The times they are a-changing: recent developments in Australia's international tax rules

by Michael Dirkis, CTA, Professor of Taxation Law, University of Sydney Law School, and Brett Bondfield, CTA, Senior Lecturer, University of Sydney Business School

Abstract: A lot has happened in international tax in 2017. There has been an escalation in new tax developments, with significant changes happening within Australia's international tax rules. Change is likely to continue as states sign up to the various multilateral agreements such as the common reporting standard (CRS) and country-by-country (CbC) reporting and to the multilateral instrument. This article provides an overview of the recent developments and potential changes to come in respect of: transparency and the public disclosure of tax information; taxation information-gathering regimes, which include the CRS, the proposed mandatory reporting regime and CbC reporting; selected transfer pricing developments; and tax treaties, including the impact of the 2017 Multilateral Convention, the 2017 OECD *Model Tax Convention on Income and on Capital* and the 2016 Australia–Germany comprehensive tax treaty. It is expected that in the foreseeable future, more changes are to come.

Introduction

This article is structured to provide an overview of recent developments and the potential changes to come in respect of:

- transparency — public disclosure of tax information;
- taxation information-gathering regimes — which includes the common reporting standard (CRS), the proposed mandatory reporting regime and country-by-country (CbC) reporting;
- selected transfer pricing developments; and
- tax treaties — including the impact of the 2017 Multilateral Convention, the 2017 OECD *Model Tax Convention on Income and on Capital* and the 2016 Australia–Germany comprehensive tax treaty.[1]

At the outset, it needs to be acknowledged that activity in international tax space has been dynamic recently and significant Australian developments that will not be covered include:

- the 16 November 2016 High Court's decision in *Bywater Investments Limited v FCT*,[2] the subsequent withdrawal of TR 2004/15 on 15 March 2017 by the Commissioner of Taxation and the release of a draft ruling which adopts the High Court's rejection of the view that formality is insufficient to determine central management and control;[3]
- the proposed domestic anti-hybrid rules implementing the Organisation for Economic Co-operation and Development's (OECD's) base erosion and profit shifting (BEPS) project's recommendations in respect of action 2 (neutralise hybrid mismatch across borders allowing double non-taxation);[4] and
- the enacting of so called diverted profits tax (DPT) from 1 July 2017 by the *Treasury Laws Amendment (Combating Multinational Tax Avoidance) Act 2017* (Cth) and *Diverted Profits Tax Act 2017* (Cth)[5] and the proposed extension to those rules to trusts and partnerships released as an exposure draft on 12 February 2018.[6]

Transparency: public disclosure of tax information

Introduction

In a 2016 paper, Dirkis examined the development of the mandatory disclosure to the public of individual corporate taxpayer's financial information (eg in Australia, this has included law changes requiring the Australian Taxation Office (ATO) to publish tax information (including total income and the tax paid) of certain larger Australian companies and the Board of Taxation being tasked with the development, by May 2016, of a voluntary code for the increased public disclosure of tax information by businesses, particularly large multinationals).[7]

For completeness, it is appropriate to note two public disclosure initiatives discussed in that paper before examining the developments in respect of the Board of Taxation's voluntary tax transparency code (TTC) in detail.

First, there are the 2013 and 2015 changes that require certain companies (essentially large and multinational businesses) to report certain information to the ATO for public disclosure. The reporting obligations relate to Australian-owned private companies with a total income of $200m,[8] corporate tax entities, other than Australian-owned private companies, that return a total income of $100m or more for an income year,[9] entities liable for any amount of petroleum resource rent tax (PRRT)[10] and to all significant global entities (SGEs)[11] (this concept will be explained in more detail in the section covering "Taxation information-gathering regimes").

The measures also ensure that SGEs that do not lodge a general purpose financial statement (GPFS) with the Australian Securities and Investment Commission (ASIC) lodge a GPFS for the financial year most closely corresponding to the income year with the Commissioner, who will pass it on to ASIC.[12] This process renders the statements available to inspection or a request for a copy or extract from the statements from ASIC by any person.[13]

The stated objectives of these amendments are to discourage large corporate tax entities from engaging in aggressive tax avoidance practices and to provide more information to inform public debate about tax policy, particularly in relation to the corporate tax system.[14]

Second, there are the 2013 changes to the taxpayer confidentiality provisions relating to protected information (the secrecy rules)[15] enabling the Commissioner to publish aggregate tax collection information in fulfilment of the financial reporting obligations imposed on the Commissioner.[16] It was argued that this change would to enable better public disclosure of aggregate tax revenue collections, even when the identity of particular taxpayers could potentially be deduced.[17]

Voluntary tax transparency code

Background

On 12 May 2015, the then Treasurer announced that the government would work with businesses to develop a code on greater public disclosure of tax information by large corporates by May 2016.[18] He noted that:

> "the voluntary code will highlight companies that are paying their fair share of tax. It will also discourage companies from engaging in aggressive tax avoidance."

The Treasurer appointed the Board of Taxation to lead the development of the TTC, in particular to determine what information is disclosed and how it is disclosed. The Board of Taxation, in a consultation paper released on 11 December 2015, noted that the concept of a TTC is a "set of principles and 'minimum standards' to guide disclosure of tax information by businesses".[19] The board viewed the TCC as being consistent with a broad international move towards greater tax transparency.

In February 2016, the board finalised its report[20] and sent it to the Treasurer. On 3 May 2016, the government announced the release of the board's final report on the TTC and endorsed it as part of the 2016-17 Budget announcements. This was despite, prior to the May 2016 Budget, the Senate Economics References Committee *Inquiry into corporate tax avoidance and aggressive minimisation* in both its interim report (18 August 2015)[21] and final report (released 22 April 2016)[22] casting doubts on the effectiveness of the voluntary disclosure scheme and recommending the adoption of a mandatory scheme. The committee:[23]

> "[did] not believe that this initiative [the voluntary code] will suitably incentivise companies that push the letter and spirit of the law to publish tax information. As such, the committee restates its recommendation that a mandatory tax transparency code be implemented."

What is the TCC?

The TCC applies to with businesses with "aggregated TTC Australian turnover" of at least $100m. The TTC Australian turnover is calculated as follows:

- in respect of an Australian-headquartered business (ie Australian company (or entity that is treated as a company for Australian tax purposes), or an accounting consolidated group headed by an Australian parent): the TTC Australian turnover is the turnover of the Australian entity, or the income tax consolidated group headed by an Australian parent; and
- in respect of a foreign multinational business (ie an accounting consolidated group headed by a non-Australian parent): the TTC Australian turnover is the turnover of the accounting consolidated group headed by a foreign parent to the extent that the turnover relates to:
  - any Australian entities or an Australian tax consolidated group; and
  - any foreign entities to the extent that the turnover is attributable to a permanent establishment in Australia.[24]

It prescribes two levels of levels of disclosure, with a higher level for large businesses (ie businesses with aggregated TTC Australian turnover of $500m or more) and a lesser level for medium businesses (ie businesses with aggregated TTC Australian turnover of at least $100m but less than $500m). Although the TTC currently applies to companies and entities that are treated as companies for Australian tax purposes, the board considers other entities such as superannuation funds, trusts and partnerships should consider adopting the TTC.[25]

In the board's 2016 report, it sets out the minimum standard for disclosure. It is divided into two parts (part A and part B), with large businesses expected to adopt both parts and medium businesses part A (see Table 1).[26]

Parts A and B prescribe a minimum standard of content and it is expected that many businesses will provide additional disclosures. The standard of transparency is satisfied by businesses electing to publish the required information as part of other public disclosures, including as part of corporate social responsibility reports or disclosed in a global "taxes paid" report, an Extractive Industries Transparency Initiative report or a European Union Tax Directive report (ie "taxes paid" reports).[27]

The board recommended that the "taxes paid" reports should not be subject to an explicit audit requirement nor are specific penalties required for misstatement in the TTC report. They expected existing external and internal audit or review procedures should be sufficient to ensure accuracy. Further, existing penalties being imposed for misleading disclosures under other laws and regulations should alleviate the need for explicit penalties for misleading disclosure of TTC information.

The ATO is the "responsible agency" for a central website that provides a link to all publicly issued TTC reports.[28]

Table 1. Summary of the content of part A and part B

TTC disclosure	Who	Minimum standard of information
Part A	"Large" and "medium" businesses	A reconciliation of accounting profit to tax expense and to income tax paid or income tax payable Identification of material temporary and non-temporary differences Accounting effective company tax rates for Australian and global operations (pursuant to AASB guidance)
Part B	"Large" businesses	Approach to tax strategy and governance Tax contribution summary for corporate taxes paid Information about international related party dealings

What is the future of the voluntary code?

The board recommended the code remain voluntary. The board considered that:[29]

> "As a voluntary code it would be expected that the board of a company and/or senior management will be actively involved in the decision to adopt the code and the level of information to be disclosed. The involvement of the board/senior management will foster a culture within companies to meaningfully and accurately address the public desire for increased corporate tax transparency. As with companies who are currently voluntarily disclosing, the Board expects disclosures will evolve over time as corporate governance cultures develop and as global transparency initiatives evolve. In contrast, a mandatory code is more likely to be viewed as a compliance and boxchecking exercise delegated to lower levels within the organisation with less impact on the disclosure culture of the organisation, ultimately resulting in less information being disclosed overall."

Through numerous *CEO newsletters*, the Board of Taxation has provided a monthly update of the uptake of the TTC. The CEO reports that, as at 1 December 2017, there were 120 signatories (including 12 private companies and four Australian government enterprises) to the TCC. They represent more than 50% of company tax payable and taxable income. Of the signatories, 89 have published a tax transparency report.[30]

In a recent preliminary review of 21 out of the 89 TTC reports (roughly 25% of those reporting), the board's secretariat has noted that:

- although the code provides signatories with the flexibility to choose the form of their disclosure, most groups in the sample selected opted to make their disclosure via a separate tax transparency report (18). Two companies made their disclosures within financial statements and one disclosed by "other" means;
- several "separate" reports included cross-references to notes to the financial statements;
- the code does not require reports to be audited. Most reports in the sample set were not audited. Five reports were audited (this includes two disclosures by a separate report);
- the disclosure of the effective tax rate (ETR) is an area where there is a variety of disclosure practices and, in some cases, more than one disclosure. The code permits ETRs to be calculated on different bases (for example, total earnings vs underlying earnings) where the base is defined and any assumptions are disclosed. The variations in approach are likely due to the different reasoning around the form of ETR which is meaningful to stakeholders. For example, some may consider that an ETR calculated on underlying earnings rather than total earnings is more reflective of the ongoing ETR on the basis that one-off or abnormal transactions are excluded from underlying earnings; and
- fifteen of the eighteen reports sampled for large businesses included both the core element and optional elements of part B and a small number of groups in the sample selected disclosed their use of entities incorporated in low taxing jurisdictions.[31]

> *"... given ... the slow uptake of the voluntary code and limited reporting beyond the standard, pressure may be mounting to make these disclosures mandatory."*

Also in 2017, and following a request from the Board of Taxation, the Australian Accounting Standards Board (AASB) released a document on 16 May 2017 titled *Invitation to comment: draft appendix to the tax transparency code*.[32] The AASB draft guidance, issued for public comment, is another example of "normalising" the concept of a corporation making public statements on its tax position as well as trying to standardise what is meant when a corporation publishes its ETR.

However, given the recommendations of the Senate Economics References Committee *Inquiry into corporate tax avoidance and aggressive minimisation* for a mandatory code, the slow uptake of the voluntary code and limited reporting beyond the standard, pressure may be mounting to make these disclosures mandatory.

Taxation information-gathering regimes

Introduction

There are three ATO information-gathering regimes considered in this section: the common reporting standard (CRS), country-by-country reporting (CbC) and the proposed mandatory disclosure rules to require tax advisers and/or taxpayers to make early disclosures (including pre-lodgment disclosures) of aggressive tax arrangements. As they are all regimes that empower the Commissioner to obtain information, it seems logical to address them in this context in turn. As both the CRS and CbC have been implemented and most of the reports generated for both regimes are due to be lodged with the Commissioner by July 2018 (this year), after providing the necessary context, the article explores potential due diligence issues and possible compliance issues.[33]

As the concept of a significant global entity (SGE) under Australian taxation law is something that recurs throughout this section, it is thought best to define it at the outset. An SGE is defined in Subdiv 960-U ITAA97 as a "global parent entity" whose "annual global income" is AU$1b or more, or a member of a group of entities consolidated (for accounting purposes) where the global parent entity has an annual global income of AU$1b or more. This definition includes both Australian-headquartered entities (with or without foreign operations) and the local operations of foreign-headquartered multinationals.

An entity is also an SGE for a period when the Commissioner makes a determination if global financial statements have not been prepared and it is reasonable for the Commissioner to conclude that the annual global income of the global parent entity would have been AU$1 billion or more.[34]

The common reporting standard

Background

The CRS represents the latest step in a line of OECD-led initiatives in the international exchange of information for tax purposes. The advent of the CRS in Australia starts on 19 June 2014 with Australia's endorsement of the G8's decision to adopt a global standard[35] for the automatic exchange of information

(AEOI) — the CRS.[36] Australia is one of at least 102 jurisdictions have publicly committed to implement the CRS.[37] Following that, Australia signed the *Multilateral Convention on Mutual Administrative Assistance in Tax Matters* (Multilateral Convention) on 3 June 2015[38] that provides a further avenue to exchange account information with participating CRS jurisdictions. Under the CRS, Australia is required to obtain information from its financial institutions and automatically exchange that information with other jurisdictions on a bilateral and annual basis. The CRS reporting is based on a calendar year. However, the first "calendar" year is the six months (1 July 2017 to 31 December 2017) that is due to be lodged with the ATO by 31 July 2018.

The CRS sets out the financial account information to be exchanged, the financial institutions required to report, the different types of accounts and taxpayers covered, as well as common due diligence procedures to be followed by financial institutions. In order to obtain the financial information, the government amended the domestic law to impose further obligations on financial institutions to report information to the Commissioner *(Tax Laws Amendment (Implementation of the Common Reporting Standard) Act 2016* (Cth) which inserted Subdiv 396C Common Reporting Standard in Sch 1 of the *Taxation Administration Act 1953* (Cth) (TAA).

