral instrument:
- As is the case with the existing network of bilateral tax treaties, parties to a multilateral instrument may have tax policies that differ from one another and could not be harmonised amongst all the parties to the instrument. They may not be ready to accept the same precise commitments vis-à-vis all other parties.
  - One of the main challenges for negotiators of a multilateral instrument will therefore be to ensure flexibility regarding the extent of the rights and obligations established by the treaty vis-à-vis all the other parties, as well as the level of commitments towards certain parties, while at the same time maintaining consistency, in order to create a level playing field, and transparency, in order to provide certainty.<sup>47</sup>
- h) There are ample legal means for providing flexibility to modulate, within agreed boundaries, parties' commitments:
- A multilateral instrument could allow for the tailoring of the level of certain commitments towards all the other parties and/or depending on the partner country.
  - There are a number of tools to ensure flexibility and a number of relevant precedents in this regard.

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<sup>45</sup> OECD/G20 2015 Final Report on Action 15 in para 22.

<sup>46</sup> OECD/G20 2015 Final Report on Action 15 in para 23.

<sup>47</sup> OECD/G20 2015 Final Report on Action 15 in para 24.

- It should be recognised that some provisions may require consistent adoption among the parties to a multilateral instrument for reasons of technical administrability.<sup>48</sup>
- i) The relationship with other multilateral instruments should be closely examined.<sup>49</sup>
- j) Negotiation of the multilateral instrument must be speedy to avoid uncertainty.<sup>50</sup>
  - This is necessary so that business may adjust to the new reality and continue to support growth, create jobs, and foster innovation.
  - To avoid the fact that putting some issues in a multilateral instrument may slow the ability to address BEPS, a targeted multilateral instrument will be set with a well-defined scope and a precise timetable for negotiation.<sup>51</sup>
- k) The BEPS Project is intended to result in shared principles to shore up the clarity and predictability of the tax treatment of cross-border activities.<sup>52</sup>

## **2.5 SCOPING THE INTERNATIONAL CONFERENCE**

- The development of a multilateral instrument requires framework provisions related to its entry into force, language, etc. and more importantly agreement on the substance of the tax treaty measures required to respond to BEPS.<sup>53</sup>
- The OECD convened an International Conference to develop the multilateral instrument in November 2015.
- The International Conference was open to all interested countries, under the aegis of the OECD and the G20.<sup>54</sup>

## **2.6 SUMMARY OF THE TOOLBOX FOR THEORETICAL OPTIONS IN THE DEVELOPMENT OF A MULTILATERAL INSTRUMENT**

The multilateral instrument offers an expansive and adaptable toolkit to ensure:

- a) A multilateral instrument can implement BEPS measures and modify the existing network of bilateral tax treaties.
  - The bilateral tax treaties would remain in force for all non-BEPS related issues.
  - It would be preferable, for reasons of efficiency and transparency, to define this relationship through the inclusion of compatibility clauses in the multilateral instrument.
  - There are several options in order to ensure consistency in the interpretation and implementation of the multilateral instrument. Solutions

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<sup>48</sup> OECD/G20 2015 Final Report on Action 15 in para 25.

<sup>49</sup> OECD/G20 2015 Final Report on Action 15 in para 26.

<sup>50</sup> OECD/G20 2015 Final Report on Action 15 in para 27.

<sup>51</sup> OECD/G20 2015 Final Report on Action 15 in para 27.

<sup>52</sup> OECD/G20 2015 Final Report on Action 15 in para 28.

<sup>53</sup> OECD/G20 2015 Final Report on Action 15 in para 36.

<sup>54</sup> OECD/G20 2015 Final Report on Action 15 in para 37.



also exist with regard to the dates of entry into force of different provisions and logistical issues including differences in the authentic languages of the multilateral instrument and bilateral tax treaties.<sup>55</sup>

- b) A multilateral instrument can provide appropriate flexibility for stakeholders in their level of commitment in order to move towards a level playing field.
- o Flexibility can be defined as to the level of commitment of the parties vis-à-vis all or certain parties can be achieved through the use of:
    - opt-out mechanisms allowing parties to exclude or modify the legal effects of certain provisions;
    - a choice between alternative – and clearly delineated – provisions; and
    - opt-in mechanisms offering parties the possibility to take on additional commitments.

The level of commitment of parties can also be modulated through the language used in the multilateral instrument (strong or soft wording) and types of obligations (of results and/or means).<sup>56</sup>

- c) A multilateral instrument can ensure transparency and clarity for all stakeholders. Mechanisms are available to ensure clear and publicly accessible information as regards, on the one hand, the interaction between the multilateral instrument and bilateral tax treaties and, on the other hand, the use of the mechanisms for flexibility set up by the multilateral instrument.<sup>57</sup>

As with the development of any new instrument, there are technical issues but they can be solved through well-tested solutions drawing on treaty law and practice. International tax experts and public international law experts will need to continue working hand in hand as this project moves forward.<sup>58</sup>

### **3 CONCLUDING REMARKS AND RECOMMENDATIONS FOR SOUTH AFRICA**

**The signing of the multilateral agreement seems to be the pinnacle upon which one can judge if the BEPS project will succeed or fail.**<sup>59</sup>

As a G20 country and as a member of the OECD BEPS committee, South Africa is supportive of the OECD work on multilateral instrument that is intended to amend numerous bilateral treaties via a single instrument. A Mandate to set up an ad hoc for the Development of a Multilateral Instrument on Tax Treaty Measures to Tackle BEPS<sup>60</sup> was developed by the OECD Committee on Fiscal Affairs and endorsed by

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<sup>55</sup> OECD/G20 2015 Final Report on Action 15 in para 2 of Annex A.