Scope of the rules

To ensure the information gathered and exchanges can be utilised by partner states, the language, meanings and concepts used in the OECD's CRS are imported into the domestic legislation[39] to ensure consistency with the CRS. As countries continue to elect into the CRS, to avoid reoccurring due diligence specific to those new jurisdictions, all jurisdictions (other than Australia) are treated as reportable jurisdictions.[40]

The rules require a reporting financial institution (RFI) (as defined in section VIII of the CRS)[41] which maintains at least one reportable account (as defined within the meaning of the CRS — usually a financial account held a by foreign tax resident) at any time during a calendar year to give a statement to the Commissioner in relation to each account in a form required by the CRS and approved by the Commissioner.[42] The reporting relates to a calendar year with reporting to the ATO by 31 July of the following year and the ATO automatically exchanging the data by 30 September of that year.

The list of participating jurisdictions (those with CRS exchange agreements in place with Australia for exchange from September 2018) will be updated by the ATO as new jurisdictions establish CRS exchange arrangements with Australia.[43] In a legislative instrument, the Commissioner has created a class of jurisdiction: declared jurisdictions which are expected to establish a CRS exchange relationship with Australia in the near future.[44]

As a result, RFIs have had to identify relevant accounts, by carrying out the due diligence procedures outlined in the CRS. There is no dollar threshold exception for the need to carry out due diligence and report as necessary individual and entity accounts (see one exception discussed below) under the CRS regime. This means the CRS due diligence will be applied to identify then report existing and new US accounts as part of the CRS regime, including accounts that are required to be reported to the ATO pursuant to Subdiv 396-A of Sch 1 TAA which is Australia's response to the *Foreign Account Tax Compliance Act 2010* (US) (FATCA).

FATCA is a unilateral anti-tax evasion regime enacted by the US Congress in March 2010. Under this law, to avoid a tax surcharge (30%), a financial institution has to supply specific information to the IRS on US citizens and tax residents. To stop Australian financial institutions from incurring the resultant major compliance costs, the Australian Government took on the information collection role by requiring impacted financial institutions (basically RFIs as defined under the CRS) to report this information to the ATO, which would then provide it to the IRS. The first FATCA reports to the ATO were made on 31 July 2015 and exchanged with the IRS on 30 September 2015. There is a reciprocal requirement for the IRS to provide information on Australian tax residents' US accounts to the ATO. To facilitate this exchange, the *Agreement between the Government of Australia and the Government of the United States of America to Improve International Tax Compliance and to Implement FATCA* (FACTA agreement) was signed on 28 April 2014.[45]

Nothing in the CRS regime changes what needs to be reported to the ATO due to FATCA as regards individuals and entities. There are two categories of accounts: those held by individuals and those held in the name of entities. Within those categories, there are the sub-classes of accounts that pre-exist the relevant reporting regime and those created in the relevant period. An RFI is required to conduct look-though due diligence procedures for certain entity account holders resident in countries that are not participating or declared jurisdictions. Those look-through procedures apply to entities that are "Type B Investment Entities"[46] which are not resident in a participating or declared jurisdiction. These are called passive non-financial entities (passive NFEs) and are not financial institutions. In these cases, RFIs need to apply due diligence to identify and determine the status of the "controlling persons" (the trustee(s) and potential beneficiaries should the passive NFE be a trust). When a jurisdiction becomes a participating jurisdiction, the ATO will state the date from which look-through due diligence of passive NFEs of that jurisdiction is not required. Because the US exchanges on the basis of FACTA, it is neither a participating or declared jurisdiction and the CRS look-through due diligence set out above applies to RFIs with US tax resident accounts.

For the first reporting under the CRS, pre-existing individual accounts and pre-existing entity accounts with a balance over $250,000 on 30 June 2017 are reviewable by 31 July 2018 and if identified as reportable accounts, must be reported for the reporting period 1 July to 31 December 2017, even if not identified as such until after 31 December 2017. This is an exception to the general rule that an account only becomes reportable when identified as such (there being no threshold for individual accounts and a $250,000 threshold for pre-existing entity accounts in subsequent years (as at 31 December of the relevant year)).

The CRS report to the ATO is on all foreign resident accounts, rather than just those of jurisdictions with which Australia has CRS exchange arrangements. Regardless of which foreign jurisdiction the account holder is resident, if the account is one requiring to be reported under the OECD's CRS, it must be reported to the ATO.[47] Financial institutions that fail to collect account holder selfcertifications about the jurisdiction of residence for tax purposes[48] (and account holders that provide false or misleading selfcertifications) will be subject to administrative penalties.

Once gathered, the Commissioner will provide the CRS information to the participating tax authorities covering their residents,[49] and in parallel, will receive information on Australian tax residents with financial accounts held overseas. This requires an instrument that permits information to be exchanged which can be either the Multilateral Convention or a bilateral treaty and agreement.[50] Then, there must be an arrangement that sets the protocols between the exchanging competent authorities as that set out in the OECD's Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information (MCAA).[51]

Possible areas of difficulty

As the CRS is a system in operation, it is important to highlight some impacts on practice.

First, from a compliance view, it is important to remember that the information collected under CRS can be used for any legitimate purpose regardless of whether the information obtained relates to a CRS exchange jurisdiction. Such uses would include audit and enforcement activities, risk profiling and exchange on a basis other than CRS where that is permitted. Whether the fact that the requirement to report to the ATO is framed by reference to the OECD CRS (that includes reference to restrictions on secondary use of exchanged information) restricts such use of information is unknown and untested.

Second, as the CRS information relates to calendar years, there is a risk of unnecessary compliance action due to the difficulty of ascertaining which income belongs to which financial years.

Third, RFIs that are SGEs are liable to the new high civil penalties for false or misleading statements and penalties for non- or late lodgment (CRS returns are "approved forms" for the purpose of the taxation laws)[52] and not being able to provide supporting documents to the ATO if requested that are specific to SGEs. For example, the base penalty is multiplied by five hundred for SGEs that fail to lodge a taxation document required to be given on or after 1 July 2017.[53]

Finally, the interplay between the FATCA and CRS requirements could cause issues for RFIs. For example, FATCA is not a subset of CRS and this runs a risk that CRS due diligence may not pick up a FACTA account if a US citizen is an Australian tax resident. Further problems may arise from the fact the timing and content of reports under both regimes are not exactly aligned, including monetary thresholds.

> *"... information collected under CRS can be used for any legitimate purpose regardless of whether the information obtained relates to a CRS exchange jurisdiction."*

Future developments

The next step of the evolution of AEOI at the international level is likely an increased focus on reporting being able to disclose to the standard set by the anti-money laundering Financial Action Task Force the identity of the ultimate "beneficial ownership" of an account.[54]

Country-by-country reporting

Background

Country-by-country reporting grew out of the G20/OECD's BEPS initiative. In particular action 13, which was to develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business.[55] It is a tax transparency initiative between participating jurisdictions to automatically exchange information on the economic footprints of large multinational enterprises. Australia is currently one of 68 jurisdictions that have signed the CbC Multilateral Competent Authority Agreement (the CbC MCAA) to facilitate the exchange of CbC reports between tax authorities in different jurisdictions.[56] The CbC report can only be exchanged between Australia and another signatory when each jurisdiction has activated a bilateral exchange protocol with the other, usually based on the CbC MCAA.[57] In Australia, the CbC reporting rules are contained in Subdiv 815-E ITAA97 which was enacted by *Tax Laws Amendment (Combating Multinational Tax Avoidance) Act 2015*, which received royal assent on 11 December 2015.

Scope of the rules

In Australia, this requires SGEs to provide three reports (a local file, a master file and a CbC report) to the ATO.[58] The schema is that in each jurisdiction the SGE has a tax presence, they provide a master file and a local file to the local competent authority. The CbC report is to be provided to the SGE's home jurisdiction and that report will be automatically exchanged with the other jurisdictions identified in the report that are parties to CbC initiative with the first exchanges in 2017.

In a very broad sense, the reporting schema is that:

- a master file contains standardised information relevant for all SGE group members;
- a local file refers specifically to material transactions of the local taxpayer; and
- a CbC report contains information relating to the global allocation of the SGE group's income and taxes paid together with certain indicators of the location of economic activity within the SGE's group.[59]

Section 815-355(1) ITAA97 makes each CbC reporting statement (CbC report, master file and local file) a separate approved form, thus the increased SGE lodgment requirements and associated penalties apply to each statement individually. Detailed support and guidance has been provided as to the logistics for impacted entities and groups of entities to meet their Australian CbC obligations.[60] These obligations started for income years commencing on or after 1 January 2016 with reports due 12 months after the relevant year end.[61]

As a transitional arrangement, the first reports for December balancing SGEs to lodge their 2016 statements was 15 February 2018. A further transitional arrangement is where the jurisdiction of the head entity of a SGE does not require a master file. Australian resident entities in that position with a 31 December 2016 year end do not have to lodge a master file for that year as long as they commit to lodging a master file in subsequent years.[62]

The ATO has entered 51 exchange relationships under CbC MCAA which have, in the main, been activated during 2017.[63] Also, on 1 August 2017, the US and Australia signed their Competent Authority Arrangement to implement an arrangement for the automatic exchange of CbC reports,[64] bringing the total number of exchange jurisdictions to 52. However, only 49 jurisdictions will mutually exchange CbC reports with Australia as Bermuda, Cayman Islands and Cyprus have elected not to receive CbC information from Australia.

The ATO is required to exchange the first CbC reports lodged with it within 18 months of the end of the first income year commencing on or after 1 January 2016 (ie before July 2018 for the returns due 15 February 2018 covering 2016 for December balancing SGEs), and within 15 months of the end of the income years thereafter. The worldwide list of exchange relationships activated and the period for which exchange will first occur are on the OECD website.[65]

Future developments

Currently only the CbC report is subject to automatic exchange. Pressure is growing for the master file and a local file also to be exchanged. A potential further threat to the privacy of the information lodged is the Senate Economics References Committee's recommendation 6 in its interim report (*Inquiry into corporate tax avoidance and aggressive minimisation*)[66] "that the government consider publishing excerpts from the Country-by-Country reports".

The proposed mandatory reporting regime

Background

In the final report in respect of BEPS action 12 (mandatory disclosure rules), it was recommended that countries should adopt mandatory disclosure rules which require tax advisers and/or taxpayers to make early disclosures (including pre-lodgment disclosures) of aggressive tax arrangements.[67] The final report sought to provide "a modular framework that enables countries without mandatory disclosure rules to design a regime that fits their need to obtain early information on potentially aggressive or abusive tax planning schemes and their users".[68] The recommendations did not represent a minimum standard and allowed countries to choose whether or not to introduce mandatory disclosure regimes.[69]

Australia's response

Compulsory disclosures already made by companies to the ATO include the reportable tax position (RTP) schedules, which require large businesses to disclose their most contestable and material tax positions to the ATO when they lodge their tax returns (there is also provision to make a voluntary RTP disclosure to the ATO at any time). Companies also voluntarily provide relevant tax information to the ATO through annual compliance arrangements, advanced pricing agreements and pre-lodgment compliance reviews.[70]

Despite both mandatory and voluntary disclosure schemes in existence, the Treasurer, on 3 May 2016 as part of the May 2016 Budget, announced that the government "will develop new rules requiring tax and financial advisors to report potentially aggressive tax planning schemes".[71] A discussion paper was released setting out the government's preliminary positions on how the proposed mandatory disclosure rules should be framed in the Australian context and seeking community views.[72] Those preliminary positions were that:

- the proposed mandatory disclosure rules should apply to tax advisers who are involved in the design, distribution and management of aggressive tax arrangements;
- the proposed mandatory disclosure rules would only be triggered in relation to aggressive tax arrangements with specifically described features to ensure the disclosure rules can be limited to particular arrangements implemented by a specific targeted cohort, rather than imposing more general disclosure requirements on all taxpayers;
- a broad discretion should be provided to the ATO in determining "aggressive tax arrangements" that would trigger mandatory disclosure;
- there should be clear legislative guidelines on the type of information that should be required to be disclosed;
- consistent with the OECD's position, the ATO should have discretion to determine when tax advisers are required to disclose information. However, the information should not be required earlier than 90 days from the publication of the ATO's statement; and
- lateness or non-compliance with the disclosure obligation would be subject to monetary tax penalties on the tax adviser (or the taxpayer, depending on who the disclosure requirement is imposed on).[73]

Consultation closed on 15 July 2016.[74] In September 2016, the Board of Taxation indicated that it was also considering the OECD proposal for mandatory disclosure rules,[75] having been asked to undertake consultation and provide advice on implementation issues.[76] In May 2017, the board undertook consultation aimed at further developing and evaluating the proposed mandatory disclosure rules.[77] Although submissions were made, the timing of any decision on the introduction of the mandatory disclosure rules is still unknown.

Future developments

Given that the Senate Economics References Committee, in its 2016 report *Corporate tax avoidance part II: gaming the system,* made numerous comments about the need to increase the ATO's access to information, the government's May 2016 Budget promise to "develop new rules requiring tax and financial advisors to report potentially aggressive tax planning" and pressure from the OECD, a mandatory reporting scheme is inevitable.

The scope of what may be subject to mandatory reporting is widening internationally. On 11 December 2017, responding to a request of the G7, the OECD issued a discussion paper setting out model mandatory disclosure rules:[78]

> "… to provide tax administrations with intelligence on both the design and supply of CRS Avoidance Arrangements and Offshore Structures as well as to act as a deterrent against the marketing and implementation of these type of schemes where they are being used to circumvent CRS reporting or to obscure or disguise the beneficial ownership in an offshore vehicle."

This was quickly finalised in early March 2018 as *Model mandatory disclosure rules for CRS avoidance arrangements and opaque offshore structures.*[79]

Selected transfer pricing changes

Introduction

A number of transfer pricing changes have either been discussed (eg CbC reporting was addressed in the context of the taxation information-gathering regimes above) or will be addressed (eg the tax treaty changes which are addressed in the context of the tax treaty discussion).

The following will address changes to the OECD Transfer Pricing Guidelines and some of the key ATO transfer pricing guidance.

Changes to the OECD Transfer Pricing Guidelines

A minor, but important, legislative change was the insertion on 4 April 2017 of s 815-135(2)(aa) into the ITAA97).[80] Broadly, s 815-135 ensures that the process of determining:

- the arm's length conditions in the context of relevant dealings between both associated and non-associated entities under Subdiv 815-B ITAA97; or
- the arm's length profits and arm's length conditions under Subdiv 815-C ITAA97,

is done in a way that best achieves consistency with "prescribed guidance material" (which includes the 2010 OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*[81] (2010 OECD Transfer Pricing Guidelines)).

Section 815-135(2)(aa) includes in the "prescribed guidance material", for income years starting on or after 1 July 2016:

> "… the Aligning Transfer Pricing Outcomes with Value Creation, Actions 810 2015 Final Reports, of the Organisation for Economic Cooperation and Development, published on 5 October 2015."

In essence, this means the 23 May 2016 amendments to the 2010 OECD Transfer Pricing Guidelines are prescribed materials.[82] The difference between the 2010 and 2016 amended OECD Transfer Pricing Guidelines is the adoption of the BEPS project's recommendations in respect of BEPS actions 8-10 (aligning transfer pricing outcomes with value creation) and action 13 (transfer pricing documentation and CbC).[83] The major changes are as follows:

- the 2010 guidance for applying the arm's length principle in chapter I, section D has been deleted and replaced by new guidance;
- in chapter II, the guidance on the operation of the comparable uncontrolled price (CUP) method has been updated by the inclusions of paras 2.16A to 2.16E and a new para 2.29A has been added to stress that "… a general rule of thumb will not provide an adequate substitute for a complete and functional and comparability analysis conducted under the principles of Chapters I-III"; and
- documentation requirements set out in chapter V, the content of chapter VI relating to special considerations for intangible property, the content of chapter VII relating to special considerations for the intra-group services and the content of chapter VIII concerning cost contribution arrangements have all replaced by new guidance and annexes.

These changes represent a major change to transfer pricing practice and of more concern is the fact that, despite only receiving royal assent on 4 April 2017, they are deemed to be the "prescribed guidance material" which has been used by taxpayers in self-assessing their transfer pricing positions since 1 July 2016.

> *"These changes represent a major change to transfer pricing practice …"*

Further, on 7 July 2017, the OECD released the 2017 edition of the *OECD Transfer Pricing Guidelines For Multinational Enterprises And Tax Administrations* (2017 OECD Transfer Pricing Guidelines).[84] Although not yet strictly applicable in Australia, these guidelines are likely to become part of the "prescribed guidance material". The 2017 OECD Transfer Pricing Guidelines consolidate in a single volume the 2016 changes to chapters I, II, V, VI, VII and VIII (discussed above) and also include:[85]

- the revisions to chapter IX to conform the guidance on business restructurings to the revisions introduced by the 2015 BEPS reports on actions 8-10 and 13 (approved by the OECD Council in April 2017);
- the revised guidance on safe harbours in chapter IV (approved by the OECD Council in May 2013);
- the consistency changes that were needed in the rest of the OECD Transfer Pricing Guidelines to produce this consolidated version of the guidelines (approved by the OECD's Committee on Fiscal Affairs on 19 May 2017); and
- the revised recommendation of the OECD Council on the determination of transfer pricing between associated enterprises [C(95)126/FINAL].[86]

These developments represent a further change and challenge to transfer pricing practice and the rapid pace of the change is a challenge in itself.

ATO guidance on simplified transfer pricing record-keeping

As part of the implementation of the transfer pricing rules introduced in 2013, the ATO has continued to release a myriad of guidance material, the most recent being in relation to simplified transfer pricing record-keeping, most relevant in the context of this article is PCG 2017/2.[87] PCG 2017/2 sets out a practical administration approach to assist taxpayers in complying with relevant tax laws by formalising the simplified transfer pricing record-keeping FAQs that were previously published in early April 2016 on the ATO website. It provides further explanations and examples for each self-assessing option and the relevant qualifying conditions. These options, which in turn are subject to a number of qualifying conditions, are generally available to small taxpayers, distributors, certain low-level inbound and outbound loan transactions and intra-group services (including technical, management and administration services) and taxpayers with a low level of international related-party dealings.[88]

PCG 2017/2 notes that, if the qualifying conditions are met, taxpayers may self-assess their eligibility for simplified transfer pricing record-keeping. In doing so, they are required to notify the ATO in their annual international dealings schedule.[89] The ATO warns that the use of this option under PCG 2017/2 does not excuse the taxpayer from meeting the general record-keeping requirements in s 262A of the *Income Tax Assessment Act 1936* (Cth) (ITAA36).[90]

On the compliance side, the ATO warns that it may also request documents from taxpayers, confirming their eligibility assessment, but states it "will not allocate compliance resources to review the covered transactions or arrangements specified in that option for transfer pricing purposes, beyond reviewing your eligibility to use the option you have applied [for]".[91]

Tax treaties

Introduction

The majority of recent changes in domestic law governing international tax and in tax treaties have been driven by the recommendations contained in the OECD's BEPs 15 actions final reports released on 5 October 2015.[92]

Some of these recommendations have been, or will be, implemented in our domestic law. The changes mentioned above, include: the proposed anti-hybrid mismatch rules (action 2), the DPT and multinational anti-avoidance law (MAAL) (action 7), the enacting via reference in Australian law of 2016 amendments to the OECD Transfer Pricing Guidelines (actions 8-10), the proposed mandatory disclosure rules (action 12) and the CbC reporting regime (action 13).

The recommendations in the BEPs action final reports that have been implemented have been incorporated into both the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (the Multilateral Convention or the Multilateral Instrument (MLI)) is the outcome of BEPS action 15)[93] and in the OECD (2017) *Model Tax Convention on Income and on Capital* (2017 OECD Model), which was approved by the OECD Council on 21 November 2017.[94] The influence of the BEPS initiative on Australian tax treaty practice can be seen in the Australia–Germany comprehensive tax agreement and its protocol (the German agreement)[95] signed on 12 November 2015 [96] and through the pending implementation of the MLI. As a member of the OECD since 7 June 1971, Australia, like all OECD members, has given undertakings to ensure that its bilateral income tax treaties conform to the OECD Model as interpreted by the OECD commentaries.[97] Therefore, 2017 OECD Model will influence Australian treaty policy for the foreseeable future.

In the following, the article illustrates where the BEPS actions final reports have been implemented and highlights selected aspects of the new rules.

Tax treaty with Germany

Background

As mentioned above, Australia signed a new comprehensive tax treaty with Germany on 12 November 2015 which came into force on 7 December 2016.[98] It replaced the previous German agreement, which had not been altered despite being entered into almost 43 years previously, on 24 November 1972. Markham notes that the overlap of Australia's G20 presidency (1 December 2013 to 30 November 2014) and Germany's presidency of the G7 (1 July 2014 to 31 December 2015), amid the finalisation of the BEPS action plan,[99] uniquely positioned both Australia and Germany to conclude one of the first comprehensive tax treaties to incorporate most of the final BEPS recommendations.[100] The treaty incorporated recommendations from action 2 (anti-hybrid mismatch rules), action 6 (preventing the granting of treaty benefits in inappropriate circumstances),[101] action 7 (preventing the artificial avoidance of permanent establishment status)[102] and action 14 (making dispute resolution procedures more effective).[103] There are a large number of changes between the 1972 and 2015 German agreements, many of which do not arise from the final BEPS recommendations but from the evolution of the OECD Model (eg the changes to article 26 (exchange of information)).[104] However, as stated above, the focus of the following discussion will be on those changes arising from the final BEPS recommendations.

The BEPS changes

The BEPS recommendations in the German treaty commence with title of the treaty and the preamble, as required by the treaty shopping minimum standard set out in the action 6 2015 final report.[105] The additional words are shown in bold in the following extracts:

> "**Title:** Agreement between Australia and the Federal Republic of Germany for the elimination of double taxation with respect to taxes on income **and on capital and the prevention of tax evasion and avoidance**
>
> Explicit Preamble;
>
> Intending to conclude an Agreement for the elimination of double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (**including through treaty–shopping arrangements aimed at obtaining reliefs provided in this Agreement for the indirect benefit of residents of third States**)"

BEPS action 2 final report (anti-hybrid mismatch rules) changes. There are two key BEPS recommendations arising from the action 2 final report incorporated into the 2015 German agreement. The first is in respect of transparent entities, which is encapsulated in a new para 2 in article 1 of the German agreement.[106] It states:

> "2. For the purposes of this Agreement, income (including profits or gains) derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the tax law of either Contracting State shall be considered to be income of a resident of a Contracting State but only to the extent that the income is treated, for purposes of taxation by that State, as the income of a resident of that State."

The inclusion of such a provision is not unique to Australian tax treaties. Given the widespread use of trusts in Australia[107] and the concerns that exist that other treaty partners adopt different views as to whether trusts are fiscally transparent, Australia has adopted a number of uniquely drafted provisions in some other recent treaties[108] to ensure that treaty benefits are available to residents who are participants in (beneficiaries of) trusts. This reduces the risk of both double taxation and double non-taxation of income derived by or through trusts.[109]

The protocol to the agreement between Australia and Germany to the German agreement goes further than the BEPS action 2 recommendations on transparent entities by permitting in cases of any resultant double taxation resort to the mutual agreement provisions (MAP) in article 25.[110] To ensure that para 2 of article 1 does not alter the availability of specific treaty benefits, in the context of dividends, article 3 of the protocol specifically ensures that a dividend exemption will not be required to be applied by one state in respect of tax imposed in other state in respect of dividends received by a resident of that state which were received from an entity in a third state which is considered by the first and second states to be fiscally transparent.[111] Article 3 of the protocol achieves this by deeming a resident of a state to have received dividends directly where the "dividends are derived by or through a fiscal transparent entity or arrangement".

A second BEPS recommendation arising from the action 2 final report is aimed at limiting dual residents access to treaty benefits by ensuring that the dual residents are deemed to be resident in only one of the contracting states. Article 4(3), which in the 1972 German agreement specified that, in the case of dual residence of non-individuals, the place of residence will be the place of effective management (POEM). A gloss has been added which requires, in cases where POEM does not resolve the dual residence, that the contracting states should, under the MAP in article 2, endeavour to determine by mutual agreement the country of which the person will be deemed to be resident. In doing so "the competent authorities will have regard to the person's places of management, the place where it is incorporated or otherwise constituted and any other relevant factors".[112] If the competent authorities cannot reach agreement, the person will not be considered to be a resident of either country for the purposes of enjoying the benefits of the German agreement in certain circumstances.

Other BEPS action 6 final report (preventing the granting of treaty benefits in inappropriate circumstances) changes.
Other than the changes to the title and preamble, discussed above, there are three other key BEPS recommendations arising from the action 6 final report incorporated into the 2015 German agreement. The first is in respect of holding requirements imposed on taxpayers seeking reduced withholding tax benefits in respect of dividends under article 10(2)(a) (which limits source taxation to 5% subject to the shares owned constituting 10% of the voting power of the company).[113] The minimum holding period seeks "to address potential abuse cases where a company with a holding of less than the specified holding percentage increases its holding shortly before the dividends are paid for the purpose of securing the benefits of the provision".[114] The requisite voting power must be held directly throughout a six-month period compared with the 365-day holding period condition contained in the 2017 OECD Model provision.

A second holding period is also imposed in respect of article 10(3) (which excludes source country taxation on intercorporate dividends paid to a company that is the beneficial owner and resident in the other country). Under article 10(3), the source taxation is only excluded if the beneficial owner "directly holds shares representing 80 per cent or more of the voting power of the company paying the dividends and has held those shares for a 12 month period ending on the date of declaration of the dividend". Although such a holding period is consistent with the action 2 final report recommendations, it is not a BEPS change per se. Rather, article 10(3) is a departure from the OECD Model and is similar to holding provisions imposed on similar zero rate concessions in other Australian treaties.[115]

> *"If the competent authorities cannot reach agreement, the person will not be considered to be a resident of either country ..."*

The second BEPS action 6 recommendation is found in article 13(4), which is aimed countering measures to avoid source taxation of shares and other interests in land-rich entities by diluting the proportion of the value of these shares or interests by contributing assets to an entity shortly before the sale of the shares or other interests.[116] Article 13(4) ensures source taxing rights remain "if at any time during the 365 days prior to the alienation, those shares or interests derive more than 50 per cent of their value directly or indirectly from immovable property situated in the other country".[117] Article 13(4) is consistent with article 13(4) of the 2017 OECD Model provision.

The last BEPS action 6 recommendation is found in article 23(2) and (3) and para 7 of the protocol.[118] Under the BEPS minimum standard for treaty shopping, countries are required to include in their bilateral treaties either:

- a combined approach of a specific anti-abuse rule, the limitation-on-benefits (LOB) rule, that limits the availability of treaty benefit to entities that meet certain conditions, and a more general anti-abuse rule based on the principal purpose of transactions or arrangements, the principal purpose test (PPT) rule;
- a PPT rule alone; or
- an LOB rule supplemented by a mechanism that would deal with conduit financing arrangements.

Consistent with this minimum standard, the PPT rule recommended in the action 6 2015 final report has been included as para 2 of article 23 of the German agreement.[119] As such:[120]

> "… the Commentary on the PPT rule set out in paragraph 26 of the Action 6 2015 Final Report, including the examples in that Commentary, is therefore relevant for the interpretation of the German agreement PPT rule."

Article 23(2) states that:

> "… treaty benefits under the German agreement will not be granted in respect of an item of income, or in respect of an item of capital in the case of Germany, if it can be reasonably concluded that the obtaining of the benefit was one of the primary purposes of an arrangement or transaction that resulted in that benefit, unless it is established that the granting of that benefit is in accordance with the object and purpose of the relevant provisions of the German agreement."

Article 23(3) ensures that nothing in the "German agreement will prevent the application of a domestic law of either Australia or Germany which is designed to prevent tax evasion or avoidance".[121] However, where double tax does occur, the competent authorities must consult. Subparagraph 7(1) of the protocol seeks to clarify which domestic laws are "designed to prevent tax evasion or avoidance". They include:

- measures designed to prevent improper use of the provisions of tax agreements;
- measures designed to address thin capitalisation, dividend stripping and transfer pricing;
- in the case of Australia, controlled foreign company, transferor trusts and foreign investment fund rules; and
- measures designed to ensure that taxes can be effectively collected and recovered, including conservancy measures.[122]

BEPS action 7 final report (preventing the artificial avoidance of permanent establishment (PE) status) changes.
There are two groups of BEPS recommendations arising from the BEPS

action 7 final report incorporated into the 2015 German agreement.

The first group of recommendations relate to article 5 (permanent establishment). These recommendations are found in article 5(5), (6), (7), (8), (9) and (10) of the German agreement. In order to counter attempts to avoid the existence of a deemed PE under articles 5(3) and (4), article 5(5) is an anti-abuse rule to counter measures aimed at circumventing the time periods specified in articles 5(3) and (4) by determining the length of the entire project by linking the length of the primary activity with all "closely related enterprises" undertaking activates with a duration of greater than 30 days.[123]

Consistent with the recommendations in the action 7 2015 final report, "closely related enterprises" is defined in article 5(10) of the German agreement to be:[124]

> "… a person shall be considered to be closely related to an enterprise if, based on the relevant facts and circumstances, one has control of the other or both are under common control of the same persons or enterprises. In any case a person will be automatically considered to be closely related to an enterprise if one possesses directly or indirectly more than 50 per cent of the beneficial interests in the other (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company), or if another person possesses directly or indirectly more than 50 per cent of the beneficial interest (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise."