<sup>56</sup> OECD/G20 2015 Final Report on Action 15 in para 2 of Annex A.

<sup>57</sup> OECD/G20 2015 Final Report on Action 15 in para 4 of Annex A.

<sup>58</sup> OECD/G20 2015 Final Report on Action 15 in para 5 of Annex A.

<sup>59</sup> Ibid.

<sup>60</sup> OECD/G20 Base Erosion and Profit Shifting Project “Action 15: A Mandate for the Development of a Multilateral Instrument on Tax Treaty Measures to Tackle BEPS” (2015). Available at

the G20 Finance Ministers and the Central Bank Governors at their February 2015 Meeting. South Africa is one of over 80 countries that form the ad hoc group created for the development of a multilateral instrument.<sup>61</sup> Work on the development of the Multilateral Instrument begun on 27 May 2015 and South Africa participates in forums to discuss the working and crafting of the multilateral instrument.

- It is in the interest of South Africa to participate in the development of the Multilateral Instrument as the country will gain experience as to how the multilateral instrument is intended to work. This experience will enable the country to give special consideration to which provisions in the instrument it can make reservations on.
- Before South Africa signs the multilateral instrument, it should take cognisance of its economic and socio-geopolitical special circumstances. Cognisance should also be taken of the fact that South Africa has signed treaties with some countries that are based on the OECD MTC and others based on the UN MTC. The OECD MTC embodies rules and proposals by developed capital exporting countries so it favours capital exporting countries over capital importing countries. Treaties based on the OECD MTC normally eliminate double taxation by requiring the source country to give up some or all of its tax on certain categories of income earned by residents of the other treaty country.<sup>62</sup> The UN MTC favours capital importing countries over capital exporting countries and it generally imposes fewer restrictions on the tax jurisdiction of source countries.<sup>63</sup> It is not clear how these diverging interests will be protected in a multilateral instrument (despite the op-in/opt-out proposals); and whether the interests of developing countries will be addressed in the multinational instrument. It would therefore be worthwhile for South Africa –; to adopt a “wait and see” approach as it gauges how other developing and emerging economies are proceeding on the matter. The UN is currently working on a revised MTC to be released in 2017 that would take into perspective the BEPS implications. It will be worthwhile for South Africa to first consider the UN recommendations as to how developing countries should respond to the changes.
- The OECD notes that countries have gained some experience in the working of multilateral instruments through the Multilateral Convention on Mutual Administrative Assistance in Tax Matters,<sup>64</sup> which was open to

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<http://www.oecd.org/ctp/beps-action-15-mandate-for-development-of-multilateral-instrument.pdf> accessed 4 April 2016.

<sup>61</sup> OECD “Multilateral instrument for BEPS tax treaty measures: the Ad hoc Group”. Available at <http://www.oecd.org/tax/treaties/multilateral-instrument-for-beps-tax-treaty-measures-the-ad-hoc-group.htm> accessed 4 April 2016.

<sup>62</sup> BJ Arnold and M.J. McIntyre, *International Tax Primer* (Kluwer Law International, 2002), p. 109.

<sup>63</sup> Ibid.

<sup>64</sup> OECD ‘Convention on Mutual Administrative Assistance in Tax Matters’. Available at <http://www.oecd.org/tax/exchange-of-tax-information/conventiononmutualadministrativeassistanceintaxmatters.htm> (accessed on 9 May 2013).

developing countries in 2011.<sup>65</sup> Although there has been an increase in the number of countries that have signed the Multilateral Convention, significant work in administrative capacity building is still required for many developing countries, before they can be admitted as parties to the Convention.

- Administrative capacity will once again be a major hindrance for many developing countries to be part of the BEPS Action 15 multilateral instrument. On 3 November 2011, South Africa signed, but has not yet ratified the Multilateral Convention on Mutual Administrative Assistance in Tax Matters.<sup>66</sup> South Africa has therefore not gained experience from this multilateral instrument. There are however other regional multilateral instruments South Africa has signed. South Africa is a member of the African Tax Administration Forum (ATAF) which promotes and facilitates mutual cooperation among African tax administrators. ATAF has come up with an African Agreement on Mutual Assistance in Tax Matters - a legal instrument to allow African Tax Administrations to assist each other in tax matters.<sup>67</sup>
- South Africa is also a party to the SADC Agreement on Assistance in Tax Matters signed in 2012 and dealing exclusively tax administration matters. It is important that South Africa gauges its experience from its involvement in these regional instruments to determine whether it is ready to sign the multilateral instrument. As much as it is important for South Africa as a member of G20 and OECD BEPS Sub-committee to be associated with the BEPS initiatives, protection of South Africa's economic interests in light of its special circumstances as developing country is of paramount importance.

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<sup>65</sup> Ibid.

<sup>66</sup> Croome op cit note 220 at 1.

<sup>67</sup> ATAF "Twenty one African Countries finalise Mutual Assistance Agreement in collecting taxes" (2 August 2012). Available at <http://content.ataftax.org/Ataf/KodiKaticontentWeb.nsf/0/B4357C40821E9FDA42257AC9004DBE61?OpenDocument> accessed 14 March 2014.