In response to concerns that the list of activities that do not gives rise to a PE in article 5(4) of the 2014 OECD Model could give rise to PE avoidance, article 5(6) of the German agreement, consistent with the recommendations in the action 7 2015 final report, ensures that each of the exceptions included in article 5(6) is restricted to activities that are otherwise of a "preparatory or auxiliary" character.[125] To stop "multinational enterprises avoiding permanent establishment status by fragmenting a cohesive operating business into several small operations in order to argue that each part is merely engaged in preparatory or auxiliary activity",[126] article 5(7) contains an anti-fragmentation rule which provides:[127]

> "… paragraph 6 shall not apply to a place of business that is used or maintained by an enterprise if the same enterprise or of closely related enterprises carries on business at the same place or at another place in the same Contracting state and
>
> (a) that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of this Article, or
>
> (b) the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character,
>
> provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation."

To ensure PE status could not be avoided through the use of certain agency arrangements, consistent with the recommendations in the action 7 2015 final report, article 5(8)(a) (dependent agents) and article 5(9) (independent agents) were inserted in the German agreement.[128] Article 5(8)(a) and (9) specifically adopt the wording of what is now the revised article 5(5) and the new article 5(6) of the 2017 OECD Model. Article 5(8)(a) deems a dependent agency PE to exist where a person:

> "… habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are
>
> a) in the name of the enterprise, or
>
> b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or
>
> c) for the provision of services by that enterprise."

Article 5(8)(b), which prevents an enterprise that carries on substantial manufacturing or processing activities in a country through an intermediary from avoiding tax in that country, does not arise from BEPS, but from Australia's reservation to article 5.[129]

The independent agent rules in article 5(9) of the German agreement are expressed as making the deeming rules in para 8 subject to this provision. Article 5(9) deems an arrangement to constitute an independent agency where the person is carrying on business as an independent agent and acts for the enterprise in the ordinary course of that business, provided they do not act exclusively or almost exclusively for one or more enterprises to which it is closely related. If person does so act, the person will not be considered to be an independent agent.

The action 7 2015 final report also considered the concerns that some agencies of foreign insurance companies sometimes do not meet the requirements of a fixed place of business (within the meaning of article 5(1)) or do not carry on business through a person (within the meaning of article 5(5)) but do large scale business in a state without being taxed in that state on their profits arising from such business.[130] The final report concluded that the recommended modifications to articles 5(5) and (6) should deal with this issue. However, the final report accepted that:[131]

> "… various conventions concluded by OECD member countries … include a provision which stipulates that insurance companies of a State are deemed to have a permanent establishment in the other State if they collect premiums in that other State through an agent established there — other than an agent who already constitutes a permanent establishment by virtue of paragraph 5 — or insure risks situated in that territory through such an agent. The decision as to whether or not a provision along these lines should be included in a convention will depend on the factual and legal situation prevailing in the Contracting States concerned."

The German agreement includes such a paragraph (article 7(6)) which excludes the profits of an enterprise derived from carrying on any form of insurance business, other than life insurance, from the application of article 7. However, that provision is included not from concerns raised in the BEPS process; rather it is consistent with Australia's reservation to article 7.[132]

BEPS action 14 final report (making dispute resolution procedures more effective) changes. There are two groups of key BEPS recommendations arising from action 14 incorporated into the 2015 German agreement.

The first group of recommendations relate to a time limitation on adjustments of profits, found in articles 7(8) and 9(3) of the German agreement. Under article 7(8), no adjustments of profits that are attributable to a PE can be made after the expiration of ten years from the end of the taxable year in which the profits would have been attributable to the PE, except where an audit has been initiated by either country within that ten-year period, or in the case of fraud, wilful default, or, in the case of Australia, gross negligence or, in the case of Germany, negligence.[133] Similarly, under article 9(3), no adjustments of profits can be made after the expiration of ten years from the end of the taxable year in which the profits would have accrued to the enterprise. Again, the ten-year limit does not apply where an audit has been initiated by either country within that ten-year period, or in the case of fraud, wilful default, or, in the case of Australia, gross negligence and, in the case of Germany, negligence.[134]

The second group of recommendations relate to MAP in article 25 of the German agreement. Article 25(1) allows a person who believes that the actions of one or both of the countries result in taxation not in accordance with the provisions of the agreement to present a case, within three years of the first notification of the action, to the competent authority of either country.[135] Article 25(2) provides where a person is able to demonstrate actual or potential imposition of taxation contrary to the provisions of the German agreement, there must be consultation between the competent authorities of the two countries with a view to reaching a solution. If a solution is reached, it must be implemented notwithstanding any time limits in the domestic law of the two countries.[136]

Where the competent authorities cannot reach agreement on a solution to a case where a person has alleged that the actions of either Australia or Germany, or both, will result in taxation not in accordance with the German agreement, article 25(5) provides for arbitration to be used to assist in resolving that case, but only where the competent authorities are unable to reach agreement within two years from when the case was first presented.[137] If the case remains unresolved at the expiration of two years, the person has automatic access to arbitration with or without the specific agreement of the competent authorities. However, the operational rules and procedures of the arbitration mechanism must be mutually agreed by the competent authorities of Australia and Germany.

Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (Multilateral Convention) (Multilateral Instrument (MLI))

Background

Development of the MLI. It had been recognised for some time that a change in the OECD Model Tax Convention or the United Nations Model Double Taxation Convention between Developed and Developing Countries (2011)[138] can take in excess of 50 years to be adopted in the majority of the over 3,000 bilateral tax agreements. Without a mechanism for swift implementation, changes to model tax conventions only widen the gap between the content of treaty models and the content of actual bilateral tax treaties.[139] If BEPS was to be broadly implemented and updated, there was a need to come up with a solution that would enable the recommendations of the BEPS project to be implemented rapidly. OECD action 15 (develop a multilateral instrument) was aimed solving these implementation issues by analysing:[140]

> "…the tax and public international law issues related to the development of a multilateral instrument 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, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution."

It was recognised that with over 3,000 treaties based on different treaty models, the task of developing a single instrument to enable those changes was difficult enough, without taking into account the fact that the various nations engaged in the BEPS process held varying views on the scope of the problems identified and the means that needed to be adopted to solve those problems.[141]

Unlike the other BEPS actions, no discussion paper was released in respect of action 15. Despite that, a final report on action 15 was released in September 2014, well before the expected December 2015 due date.[142] The September 2014 report recognised that a multilateral instrument may be the solution, given the success of such multilateral instruments in various other areas of public international law, and concluded that a multilateral instrument was desirable and feasible, and that negotiations for such an instrument should be convened quickly.

On 15 January 2015, the OECD Committee on Fiscal Affairs (CFA) approved a mandate for development of the multilateral instrument (*Action 15: a mandate for the development of a multilateral instrument on tax treaty measures to tackle BEPS*).[143] An adhoc group of interested countries (including some non-state jurisdictions) was formed and held its first meeting by July 2015, with an aim to conclude drafting by 31 December 2016.[144]

It was announced on 24 November 2016 that the multilateral treaty to give effect to the BEPS actions of the OECD had been completed[145] and the OECD released the 49-page *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*[146] and an 85-page explanatory statement.[147] As the Convention is commonly referred to as the "Multilateral Instrument", the "MLI" or, in the Australian legislation, the "Multilateral Convention", these terms will be used interchangeably. As with the German agreement and the 2017 OECD Model, the integrity rules contained in the MLI are based on the recommendations arising from BEPS action 2 (neutralising the effects of hybrid mismatch arrangements), action 6 (preventing the granting of treaty benefits in inappropriate circumstances), action 7 (preventing the artificial avoidance of permanent establishment status) and action 14 (making dispute resolution mechanisms more effective).

In conjunction with a "speed dating" process, on 7 June 2017, Australia was one of 68 jurisdictions that signed the MLI.[148] The MLI was tabled in parliament on 16 August 2017 and referred to the Joint Standing Committee on Treaties. On 27 November 2017, the Joint Standing Committee on Treaties supported the Multilateral Convention and recommended its ratification in Committee Report 175.[149] On 8 February 2018, the government released exposure draft legislation which will give force of law in Australia to the Multilateral Convention and exposure draft explanatory materials for consultation.[150] Under article 34(2) of the MLI, the MLI enters into force for Australia on the first day of the month following three months after the date of deposit of Australia's instrument of ratification.[151]

The MLI will enter into force on 1 July 2018 following the deposit of the fifth instrument of ratification by Slovenia on 22 March 2018 (the four earlier ratifications deposited with the OECD are from: Austria, the Isle of Man, Jersey and Poland.[152] In accordance with the rules of the MLI, it will start to have effect for existing tax treaties as from 2019.

Operation of the MLI. As mentioned above, the MLI is an instrument aimed at ensuring rapid indirect adoption of the BEPS recommendations into numerous bilateral treaties. It does not operate in the same way as an amending protocol to a single existing treaty, which would directly amend the text of that treaty; rather, "it will be applied alongside existing tax treaties, modifying their application in order to implement the BEPS measures".[153]

Articles 6, 7, 16 and 17 of the MLI reflect BEPS minimum standards that jurisdictions must meet as part of their commitment to the BEPS project. As each of those minimum standards can be satisfied in many different ways, and in light of the broad range of states involved in developing the MLI, the MLI was designed to be flexible enough to accommodate the positions of different countries and jurisdictions while remaining consistent with its purpose.[154] It was also intended the MLI should provide similar flexibility in the optional articles (ie those that did not reflect minimum standards), particularly in relation to how such provisions interact with provisions in "covered tax agreements" (defined in the following paragraph).

The flexibility is provided in the following ways:[155]

> **By specifying the tax treaties to which the Convention applies** (the 'Covered Tax Agreements'). Although it is intended that the MLI would apply to the maximum possible number of existing agreements, jurisdictions wanted the flexibility to not list an agreement because it has been recently renegotiated with BEPS in mind or is in the process of renegotiation. This flexibility is accomplished by ensuring that the Convention will apply only to an agreement specifically listed by the parties (referred to throughout the Convention as 'Contracting Jurisdictions').
>
> **Flexibility with respect to provisions that relate to a minimum standard**. 'Where a minimum standard can be satisfied in multiple alternative ways, the MLI does not give preference to a particular way of meeting the minimum standard.' In cases where the parties each adopt a different approach to meeting a minimum standard that requires the inclusion of a specific type of treaty provision, those countries are required to reach a mutually satisfactory solution consistent with the minimum standard. Where a provision reflects a BEPS minimum standard, opting out of that provision is possible only in limited circumstances, such as where a Party's Covered Tax Agreements already meet that minimum standard.
>
> **Opting out of provisions or parts of provisions with respect to all Covered Tax Agreements**. Where a substantive provision is not mandatory (i.e., is not part of the minimum standard), a Party has the flexibility 'to opt out of that provision entirely (or, in some cases, out of part of that provision). Article 28(1) sets out the list of permissible reservations. This is accomplished through the mechanism of reservations, which are specifically defined for each substantive Article of the Convention. Where a Party uses a reservation to opt out of a provision of the Convention, that provision will not apply as between the reserving Party and all other Parties to the Convention. Accordingly, the modification foreseen by that provision will not be made to any of the Covered Tax Agreements of the reserving Party. An example is Article 3(5)(a) which allows a state to choose that '…the entirety of this Article not to apply to its Covered Tax Agreements'.
>
> It is recognised that a Party may have policy reasons for preserving the application of specific types of existing provisions, even when a Party intends to apply a particular provision of the Convention to its treaty network. The optional Articles allow for 'a Party **to reserve the right to opt out of applying a provision to a subset of Covered Tax Agreements in order to preserve existing provisions that have specific, objectively defined characteristics**. *Except as otherwise provided, such reservations are not mutually exclusive.'* Thus, where a Party makes one or more such reservations, 'all such reservations will apply as between the reserving Party and all Covered Tax Agreements that are covered by such reservations'.
>
> **Choosing to apply optional provisions and alternative provisions.** As the BEPS work often created multiple alternative ways to address a particular BEPS issue or in others 'resulted in a main provision that could be supplemented with an additional provision' (which effectively gives countries a menu of choices). 'The Convention incorporates a number of alternatives or optional provisions that generally will apply only if all Contracting Jurisdictions to a Covered Tax Agreement affirmatively choose to apply them.'

As the MLI has to apply across numerous jurisdictions, in so many differently structured treaties, where the policy settings are different, it had to be flexible to gain widespread support. However, Frost et al warns that this very flexibility of the MLI "could lead to strategic behaviour by countries to preserve what they regard as favourable treaty positions with respect to one or more other countries".[156] Although the OECD's 2016 *Explanatory Statement to Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (MLI ES) suggests the general treaty obligation of good faith will limit such behaviour, there appears to be "open slather" on MLI provisions that do not relate to mandatory new standards, as countries, if they do sign up, only have to act consistently towards other countries in making reservations.

Finally, if a country later withdraws a reservation, then the MLI provision affected by the reservation starts to apply going forward, without regard to the earlier reservation for all covered bilateral treaties where other countries have taken a similar position.

Structure of the MLI

The MLI is structured in order to separate the articles according to the various BEPS actions, as illustrated in the following:

- Preamble;
- Part I — Scope and interpretation of terms (articles 1 and 2);
- Part II — Hybrid mismatches (articles 3 to 5);
- Part III — Treaty abuse (articles 6 to 11);
- Part IV — Avoidance of permanent establishment status (articles 12 to 15);
- Part V — Improving dispute resolution (articles 16 and 17);
- Part VI — Arbitration (articles 18 to 26); and
- Part VII — Final provisions (article 27 to 39).

Each substantive provision of MLI (with the exception of the provisions of Part VI) is structured as follows.[157]

- Articles 3 through 17 begin with one or more paragraphs setting out the BEPS measures in the language of the provisions of the OECD Model Tax Convention that were developed during the course of the BEPS project, subject to some modification, such as:

- changes in terminology to conform the model provision to the terminology used in the MLI (eg the term "Covered Tax Agreement" is used in place of the term "Convention" in the OECD Model to clearly reflect the scope of the MLI and "Contracting Jurisdiction" is used in place of "Contracting State" to refer to the parties to a covered tax agreement, to reflect the fact that the MLI may modify agreements in relation to which one or more party is a non-state jurisdiction;
- because existing tax agreements vary significantly from each other, it was not possible for the provisions of the MLI to identify those provisions by referring to specific articles and paragraph numbers. Instead, where a reference to the provisions of existing tax agreements is necessary, the MLI uses descriptive language to identify those provisions; and
- modifications to reflect differences in underlying provisions.

- It includes compatibility clause(s) which define the relationship between the provisions of the MLI and covered tax agreements in objective terms. As noted above, many of the provisions of the MLI overlap with provisions found in covered tax agreements. Compatibility clauses address possible conflict issues arising between the provisions of the MLI and the existing provisions of covered tax agreements. These clauses, for example, describe the existing provisions which the MLI is intended to supersede, as well as the effect on covered tax agreements that do not contain a provision of the same type. The different mechanisms used to modify the provisions of a covered tax agreement are described by the use specific language. So, the words "in place of" of an existing provision in a covered tax agreement means the MLI provision replaces an existing provision if there is one. The words "applies to" or "modifies" an existing provision in a covered tax agreement means the MLI provision changes the application of an existing provision without replacing it entirely, and the words "in the absence of" an existing provision in a covered tax agreement means the MLI provision is added to the covered tax agreement if there is no existing provision. Finally, the words "in place of or in the absence of" an existing provision in a covered tax agreement means the MLI provision either replaces an existing provision or is added to the covered tax agreement if there is no existing provision.
- The articles also contain reservation clause(s) that define the reservation(s) permitted with respect to each provision (in line with the agreement reached on the relevant BEPS measure). To ensure clarity, a party making a reservation that applies to a subset of covered tax agreements based on objective criteria is required to provide a list of the existing provisions in their covered tax agreements that fall within the defined scope of that reservation.
- To reflect the choice of optional provisions, notification clause(s) are also included in each article. Parties making a choice have to notify the depositary (the Secretary-General of the OECD) of its choice, and describe the consequences of a mismatch between the contracting jurisdictions to a covered tax agreement, which vary depending on the provision in question.
- There are also notification clause(s) to ensure clarity about existing provisions that are within the scope of compatibility clauses. Where a provision supersedes or modifies specific types of existing provisions of a covered tax agreement, parties are generally required to make a notification specifying which covered tax agreements contain provisions of that type.

Australia's status list of reservations and notifications made pursuant to articles 28(7) and 29(4) of the MLI ran for 35 pages, as did Malaysia's.

Scope of the MLI in Australia

Covered tax agreements. As mentioned above, the MLI is a standalone agreement that is designed to only modify the application of a jurisdiction's covered tax agreements to give effect to the BEPS tax treaty related integrity rules. It does not replace existing treaties, nor will it amend the words of the existing treaties. Rather, similar to the *Convention on Mutual Administrative Assistance in Tax Matters*, it will modify the scope of the articles in the existing treaties to give effect to the BEPS tax treaty related integrity rules.

Under article 1 of the MLI, a "Covered Tax Agreement" is a bilateral tax agreement if it is nominated by Australia and the other state ratifies the MLI, notified to the depository and that other state nominates the bilateral tax agreement with Australia as a covered tax agreement. Australia has listed 43 of its 44 current bilateral tax agreements to be covered tax agreements. The exception was the German agreement as it already contains equivalent integrity rules to those contained in the MLI.

As eight of Australia's treaty partners have not signed the MLI (Kiribati, PNG, Philippines, Sri Lanka, Taipei, Thailand, the US and Vietnam) and four treaty partners did not nominate their treaty with Australia (Austria, Korea, Sweden and Switzerland), there remains 31 covered tax agreements, being: Argentina, Belgium, Canada, Chile, China, the Czech Republic, Denmark, Fiji, Finland, France, Hungary, India, Indonesia, Ireland, Italy, Japan, Malaysia, Malta, Mexico, the Netherlands, New Zealand, Norway, Poland, Romania, Russia, Singapore, the Slovak Republic, South Africa, Spain, Turkey and the United Kingdom. As more treaty partners sign and ratify the MLI, the numbers will increase.

The exposure draft explanatory materials note that as the effect of the MLI on Australia's bilateral agreements:[158]

> "… is contingent upon the formal ratification of the Convention by Australia and the relevant jurisdictions party to those tax agreements, as well as the lodgement of each jurisdiction's reservations and notifications. As these ratifications and lodgements are still to occur, it is not possible at this time to specify the full extent of the Multilateral Convention's application to a particular Australian bilateral tax agreement."

As the BEPS changes are likely to be incorporated future treaties (eg Israel) they are unlikely to be nominated as covered tax treaties. Thus, the MLI will only have operation until treaties are updated.

In terms of impact, Vann has estimated that there are 434 possible changes to Australian treaties (ie the 14 substantive provisions in 31 covered tax treaties), even when reduced significantly by the reservations, notifications and the symmetry principle (which eliminates some 241 changes) this still leaves 179 changes (not counting the changes caused by Malaysia signing the MLI).[159]

When will treaties be impacted? As a bilateral tax agreement will only be modified when the MLI enters into force for both jurisdictions, the covered treaties will be modified at different times. Through the concept of "covered tax agreement", which is incorporated into Australian domestic law by the operation of ss 4 and 4AA of the *International Tax Agreements Act 1953* (Cth), the modifications by the MLI will apply automatically whenever a bilateral tax agreement becomes a covered tax agreement.

Impact on Australia's bilateral treaties

Introduction. From the structure of the MLI above, it is clear that the parts of Australia's tax treaties which will be affected are those that fall with the BEPS actions dealing with:

- hybrid mismatches as dealt with in articles 3 to 5 of the MLI covering fiscally transparent entities, dual resident entities and relief of double taxation;
- treaty abuse as dealt with in articles 6 to 11 of the MLI covering the preamble, principal purpose test (PPT), dividend transfers, land rich companies, third state PEs and saving clause;
- avoidance of PE status as dealt with in articles 12 to 15 of the MLI covering the PE definition, in particular the agency test, minor activities exclusion and splitting time thresholds;
- improving dispute resolution as dealt with in articles 16 and 17 of the MLI covering MAP and corresponding adjustments; and
- arbitration as dealt with in articles 18 to 26 of the MLI dealing with compulsory arbitration.

The impact and content of each of these articles and Australia's response to each article is explored below. This examination is not intended to be a detailed analysis of every nuance.

Part II – Hybrid mismatches (articles 3 to 5)

Article 3: Transparent entities (optional article). Under article 3, treaty benefits will be granted for income derived through fiscally transparent entities, such as partnerships or trusts, but only where one of the two countries treats the income as income of one of its residents under its domestic law. These rules will not prevent either country from taxing its own residents.

Australia will adopt article 3 but will make the reservation contained in article 3(5)(d) to not modify existing corresponding bilateral treaties that already have a detailed fiscally transparent entities provision. Australia has indicated that its tax agreements with France and Japan already contain such a provision.[160] As a result, "based on the known or proposed adoption positions of other Signatories to the MLI, Article 3 is expected to modify Australia's tax agreements with: Argentina, Belgium, Chile, Fiji, Ireland, Mexico, the Netherlands, New Zealand, Norway, Poland, Romania, Russia, the Slovak Republic, South Africa, Spain, Turkey and the United Kingdom".[161]

> *"… article 6 will clarify that tax treaties are not intended to create opportunities for non-taxation …"*

Article 4: Dual resident entities (optional article). Most treaties use an entity's place of effective management as the key tiebreaker test to determine a dual resident's country of tax residence for treaty purposes. This test will be expanded to include other factors and authorise the two tax administrations to agree on a single country of residence.

Australia will adopt article 4 but not the rule that would allow the two tax administrations to grant treaty benefits in the absence of such an agreement. As a result, "based on the known or proposed adoption positions of other Signatories to the MLI, Article 4 is expected to modify Australia's tax agreements with: Argentina, China, Fiji, India, Indonesia, Japan, Mexico, the Netherlands, New Zealand, Norway, Poland, Romania, Russia, the Slovak Republic, South Africa and the United Kingdom".[162]

Article 5: Application of methods for elimination of double taxation (optional article). Three options will ensure that countries relieve double taxation by crediting foreign tax against domestic tax, rather than by exempting foreign income from domestic tax.

Australia will not adopt article 5 because all of its treaties apply the credit method in relieving double taxation for Australian residents. Australia will also not adopt the provisions that would prevent other countries from applying their chosen positions under article 5.

Part III – Treaty abuse (articles 6 to 11)

Article 6: Purpose of a covered tax agreement (mandatory article). A new treaty preamble prescribed by article 6 will clarify that tax treaties are not intended to create opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty-shopping arrangements.

Australia will adopt article 6, including the optional text indicating a desire to further develop its economic relationships with other signatories and enhance cooperation in tax matters. As a result, "based on the known or proposed adoption positions of other Signatories to the MLI, Article 6(1) is expected to modify Australia's tax agreements with Argentina, Belgium, Canada, Chile, China, the Czech Republic, Denmark, Fiji, Finland, France, Hungary, India, Indonesia, Ireland, Italy, Japan, Malta, Mexico, the Netherlands, New Zealand, Norway, Poland, Romania, Russia, Singapore, the Slovak Republic, South Africa, Spain, Turkey and the United Kingdom".[163]

Article 7: Prevention of treaty abuse (mandatory article). Article 7 prescribes new anti-abuse rules that will enable tax administrations to deny treaty benefits in certain circumstances: the principal purpose test (PPT) and the simplified limitation on benefits rule (S-LOB). Adopting the PPT is mandatory. The S-LOB is a supplementary and optional rule.

Australia will adopt article 7 with only the PPT, including the discretion not to apply the PPT in certain circumstances. As a result, "based on the known or proposed adoption positions of other Signatories to the MLI, Article 7 is expected to modify Australia's tax agreements with: Argentina, Belgium, Canada, Chile, China, the Czech Republic, Denmark, Fiji, Finland, France, Hungary, India, Indonesia, Ireland, Italy, Japan, Malta, Mexico, the Netherlands, New Zealand, Norway, Poland, Romania, Russia, Singapore, the Slovak Republic, South Africa, Spain, Turkey and the United Kingdom".[164]

Article 8: Dividend transfer transactions (optional article). Shares will be required to be held for 365 days before any non-portfolio intercorporate dividends payable in respect of those shares become eligible for reduced tax rates under tax treaties. This holding period will be added to bilateral treaties that do not already include a minimum holding period and replace existing holding periods in treaties that do.

Australia will adopt article 8 without reservation. As a result, "based on the known or proposed adoption positions of other signatories to the MLI, article 8 is expected to modify Australia's tax agreements with: Argentina, France, Mexico, New Zealand, Romania, Russia and South Africa".[165]

Article 9: Capital gains from alienation of shares or interests of entities deriving their value principally from immovable property (optional article). Countries will be able to tax capital gains derived by foreign residents from the disposal of shares or other interests in "land-rich" entities (where the underlying property is located in that country) if the entity was land-rich at any time during the 365 days preceding the disposal.

Australia will adopt article 9 but preserve existing bilateral rules that apply to the disposal of comparable interests (non-share interests) in land-rich entities. As a result, "based on the known or proposed adoption positions of other Signatories to the MLI, Article 9 is expected to modify Australia's tax agreements with: Argentina, Belgium, Chile, China, Fiji, France, India, Indonesia, Ireland, Japan, Mexico, the Netherlands, New Zealand, Poland, Russia, the Slovak Republic and Spain".[166]

Article 10: Anti-abuse rule for permanent establishments situated in third jurisdictions (optional article). Under article 10, treaty benefits will be denied where an entity that is a resident of one country derives "passive" income from the other country through a PE located in a third country, and that income is both exempt in the entity's home country and subject to reduced taxation in the third country.

Australia has made a reservation under article 10(5)(a) to not adopt article 10 at this time, pending further review of its potential impacts in the Australian context.

Article 11: Application of tax agreements to restrict a party's right to tax its own residents (optional article). A tax treaty will not generally restrict a country's right to tax its own residents. The article 11 rule will replace existing bilateral rules that give effect to this principle, some of which have more limited application.

Australia will adopt article 11 without reservation. As a result, "based on the known or proposed adoption positions of other Signatories to the MLI, Article 11 is expected to modify Australia's bilateral tax agreements with: Argentina, Belgium, Chile, China, Fiji, India, Indonesia, Mexico, New Zealand, Norway, Poland, Romania, Russia, the Slovak Republic and the United Kingdom".[167]

> "*Article 13 seeks to ensure that only genuine preparatory or auxiliary activities will be excluded from the definition of permanent establishment.*"

Part IV – Avoidance of permanent establishment status (articles 12 to 15)

Article 12: Artificial avoidance of permanent establishment status through commissionnaire arrangements and similar strategies (optional article). Article 12 prescribes that where an intermediary plays the principal role in concluding substantively finalised business contracts in a country on behalf of a foreign enterprise, that arrangement will constitute a "permanent establishment" of the foreign enterprise in that country. Genuine independent agency arrangements will not be affected.

Australia will not adopt article 12 at this time. Australia will consider adopting these rules bilaterally in future treaty negotiations to enable bilateral clarification of their application in practice. Pending this, the MAAL will continue to safeguard Australian revenue from egregious tax avoidance arrangements that rely on a "book offshore" model.

Article 13: Artificial avoidance of permanent establishment status through the specific activity exemptions (optional article). Most tax treaties include a list of exceptions to the definition of "permanent establishment" where a place of business is used solely for specifically listed activities, such as warehousing or purchasing goods. Article 13 seeks to ensure that only genuine preparatory or auxiliary activities will be excluded from the definition of permanent establishment. In addition, related entities will be prevented from fragmenting their activities in order to qualify for this exclusion.

Australia will adopt article 13 but preserve existing corresponding bilateral rules. As a result, "based on the known or proposed adoption positions of other Signatories to the MLI, Article 13 is expected to modify Australia's tax agreements with: Argentina, Belgium, Chile, Fiji, France, India, Indonesia, Ireland, Italy, Japan, Mexico, the Netherlands, New Zealand, Norway, Romania, Russia, the Slovak Republic, South Africa, Spain, Turkey and the United Kingdom".[168]

Article 14: Splitting-up of contracts (optional article). Most tax treaties include rules that deem building or construction projects that exceed a specified time period (eg 12 months) to constitute a PE. Article 14 will prevent related entities from avoiding the application of the specified time period by splitting building or construction-related contracts into several parts.

Australia will adopt article 14 but preserve existing bilateral rules that deem a PE to exist in relation to offshore natural resource activities. As a result, "based on the known or proposed adoption positions of other Signatories to the MLI, this Article is expected to modify Australia's tax agreements with: Argentina, Fiji, France, India, Indonesia, Ireland, the Netherlands, New Zealand, Norway, Romania, Russia and the Slovak Republic".[169]

Article 15: Definition of a person closely related to an enterprise (optional article). Under article 15, a "person closely related to an enterprise" will be defined for the purpose of establishing whether or not a PE exists under articles 12, 13 and 14. A person is closely related to an enterprise if, based on all the relevant facts and circumstances:

- one has control of the other;
- both are under the control of the same persons or enterprise;

- one person possesses directly or indirectly more than 50% of the beneficial interest in the other (or, in the case of a company, the aggregate vote and value of the company's shares or of the beneficial equity in the company); or
- if another person possesses directly or indirectly more than 50% of the beneficial interest (or, in the case of a company, the aggregate vote and value of the company's shares or of the beneficial equity in the company) in the person and the enterprise.

Article 15 is necessary for the coherent operation of articles 12, 13 and 14. Article 5(10) of the 2015 German agreement includes this definition. On this basis, Australia's approach is to adopt article 15 without reservation across its covered tax agreements.

Part V – Improving dispute resolution (articles 16 and 17)

Article 16: Mutual agreement procedure (mandatory article). As the new rules in article 16 seek to ensure the consistent and proper implementation of tax treaties, including the resolution of disputes regarding their interpretation or application, taxpayers will have a more effective tax treaty-based dispute resolution procedure.

Australia will adopt article 16 without reservation.

Article 17: Corresponding adjustments (mandatory article). Transfer pricing adjustments can result in double taxation when one country makes an adjustment to an entity's profits and the other country does not make a compensating adjustment to the profits of the relevant related entity. Under article 17, a country will be required to make a downward adjustment to the profits of a resident entity, as a result of an upward adjustment by the other country to the profits of an associated entity which is a resident of that other country (provided both countries agree that the upward adjustment is justified).

Australia will adopt article 17 but preserve existing corresponding bilateral rules. This will only affect the treaty with Italy as all the rest of Australia's covered tax agreements have corresponding bilateral rules.[170]

Part VI – Arbitration (articles 18 to 26)

Articles 18-26: Arbitration (optional article). Taxpayers will be able to refer MAP disputes that remain unresolved after two years to independent and binding arbitration.

Australia will adopt independent and binding arbitration subject to the following conditions:

- disputes which have been the subject of a decision by a court or administrative tribunal will not be eligible for arbitration, or will cause an existing arbitration process to terminate;
- breaches of confidentiality by taxpayers or their advisers will terminate the arbitration process; and
- disputes involving the application of either Pt IVA ITAA36 or s 67 of the *Fringe Benefits Tax Assessment Act 1986* (Cth) will be excluded from the scope of arbitration.[171]

Altering positions and withdrawal from MLI

Countries which sign the MLI may in the future withdraw from it. If that occurs, changes made to existing bilateral treaties through the MLI will not be affected and it will still be necessary to either terminate or renegotiate the bilateral treaty for a country to rid itself of particular MLI treaty obligations.[172]

2017 OECD Model Tax Convention on Income and on Capital

Background

As mentioned above, the 2017 OECD Model has become the new template for the future of Australia's tax treaty practice. The majority of changes to 2017 OECD Model compared to 2014 OECD Model have resulted from the BEPS final reports on actions 2, 6, 7 and 14.[173] As many of these changes have been discussed in the context of both the Australian–Germany comprehensive tax treaty and the MLI, the following will be a high level description of the changes.[174]

Principal changes

Following from the BEPS action 6 (Preventing the granting of treaty benefits in inappropriate circumstances) final report, the changes are to:[175]

- the title and preamble;
- article 1 (Persons covered) to add para 3 (savings clause) and to the commentary on article 1 relating to "Improper use of the Convention";
- articles 3 (General definition) and 4 (Resident) concerning treaty residence of pension funds and to para 3 of article 4 (the tie-breaker rule for determining the treaty residence of dual-resident persons other than individuals);
- para 4 of article 13, addressing transactions that seek to circumvent the application of that provision, and related commentary changes;
- subpara 2(a) of article 10, introducing a minimum holding period to access the 5% rate applicable to dividends, and related commentary changes;
- articles 23A and 23B as a consequence of changes to paras 2 and 3 (savings clause) of article 1 (Persons covered); and
- a new article 29 (Entitlement to benefits), which includes in the OECD Model a limitation-on-benefits (LOB) rule (both simplified and detailed versions), an anti-abuse rule for PEs situated in third states and a principal purpose test (PPT) rule.

There are also changes to article 1 (Persons covered), to introduce a new para 2 and its commentary concerning transparent entities resulting from BEPS action 2 (Neutralising the effects of hybrid mismatch arrangements) final report.[176] As well, there are changes to article 5 (Permanent establishment) and its commentary resulting from the BEPS action 7 (Preventing the artificial avoidance of permanent establishment status) final report and the follow-up work.

Arising from the BEPS action 14 final report (Making dispute resolution procedures more effective), there are changes to:

- para 2 of article 3 and related changes to the commentaries on articles 3 and 25 which are intended to clarify the legal status of a competent authority mutual agreement by removing any doubt that, in a case where the competent authorities have agreed on a common meaning of an undefined term, the domestic law meaning of that term would not be applicable; and
- article 25 (Mutual agreement procedure (MAP)) and to the commentaries on articles 2, 7, 9 and 25 to reflect the MAP arbitration provision developed in the negotiation of the MLI.

The 2017 update also includes certain other changes to the OECD Model that were previously released for comment and were not developed as part of the work on the treaty-related BEPS measures. These changes include:

- the commentary on article 5 integrating previous work on the interpretation and application of article 5 and changes resulting from the work on action 7 of the BEPS project; and
- article 8 (International shipping and air transport), related changes to subpara 1(e) of article 3 (the definition of "international traffic") and para 3 of article 15 (concerning the taxation of the crews of ships and aircraft operated in international traffic), and consequential changes to articles 6, 13 and 22.

Other minor changes that were not BEPS-related were the changes to:

- the commentary on article 4 relating to the issue of whether a house rented to an unrelated person can be considered to be a "permanent home available to" the landlord for purposes of the tie-breaker rule in article 4(2)(a) and to clarify the meaning of "habitual abode" in the tie-breaker rule in article 4(2)(c);
- the commentary on article 5 to add a new paragraph which indicates that registration for the purposes of a value-added tax or goods and services tax is, by itself, irrelevant for the purposes of the application and interpretation of the permanent establishment definition and to provide a cross-reference to similar language in the BEPS final report on action 1 (Addressing the tax challenges of the digital economy) and to the international VAT/GST guidelines; and
- subpara 2(a) of article 10 (Dividends) to delete the parenthetical reference "(other than a partnership)" to ensure that the reduced rate of source taxation on dividends provided by that subparagraph is applicable in circumstances in which the new article 1(2) (the transparent entity provision) would apply.

Finally, the 2017 update includes the changes and additions made to the observations and reservations of OECD member countries and to the positions of non-OECD economies.

Future developments

In the treaty space, change is likely to continue as states sign up to the various multilateral agreements, such as CRS and CbC reporting and to the MLI. The OECD will continue its post-BEPS work which will result in further modifications to the OECD Transfer Pricing Guidelines and the OECD Model. From a purely Australian context, as negotiations for comprehensive tax treaty with Israel have been on foot since 17 September 2015, it would be expected that the treaty should be concluded in the foreseeable future.[177]

Conclusion

As can been seen from this article, if there is a consistent theme across Australia's international tax rules, it is change. Much, but by no means all, of that change is being driven by the BEPS initiative. There is a great deal of change that needs to be made operational, such as the MLI and CbC and CRS reporting and exchange. As well, there are initiatives such as mandatory reporting yet to evolve from their consultation phase. Initiatives also seem to be intersecting, for example, the development of the OECD's mandatory reporting recommendation relating to CRS avoidance schemes.

International taxation has always been complex and shows no sign of becoming less so. As such, it is thought best to leave some final words to reflect on from a recent Nobel laureate:[178]

> "As the present now
> Will later be past
> The order is
> Rapidly fadin'.
> And the first one now
> Will later be last
>
> For the times they are a-changin'."

MLI postscript

Consistent with the predictions of constant change, on 28 March 2018, the Treasury Laws Amendment (OECD Multilateral Instrument) Bill 2018, which seeks to give force of law in Australia to the MLI, was introduced into the parliament. For the treaty to come into force, royal assent is required and then three months must elapse from the date of the depositing of the instrument of ratification (post-royal assent) with the Secretary-General of the OECD. It will enter into force on the first day of the month following the elapse of the three months.

Once in force, the MLI will affect Australia's existing tax agreements when the relevant partner jurisdictions have also satisfied their own entry obligations. Once this match occurs, the timing of the changes will be:

- in respect of withholding tax on amounts paid or deemed to be paid to a non-resident on or after 1 January occurring on or after the later date of entry into force of the MLI for Australia and each of its relevant partner jurisdictions;
- in respect of all other taxes levied by Australia in relation to income, profits or gains of any income year beginning on or after six months after the later date of entry into force of the MLI for Australia and each of its relevant partner jurisdictions; and
- in respect of the mutual agreement procedure and mandatory binding arbitration, generally, the later date of entry into force of the MLI for Australia and each of its relevant partner jurisdictions.

Provided there are no unexpected hold-ups in the parliamentary process, this means that, for treaties with jurisdictions that have already filed instruments of ratification and are on Australia's list of covered tax agreements (eg the Slovak Republic and Poland), the new withholding taxes holding rules and the expanded mutual agreement procedures could operate as early 1 January 2019, and the MLI rules affecting all other taxes will come into effect from 1 July 2019.

Michael Dirkis, CTA
Professor of Taxation Law
University of Sydney Law School

Brett Bondfield, CTA
Senior Lecturer
University of Sydney Business School

An earlier version of this article was presented at The Tax Institute's 33rd National Convention held in Cairns on 14 to 16 March 2018.

References

1 This article has been developed from a paper presented at The Tax Institute's 33rd National Convention: M Dirkis and B Bondfield, "Recent developments in Australia's international tax rules", presented to the Tax Institute's 33rd National Convention, Cairns, 14-16 March 2018.

2 *Bywater Investments Ltd v FCT; Hua Wang Bank Berhad v FCT* [2016] HCA 45.

3 TR 2017/D2. For further discussion of these issues, see M Dirkis, "Chapter 4: The residency rules", in P Broderick et al, *The Australian taxation system: the 2017 great debate*, Australian Tax Research Foundation (2018), pp 57-75 (pending).

4 The OECD's recommendations in respect of countering hybrid mismatch rules were released on 5 October 2015 (see OECD (2015), *Neutralising the effects of hybrid mismatch arrangements, action 2 – 2015 final report*, OECD/G20 Base Erosion

and Profit Shifting Project, OECD Publishing, Paris (Action 2 final report). The 115 pages of domestic rules implementing these recommendations were released as an exposure draft on 24 November 2017. Available at https://treasury.gov.au/consultation/c2017-t237040/. This complex legislation is dependent on interpretative aid provided by the 454-page OECD Action 2 final report and did not incorporate further recommendations of the related report: OECD (2017), *Neutralising the effects of branch mismatch arrangements, action 2: inclusive framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, to which the Australian Government is also committed (see R Vann, T Eggleston and N Heggart, "Tax Brief: US tax reform and its implications for Australia" (13 February 2018), Greenwoods, Herbert Smith, Freehills). On 7 March 2018, the government released for consultation revised exposure draft legislation that incorporates the previously released exposure draft legislation, as well as rules to address branch mismatch arrangements and the integrity rule, to address arrangements used to circumvent the hybrid mismatch rules, announced in November 2017. Available at https://treasury.gov.au/consultation/c2018-t268551/.

5 These rules complemented the *Tax Laws Amendment (Combating Multinational Tax Avoidance) Act 2015* (Cth) (multinational antiavoidance law (MAAL)), which, it is argued, are consistent with the BEPS project's recommendations in respect of OECD BEPS action 7 (Preventing artificial avoidance of permanent establishment): Treasurer (media release 6 October 2015), "OECD report supports Australian government action on multinational tax avoidance". Available at http://sjm.ministers.treasury.gov.au/media-release/003-2015/.

6 The Treasury Laws Amendment (Measures for a later sitting) Bill 2018: (MAAL) (available at https://treasury.gov.au/consultation/c2018-t261444/) aims to strengthen the integrity of the MAAL by preventing large multinationals from using foreign trusts and partnerships in corporate structures to avoid the application of the MAAL. It was announced in the 2017-18 Budget with changes to apply retrospectively from 1 January 2016 and was introduced into the parliament on 28 March 2018: Treasurer, (media release 28 March 2018), "Making sure multinationals pay their fair share". Available at http://sjm.ministers.treasury.gov.au/media-release/026-2018/.

7 M Dirkis, "Recent developments in tax transparency", presented to the Tax Institute's 31st National Convention, Melbourne, 4 March 2016, pp 12-14.

8 S 3C(1)(b) of the *Taxation Administration Act 1953* (Cth) (TAA).

9 S 3C(1)(a) TAA.

10 S 3E TAA.

11 As defined in s 960-555 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97).

12 S 3CA(1) to (3) TAA.

13 S 1274 of the *Corporations Act 2001* (Cth).

14 Paras 1.7 and 1.8 of the explanatory memorandum to the Tax Laws Amendment (2013 Measures No. 2) Bill 2013.

15 S 355-25, Sch 1 TAA.

16 S 355-47, Sch 1 TAA.

17 Above, n 14 at para 1.9.

18 Treasurer, (media release 12 May 2015), "Voluntary Corporate Disclosure Code". Available at http://jbh.ministers.treasury.gov.au/media-release/043-2015/.

19 Board of Taxation, (December 2015) *A tax transparency code: consultation paper*, p 3. Available at http://taxboard.gov.au/consultation/voluntary-tax-transparency-code/.

20 Board of Taxation, (February 2016) *A tax transparency code: a report to the government* (Board of Taxation TTC report). Available at http://taxboard.gov.au/consultation/voluntary-tax-transparency-code/.

21 On 2 October 2014, the Senate referred *An inquiry into corporate tax avoidance* to the Senate Economics References Committee for inquiry and report. On 18 August 2015, the interim report: Commonwealth, Senate Economics References Committee, (released 18 August 2015) *Corporate tax avoidance: Part I—You cannot tax what you cannot see* (available at www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Corporate_Tax_Avoidance/Report_part_1) made 17 recommendations. In particular, see recommendation 3 at para 5.31.

22 Commonwealth, Senate Economics References Committee (released 22 April 2016) *Corporate tax avoidance Part II: Gaming the system*, at para 3.13. Available at www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Corporate_Tax_Avoidance/Report_part_2.

23 Ibid at para 3.13.

24 Board of Taxation TTC report, above n 20 at 14.

25 Ibid at 4.

26 Ibid at 2.

27 Ibid at 3.

28 The reports are available at data.gov.au (Cth) "Voluntary tax transparency code" at https://data.gov.au/dataset/voluntary-tax-transparency-code.

29 Board of Taxation TTC report, above n 20 at 4.

30 Board of Taxation, *CEO update – December 2017,* Available at http://tax>board.gov.au/publications-and-media/ceo-updates /.

31 Ibid.

32 Australian Accounting Standards Board (16 May 2017), "Invitation to comment: draft appendix to the tax transparency code". Available at www.aasb.gov.au/admin/file/content105/c9/ITC_Draft_Tax_Transparency_Code_Disclosures_05-17.pdf.

33 For further information on the genesis of these tax information-gathering regimes see: M Dirkis and B Bondfield, "The developing international framework and practice for the exchange of tax related information: evolution or change?", (2013) 11 *eJournal of Tax Research* 115; and M Dirkis, above n 7.

34 S 960-555(3) ITAA97.

35 See Deputy Prime Minister and Treasurer and Assistant Treasurer (joint media release 19 June 2013), "The Gillard Government welcomes automatic tax information sharing by G8 tax authorities". Available at https://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2013/111.htm&pageID=003&min=djba&Year=&DocType=0.

36 OECD (2017), *Standard for automatic exchange of financial account information in tax matters, second edition*, OECD Publishing. Available at http://dx.doi.org/10.1787/9789264267992-en.

37 OECD, (press release 14 September 2017), "First automatic common reporting standard exchanges between 49 jurisdictions set to take place this month; now over 2000 bilateral exchange relationships in place". Available at www.oecd.org/ctp/exchange-of-tax-information/first-automatic-crs-exchanges-between-49-jurisdictions-to-take-place-over-2000-bilateral-exchange-relationships-in-place.htm.

38 Treasurer, Parliamentary Secretary to the Minister for Foreign Affairs and Parliamentary Secretary to the Minister for Trade and Investment (joint media release 3 June 2015), "Australia signs up to combat tax evasion". Available at http://jbh.ministers.treasury.gov.au/media-release/054-2015/.

39 For example, s 396-110, Sch 1 TAA.

40 S 369-120(3), Sch 1 TAA.

41 It generally includes banks and other deposit-taking institutions, custodial institutions, brokers that hold financial assets for the account of others, investment entities and arrangements, and insurance companies that issue or make payments to investment-linked life insurance or annuity contracts — see para 1.20 of the explanatory memorandum to the Tax Laws Amendment (Implementation of the Common Reporting Standard) Bill 2015 (2015 EM). The cost to financial institutions in Australia identifying and collecting information about their customers that are foreign tax residents then reporting that information to the Commissioner was estimated at $67.2m per year (2015 EM, ibid ch 3).

42 Ss 396-105(1), (2) and (4), Sch 1 TAA.

43 Current participating jurisdictions to exchange with Australia in September 2018 are: Argentina, Austria, Belgium, Belize, Bermuda, Brazil, British Virgin Islands, Bulgaria, Canada, Cayman Islands, Colombia, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Faroe Islands, Finland, France, Germany, Gibraltar, Greece, Greenland, Guernsey, Hungary, Iceland, India, Ireland, Isle of Man, Italy, Japan, Jersey, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Mauritius, Mexico, Monaco, Montserrat, Netherlands, New Zealand, Norway, Portugal, Romania, St Vincent & The Grenadines, San Marino, Singapore, Slovak Republic, Slovenia, South Africa, South Korea, Spain, Sweden, Switzerland, Turks & Caicos and Uruguay. ATO, (8 January 2018), "Automatic exchange of information guidance – CRS and FATCA", 4.19. Available at www.ato.gov.au/General/International-tax-agreements/In-detail/International-arrangements/Automatic-exchange-of-information---CRS-and-FATCA/.

44 These are: Antigua & Barbuda, Bahamas, Barbados, China, Cook Islands, Costa Rica, Curacao, Hong Kong, Indonesia, Israel, Kuwait, Lebanon, Malaysia, Marshall Islands, Nauru, Panama, Poland, Russia, Saint Kitts & Nevis, Saint Lucia, Samoa, Saudi Arabia, Seychelles, Saint Maarten and the United Kingdom. Legislative Instrument F2017L00852, *CRS committed jurisdiction list* (26 June 2017) (available at www.legislation.gov.au/Details/F2017L00852) and associated explanatory statement (available at www.legislation.gov.au/Details/F2017L00852/Explanatory%20Statement/Text).

45 *Agreement between the Government of Australia and the Government of the United States of America to Improve International Tax Compliance and to Implement FATCA* (FACTA Agreement) on 28 April 2014. Available at https://treasury.gov.au/tax-treaties/intergovernmental-agreement/.

46 This concept is summarised in ATO, above n 43 para 2.5:

An entity is a Type B Investment Entity if it is:

- investing on its own account, as a collective investment vehicle on behalf of participants or as a trust on behalf of beneficiaries, and
- managed by a Depository Institution, a Custodial Institution, a Specified Insurance Company or a type A Investment Entity mentioned above, and it meets the Financial Assets test described below.

An entity is managed by a Financial Institution if that Financial Institution performs, either directly or through another service provider, any of the investing or trading activities described above on behalf of the entity. The activities may be performed as part of managing the entity as a whole, or by appointment to manage all or a portion of the Financial Assets of the entity.

An entity is not regarded as being managed by a Financial Institution if that Financial Institution does not have discretionary authority to manage the entity's assets.

47 Subdiv 396-C, Sch 1 TAA.

48 Individuals will generally need to answer two additional questions on their tax residence and taxpayer identification number, while entities will generally need to provide additional information on their controlling persons' tax residence and their taxpayer identification numbers. See paras 3.145 – 3.147 of the 2015 EM, above n 41.

49 It is stated in the 2015 EM, ibid, para 1.3 that: "To protect the confidentiality of account holders' information, the ATO will not automatically

exchange information with the tax authority of another jurisdiction unless it has the legal and administrative capacity to ensure confidentiality. In addition, the ATO will be able to suspend the exchange of information with another jurisdiction's tax authority if it determines that there is or has been significant non-compliance with confidentiality safeguards".

50 This is based on any tax treaty arrangement that permits the automatic exchange of information in tax matters and includes: Australia's DTAs listed and located at https://treasury.gov.au/tax-treaties/income-tax-treaties/; tax information exchange agreements (TIEAs) listed and located at https://treasury.gov.au/tax-treaties/tax-information-exchange-agreements/; and the multilateral *Convention on Mutual Administrative Assistance in Tax Matters* at https://treasury.gov.au/tax-treaties/convention-on-mutual-administrative-assistance-in-tax-matters/.

51 OECD, Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information www.oecd.org/tax/automatic-exchange/international-framework-for-the-crs/multilateral-competent-authority-agreement.pdf, signed by Australia on 3 June 2015. This sets the competent authority exchange arrangements required under article 6 of the Multilateral Convention which authorises AEOI.

52 S 396-105(4), Sch 1 TAA.

53 S 286-80, Sch 1 TAA.

54 OECD Global Forum on Transparency and Exchange of Information for Tax Purposes (2016), "2016 terms of reference to monitor and review progress towards transparency and exchange of information on request for tax purposes", para 5. Available at www.oecd.org/tax/transparency/about-the-global-forum/publications/terms-of-reference.pdf. The relevant FATF recommendations are 24 and 25 in: Financial Action Task Force (2012), *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation, updated October 2016*, FATF, Paris, France. Available at www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf.

55 OECD, *Action plan on base erosion and profit shifting* (2013) OECD Publishing, Paris (Action Plan), released on 19 July 2013 (available at www.oecd-ilibrary.org/docserver/download/2313331e.pdf?expires=1455337981&id=id&accname=ocid195150&checksum=C5CA19E7B8657BE28CC236FFE92D6269) at 23 notes that action 13, in part, aims to develop rules which "will include a requirement that Multination Enterprises (in Australian legislation called SGEs) provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template". The final report on action 13 was released on 5 October 2015: OECD (2015), *Transfer pricing documentation and country-by country reporting, action 13 – 2015 final report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris (Action 13 Final Report).

56 OECD website, "Activated exchange relationships for country-by-country reporting". Available at www.oecd.org/tax/beps/country-by-country-exchange-relationships.htm.

57 For example, between Australia and the USA, *Arrangement between the Competent Authority of the United States of America and the Competent Authority of Australia on the Exchange of Country-by-Country Reports* (1 August 2017). Available at www.ato.gov.au/General/International-tax-agreements/In-detail/International-arrangements/Exchange-of-CbC-report-with-the-U-S/.

58 Subdiv 815-E ITAA97.

59 OECD (2015), *Action 13: Guidance on the implementation of transfer pricing documentation and country-by-country reporting.* Available at www.oecd.org/ctp/beps-action-13-guidance-implementation-tp-documentation-cbc-reporting.pdf.

60 LCR 2015/3. See also ATO, "Country-by-country reporting guidance". Available at www.ato.gov.au/Business/International-tax-for-business/In-detail/Transfer-pricing/Country-by-Country-reporting/Country-by-Country-Reporting-Guidance/.

61 S 815-355(2) ITAA97.

62 Above n 60.

63 These are: Argentina, Austria, Belgium, Bermuda*, Brazil, Bulgaria, Canada, Cayman Islands*, Colombia, Croatia, Cyprus*, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Guernsey, Hungary, Iceland, India, Indonesia, Ireland, Isle of Man, Italy, Japan, Jersey, Korea, Latvia, Liechtenstein, Lithuania, Luxembourg, Malaysia, Malta, Mauritius, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Russia, Singapore, Slovak Republic, Slovenia, South Africa, Spain, Sweden, Switzerland, United Kingdom, United States.

Jurisdictions that will exchange with Australia for taxable periods starting on or after 1 January 2017: Chile, Uruguay.

* Non-reciprocal jurisdictions that will provide CbC reports to Australia but have chosen not to receive CbC reports from Australia.

Ibid.

64 *Arrangement between the Competent Authority of the United States of America and the Competent Authority of Australia on the Exchange of Country-by-Country Reports* (1 August 2017). Available at www.ato.gov.au/General/International-tax-agreements/In-detail/International-arrangements/Exchange-of-CbC-report-with-the-U-S/.

65 Available at www.oecd.org/tax/beps/country-by-country-exchange-relationships.htm.

66 Above n 21, recommendation 6 at para 5.40.

67 The OECD's recommendations in respect of mandatory disclosure rules were released on 5 October 2015: OECD (2015), *Mandatory Disclosure Rules, Action 12 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris (Action 12 Final Report), p 10.

68 Ibid at 9.

69 ibid at 9.

70 See Treasury, (May 2016) *OECD proposals for mandatory disclosure of tax information: discussion paper*, p 7. Available at https://static.treasury.gov.au/uploads/sites/1/2017/06/C2016-020_OECD_proposals_mandatory_tax_disclosure.pdf.

71 Budget 2016-17, "Tax and super". Available at www.budget.gov.au/2016-17/content/glossies/tax_super/html/tax_super-01.htm.

72 Above n 70.

73 Ibid at 16-19.

74 For The Tax Institute's view, see S Caredes, "Mandatory disclosure – is the necessary in Australia?" (2016) 51*Taxation in Australia* 117.

75 Board of Taxation, *CEO update – September 2016.* Available at http://tax>board.gov.au/publications-and-media/ceo-updates /.

76 K Payne (CEO, Board of Taxation), "Mandatory disclosure rules & reporting", a paper delivered to the Tax Institute's 2018 Financial Services Taxation Conference, 7-9 February 2018, p 5. As well as explaining the board's role, the paper sought to address the integration, implementation and policy issues that will need to be considered in implementing mandatory disclosure rules.

77 Board of Taxation, *CEO update – May 2017.* Available at http://tax>board.gov.au/publications-and-media/ceo-updates /.

78 OECD (2017), *Public discussion draft: mandatory disclosure rules for addressing CRS avoidance arrangements and offshore structures*, OECD Publishing, Paris, p 5.

79 OECD (2018), *Model mandatory disclosure rules for CRS avoidance arrangements and opaque offshore structures*, OECD, Paris. Available at www.oecd.org/tax/exchange-of-information/model-mandatory-disclosure-rules-for-crs-avoidance-arrangements-and-opaque-offshore-structures.pdf.

80 By Sch 3 of the *Tax Laws Amendment (Combating Multinational Tax Avoidance) Act 2017* (Cth).

81 OECD (2010), *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2010*, OECD Publishing, Paris. Available at http://dx.doi.org/10.1787/tpg-2010-en.

82 The 2016 amendments to the OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration*s were approved by the OECD Council on 23 May 2016: OECD (2016), "OECD Council approves incorporation of BEPS amendments into the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations". Available at www.oecd.org/tax/oecd-council-approves-incorporation-of-beps-amendments-into-the-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations.htm.

83 The OECD's recommendations in respect of actions 8-10 were released on 5 October 2015 (see OECD (2015), *Aligning transfer pricing outcomes with value creation, actions 8-10 - 2015 final report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris (Actions 8-10 Final Report) and action 13 recommendations were released at the same time: see Action 13 Final Report, above n 55.

84 OECD (2017), *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017*, OECD Publishing, Paris. Available at http://dx.doi.org/10.1787/tpg-2017-en and OECD (media release 7 July 2017), "OECD releases latest updates to the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations". Available at www.oecd.org/tax/oecd-releases-latest-updates-to-the-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations.htm.

85 Ibid.

86 OECD, (2017) "Revised recommendation of the OECD Council on the determination of transfer pricing between associated enterprises", C(95)126/FINAL. Available at https://legalinstruments.oecd.org/Instruments/ShowInstrumentView.aspx?InstrumentID=87&Lang=en&Book=False.

87 PCG 2017/2.

88 Ibid para 4.

89 Ibid para 8.

90 Ibid para 10.

91 Ibid para 11.

92 The OECD website lists these reports at www.oecd.org/tax/beps/beps-actions.htm.

93 OECD (2015), *Developing a multilateral instrument to modify bilateral tax treaties, action 15 - 2015 final report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris (Action 15 Final Report).

94 OECD (2017) *Model Tax Convention on Income and on Capital* (2017 OECD Model) (21 November 2017).

95 Agreement between Australia and the Federal Republic of Germany for the Elimination of Double Taxation with respect to Taxes on Income and on Capital and the Prevention of Fiscal Evasion and Avoidance and its Protocol (the German agreement). Available at https://static.treasury.gov.au/uploads/sites/1/2017/06/GermanyDTA.pdf.

96 Treasurer and Finance Minister (joint media release 13 November 2015), "New tax treaty signed with Germany". Available at http://sjm.ministers.treasury.gov.au/media-release/008-2015/.

97 See OECD, *Recommendation of the OECD Council concerning the Model Tax Convention on Income and on Capital*, doc C(97) 195/final (adopted by the Council on 23 Oct. 1997). Available at www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=C(97)195/FINAL&docLanguage=En; paras 101-103 of TR 2001/13.

98 Sch 1 of the *International Tax Agreements Amendment Act 2016* (Cth) and the German agreement, above n 95. For a more comprehensive examination of the German agreement, see R Vann, "Financial services in a post BEPS world" (2016), presented at The Tax Institute 2016 Financial Services Conference, 17-19 February 2016, Gold Coast; M Markham, "Australia-Germany Income and Capital Tax Treaty (2015); A tax treaty for the era of the OECD/G20 BEPS initiative?" (2017) 71 *Bulletin for International Taxation* 410 and Commonwealth of Australia, *Explanatory memorandum to the International Tax Agreements Amendment Bill 2016* (1 September 2016) (2016 Bill EM). Available at www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r5681.

99 OECD (2013) Action Plan, above n 55. The G20 finance ministers endorsed the package of OECD/G20 BEPS actions final reports in a meeting on 8 October 2015, in Lima, Peru. Available at www.oecd.org/tax/g20-finance-ministers-endorse-reforms-to-the-international-tax-system-for-curbing-avoidance-by-multinational-enterprises.htm.

100 Markham, above n 98 at 411. In Commonwealth of Australia, *2015-2016 Budget Paper No. 2*, (12 May 2015) p 24-25 (available at www.budget.gov.au/2015-16/content/bp2/download/BP2_consolidated.pdf), the government announced that it would act to incorporate the OECD's recommendations on tackling treaty abuse into its treaty practice.

101 OECD (2015), *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris (Action 6 Final Report).

102 OECD (2015), *Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris (Action 7 Final Report).

103 OECD (2015), *Making Dispute Resolution Procedures More Effective, Action 14 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris (Action 14 Final Report).

104 Article 26 of the 2015 German agreement is consistent with the 2017 OECD Model, which incorporates both the 2003 and 2012 updates of article 26. The 2003 update encouraged the automatic exchange of information and overcame a number of the shortcomings of the former article 26 by enabling the exchange of information to the widest possible extent through the adoption of a foreseeable relevance test, allowing for the exchange of third party information and allowing the exchange of information outside the taxes dealt with by the convention (eg GST information) by prescribing that the exchange of information is not restricted by art 2 (taxes covered article). The 2012 update permits the competent authorities to use information received for other purposes, provided such use is allowed under the laws of both states and the competent authority of the supplying state authorises such use.

105 Action 6 Final Report, above n 101 at paras 72 and 74.

106 Action 2 Final Report, above n 4 at para 435.

107 An entity is fiscally transparent where the participants in the entity, rather than the entity itself, are liable to tax on the income.

108 Examples of specific provisions for transparent entities, in particular trusts, which have been included in the tax treaties are: Chile (art 7(7)), India (art 7(9)), Japan (art 7(9)), New Zealand (arts 1(2), 3(1)(j), 7(7) and 23(3)), Switzerland (art 3(1)(c) and item 5(b)(1) of the protocol), Turkey (art 7(8)) and the United States (arts 3(1)(a) and 7(9)).

109 See M Dirkis and M Birch, "Chapter 9: Australia", in G Maisto (ed), *Departures from the OECD MC and Commentaries in EU Law and Tax Treaties* (Amsterdam: IBFD, 2014), para 9.2.2.1.

110 Protocol to the Agreement between Australia and the Federal Republic of Germany for the Elimination of Double Taxation with respect to Taxes on Income and on Capital and the Prevention of Fiscal Evasion and Avoidance, Article 2. It states "With reference to paragraph 2 of Article 1 - If, in accordance with paragraph 2 of Article 1, income is taxed in a Contracting State in the hands of an entity or arrangement that is treated as wholly or partly fiscally transparent under the laws of the other Contracting State and is also taxed in in the hands of a resident of that other State as a participant in such entity or arrangement, and this results in double taxation, the competent authorities of the Contracting States shall consult each other pursuant to Article 25 to find an appropriate solution".

111 2016 Bill EM, above n 98 at paras 1.27 and 1.29.

112 2016 Bill EM, ibid at para 1.81.

113 Action 6 Final Report, above n 101 at para 36.

114 2016 Bill EM, above n 98 at para 1.178.

115 Markham, above n 98 at 417.

116 Action 6 Final Report, above n 101 at para 446.

117 2016 Bill EM, above n 98 at para 1.262.

118 2016 Bill EM, ibid at para 1.355. The key guidance from that commentary is set out in paragraphs 1.359 to 1.361 of the 2016 Bill EM.

119 Action 6 Final Report, above n 101 at para 26.

120 2016 Bill EM, above n 98 at para 1.355. The key guidance from that commentary is set out in paragraphs 1.359 to 1.361 of the 2016 Bill EM.

121 2016 Bill EM, ibid at para 1.371.

122 2016 Bill EM, ibid at para 1.372 argues that the phrase "measures designed to prevent improper use of the provisions of tax agreements" would cover the MAAL in s 177DA ITAA36.

123 Article 5(5) is the alternative provision (with modifications to take account of the time thresholds reflected in article (5)4) allowed under para 17 of the BEPS Action 7 Final Report (above n 102) for countries specifically concerned with splitting-up of contracts. The general approach recommended under paragraph 17 of the BEPS Action 7 Final Report is the addition of the principal purpose test rule to the 2017 OECD Model – 2016 Bill EM, ibid at para 1.28.

124 Article 5(10) specifically adopts the wording that will be included in the new Article 5(8) of the 2017 OECD Model, as recommended in paragraph 9 of the Action 7 Final Report - 2016 Bill EM, ibid at para 1.150

125 Article 5(6) specifically adopts the wording that will be included in the new article 5(4) of the 2017 OECD Model, as recommended in para 12 of the Action 7 Final Report (Ibid). The commentary on the new article 5(4) set out in para 13 of the Action 7 Final Report, including the examples, is therefore relevant for the interpretation article 5(6) of the German agreement – 2016 Bill EM, ibid at paras 1.134 & 1.135.

126 2016 Bill EM, ibid at para 1.136.

127 Article 5(7) specifically adopts the wording that will be included in the new article 5(4.1) of the 2017 OECD Model, as recommended in para 15 of the Action 7 Final Report (ibid). The commentary on the new article 5(4.1) set out in para 15 of the Action 7 Final Report, including the examples, is therefore relevant for
the interpretation article 5(6) of the German agreement – 2016 Bill EM, ibid at para 1.137.

128 They are consistent with the recommendations in para 9 of the Action 7 Final Report – 2016 Bill EM, ibid at paras 1.140 & 1.148.

129 *OECD Model: Commentary on Article 5* (2017), *Reservations*, para 188.

130 Action 7 Final Report, above n 102 at paras 18 and 39.

131 Action 7 Final Report, ibid at para 39.

132 *OECD Model: Commentary on Article 7* (2017), *Reservations*, para 85. It preserves Australia's domestic taxing rights in Div 15, Pt 111 (Insurance with non-residents) ITAA36.

133 Article 7(8) specifically adopts the wording recommended in para 39 of the BEPS Action 14 Final Report (above n 103) as an alternative provision for inclusion in the commentary on article 7 (Business profits) of the OECD Model. "Consistent with that recommended wording and Australian tax treaty practice, para 8 refers to 'gross negligence' in the case of Australia. As Germany does not have a domestic law concept of 'gross negligence', para 7 instead refers to 'negligence' in the case of Germany. It is not intended that this different terminology will result in material differences in the application of this provision by Australia and Germany in practice" – 2016 Bill EM, above n 98 at para 1.175.

134 Similarly, article 9(3) specifically adopts the wording recommended in para 39 of the BEPS Action 14 Final Report (ibid) as an alternative provision for inclusion in the commentary on article 9 (Associated enterprises) of the OECD Model – 2016 Bill EM, ibid at para 1.193.

135 Article 25(1) specifically adopts one of the approaches recommended in minimum standard 3.1 of the BEPS Action 14 Final Report (ibid) to ensure that both competent authorities are aware of MAP requests that are submitted, by allowing the person to present a case to the competent authority of either country, and therefore able to give their views on whether the request is accepted or rejected and whether the person's objection is considered to be justified – 2016 Bill EM, ibid at paras 1.426 and 1.427.

136 By prescribing that domestic time limits do not prevent the implementation of competent authority mutual agreements, the second sentence of article 25(2) adopts one of the approaches recommended in minimum standard 3.3 of the BEPS Action 14 Final Report – 2016 Bill EM, ibid at paras 1.428 and 1.429.

137 Article 25(5) accords with the commitments by Australia to provide for mandatory binding mutual agreement procedure arbitration as recognised in the Executive Summary of the BEPS Action 14 Final Report - 2016 Bill EM, ibid at para 1.443.

138 United Nations, (2011), *Model Double Taxation Convention between Developed and Developing Countries.* Available at www.un.org/esa/ffd/tax/index.htm.

139 OECD (2014), *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, released 16 September 2014. Available at http://taxwatch.org.au/wp-content/uploads/2014/09/Developing-a-Multilateral-Instrument-to-Modify-Bilateral-Tax-Treaties.pdf.

140 OECD (2013) Action Plan, above n 55 at 24.

141 T Frost et al, "BEPS big bang complexity for income tax treaties - on a delayed fuse" (1 February 2017), Greenwoods, Herbert Smith, Freehills. Available at www.greenwoods.com.au/insights/tax-brief/1-february-2017-beps-big-bang-complexity-for-income-tax-treaties-on-a-delayed-fuse/.

142 OECD (2014), above n 139.

143 OECD, *Action 15: A Mandate for the Development of a Multilateral Instrument on Tax Treaty Measures to Tackle BEPS*, released 6 February 2015. Available at www.oecd.org/ctp/beps-action-15-mandate-for-development-of-multilateral-instrument.pdf.

144 Paras 1.8 and 1.9 of the exposure draft explanatory materials in respect of the proposed International Tax Agreements Amendment (Multilateral Convention) Bill 2018. Available at https://treasury.gov.au/consultation/c2018-t259216/.

145 OECD Media release, "Countries adopt multilateral convention to close tax treaty loopholes and improve functioning of international tax system" (24 November 2016).

146 OECD, *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting.* Available at www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf.

147 OECD, (November 2016) *Explanatory Statement to Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (MLI ES). Available at www.oecd.org/tax/treaties/explanatory-statement-multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf.

148 As at 22 March 2018, there were 78 signatories to the MLI. Available at www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf.

149 Joint Standing Committee on Treaties (27 November 2017), *Committee Report 175.* Available at www.aph.gov.au/Parliamentary_Business/Committees/Joint/Treaties/AirServices3Agreements/Report_175.

150 The exposure draft legislation and exposure draft explanatory materials (in respect of the proposed International Tax Agreements Amendment (Multilateral Convention) Bill 2018 which will give force of law in Australia to the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (Multilateral Convention)) are located at https://treasury.gov.au/consultation/c2018-t259216/.

151 Exposure draft explanatory materials ibid, at para 1.105.

152 OECD, (media release 22 March 2018) "Milestone in BEPS implementation: Multilateral BEPS Convention will enter into force on 1 July following Slovenia's ratification". Available at www.oecd.org/newsroom/milestone-in-beps-implementation-multilateral-beps-convention-will-enter-into-force-on-1-july-following-slovenia-s-ratification.htm.

153 MLI ES, above n 147, para 13.

154 Ibid, para 14.

155 The following paraphrases the MLI ES ibid, para 14.

156 Frost et al, above n 141.

157 The following paraphrases the MLI ES, above n 147, para 15.

158 Exposure draft explanatory materials, above n 150, para 1.40.

159 R Vann, "International tax developments: BEPS, MLI and corporate residence" presented in to the International Fiscal Association Australian Branch, at DLA Piper, Sydney, 7 August 2017.

160 Exposure draft explanatory materials, above n 150, at para 2.31.

161 Ibid at para 2.35.

162 Ibid at para 3.41.

163 Ibid at para 3.47.

164 Ibid at para 3.70.

165 Ibid at para 3.83.

166 Ibid at para 3.96.

167 Ibid at para 3.110.

168 Ibid at para 4.40.

169 Ibid at para 4.53.

170 Ibid at paras 4.57 and 4.58.

171 Ibid at para 6.36.

172 MLI ES, above n 147 at para 353.

173 OECD (2017), *Model Tax Convention on Income and on Capital: Condensed Version 2017*, OECD Publishing, para 11.2.

174 This description draws heavily on the OECD summary of changes in OECD (2017), *2017 Update to the Model Tax Convention* (21 November 2017), OECD Publishing (available at www.oecd.org/ctp/treaties/2017-update-model-tax-convention.pdf) (which is a detailed explanation of the changes) and the OECD media release "OECD Council approves the 2017 update to the OECD Model Tax Convention" (23 November 2017) (available at www.oecd.org/ctp/treaties/oecd-approves-2017-update-model-tax-convention.htm).

175 For a more detailed explanation of the changes, see OECD (2017), 2017 Update, ibid.

176 Action 2 Final Report, above n 4 at ch 14.

177 The commencement of negotiations was formally announced on 17 September 2015 (see Treasurer, "Australia announces intention to commence tax treaty negotiations with Israel", available at http://jbh.ministers.treasury.gov.au/media-release/082-2015/) though the *IBFD Tax News Service* on 24 April 2015 had revealed that on 22 April 2015, the Australian cabinet announced plans to start negotiations for a tax treaty with Israel.

178 Bob Dylan, *The times they are a-changin',* lyrics © Sony/ATV Music Publishing LLC.