
INTERNATIONAL TAX AGREEMENTS AMENDMENT
(MULTILATERAL CONVENTION) BILL 2018

EXPOSURE DRAFT EXPLANATORY MATERIALS

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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
ATO	Australian Taxation Office
BEPS	Base erosion and profit shifting
Bill	<i>International Tax Agreements Amendment (Multilateral Convention) Bill 2018</i>
FBT Assessment Act	<i>Fringe Benefits Tax Assessment Act 1986</i>
German agreement	<i>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 Protocol, done at Berlin on 12 November 2015</i>
ITAA 1936	<i>Income Tax Assessment Act 1936</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
Japanese Convention	<i>Convention between Australia and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, Protocol and Exchange of Notes, done at Tokyo on 31 January 2008</i>
New Zealand Convention	<i>Convention between Australia and New Zealand for the Avoidance of Double Taxation with respect to Taxes on Income and Fringe Benefits and the Prevention of Fiscal Evasion, done at Paris on 26 June 2009</i>
OECD	Organisation for Economic Cooperation and Development
OECD Model	Organisation for Economic Cooperation and Development <i>Model Tax Convention on Income and on Capital</i>
TAA 1953	<i>Taxation Administration Act 1953</i>
Tax Agreements Act	<i>International Tax Agreements Act 1953</i>

Chapter 1

Overview of the Multilateral Convention

Outline of chapter

1.1 This Bill contains amendments to the Tax Agreements Act to 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).

1.2 The Multilateral Convention is a multilateral tax treaty that will enable jurisdictions to quickly modify their bilateral tax agreements to give effect to internationally agreed tax integrity rules.

Context of amendments

1.3 BEPS is the term given by the OECD to describe tax planning strategies that exploit gaps and mismatches in jurisdictions' tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid. The OECD has estimated that USD 100-240 billion (or 4-10 per cent) of global corporate income tax revenues are lost annually, worldwide, as a result of BEPS.

1.4 The OECD/G20 BEPS Project aims to equip governments with tools to address tax avoidance by ensuring that profits are taxed where the economic activities generating those profits are performed and where economic value is created.

1.5 In November 2015, the G20 Leaders endorsed the OECD's Final BEPS package of recommendations (BEPS reports), which were based on 15 BEPS Actions identified in the 2013 OECD/G20 BEPS Action Plan.

1.6 Action 15 (Develop a Multilateral Instrument) of the 2013 OECD/G20 BEPS Action Plan mandated an analysis of the possible development of a multilateral instrument to implement tax treaty related BEPS measures in existing tax agreements.

1.7 Drawing on the expertise of public international law and tax experts, the 2014 Interim Report on Action 15 concluded that a multilateral instrument is desirable and feasible, and that negotiations for such an instrument should be convened quickly. The report also recommended that an international conference (an *ad hoc* Group) be convened to negotiate the multilateral instrument. The Action 15 Final

Report which forms part of the BEPS Package reflected these developments.

1.8 The *ad hoc* Group involved over 100 jurisdictions (including Australia) participating in the development of the Multilateral Convention.

1.9 A Sub-Group on Arbitration was also established to develop a mandatory binding mutual agreement procedure arbitration provision in which 27 countries participated, including Australia.

1.10 The work of the *ad hoc* Group culminated in the finalisation and adoption of the text of the Multilateral Convention and the Explanatory Statement to the Multilateral Convention on 24 November 2016.

1.11 The Multilateral Convention will help protect Australia's revenue base from BEPS practices by implementing specific integrity provisions designed to protect tax agreements from being inappropriately exploited for tax avoidance purposes. It will also implement provisions designed to make tax treaty-based dispute resolution mechanisms more effective.

1.12 The Multilateral Convention modifies in the most efficient way possible the provisions of existing tax agreements to implement these rules, thereby also aligning Australia's bilateral tax agreements with current international standards. In the absence of the Multilateral Convention, Australia would need to introduce these rules by negotiating each tax agreement bilaterally, which would take an extensive period of time and involve significant costs.

1.13 The integrity rules contained in the Multilateral Convention are based on the recommendations arising from the following BEPS Actions:

- 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.

1.14 The rules target tax avoidance behaviour that can arise in relation to income derived by or through fiscally transparent entities, dual resident entities, applying methods for eliminating double taxation, treaty shopping and other forms of treaty abuse, dividend transfer transactions, capital gains derived from the disposal of interests in land-rich entities, and the definition of permanent establishment.

- 1.15 The Multilateral Convention also contain rules to:
- clarify that tax agreements do not prevent jurisdictions from taxing their own residents;
 - prevent the double taxation of income relating to cross-border transactions between related parties; and
 - implement improvements to tax treaty-based dispute resolution mechanisms, including the option of mandatory binding arbitration.

1.16 Certain rules contained in the Multilateral Convention reflect BEPS minimum standards that jurisdictions must meet as part of their commitment to the BEPS Project. These are found in Articles 6, 7, 16 and 17 of the Multilateral Convention and are further explained below.

1.17 The Explanatory Statement accompanies the Multilateral Convention. It provides clarification of the approach in the Multilateral Convention by explaining how the Multilateral Convention would modify a bilateral tax agreement. With regard to arbitration (Articles 18 to 26 of the Multilateral Convention), the Explanatory Statement describes the functioning of the operative provisions.

1.18 The text of the Multilateral Convention and the Explanatory Statement are available on the OECD website (<http://www.oecd.org>). The text of the Multilateral Convention is also available through the Australian Treaties Library on the AustLII website (www.austlii.edu.au).

1.19 On 7 June 2017, Australia was one of 68 jurisdictions that signed the Multilateral Convention, reinforcing Australia's commitment to addressing tax avoidance and helping to ensure international consistency in the implementation of the relevant BEPS recommendations. Since then, further jurisdictions have signed the Multilateral Convention.

1.20 The Multilateral Convention 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 (Committee Report 175).

1.21 Passage of these amendments form part of the ratification process.

1.22 Once Australia and its relevant partner jurisdiction have ratified the Multilateral Convention and notified the Depository (the Secretary-General of the OECD) accordingly, the application of the existing Covered Tax Agreement between Australia and the partner jurisdiction will be modified only if both jurisdictions have nominated for the Multilateral Convention to apply to the relevant Covered Tax Agreement.

Summary of new law

1.23 The amendments give the Multilateral Convention force of law in Australia.

1.24 The main parts of the Multilateral Convention are separated into:

- 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).

1.25 The following chapters of this explanatory memorandum replicate the titles of Parts II to VI and discuss in detail the various Articles contained in each Part of the Multilateral Convention.

1.26 However, although Article 4 is located in Part II (Hybrid Mismatches) of the Convention, the underlying recommendation to Article 4 are located in the BEPS Final Report on Action 6 on treaty abuse. Thus Article 4 is discussed in detail in Chapter 3 (Treaty abuse) below.

1.27 Part I and Part VII of the Multilateral Convention provide the interpretative and implementation provisions, which are discussed in this chapter.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<p>An Australian bilateral tax agreement has force of law as modified by the Multilateral Convention if:</p> <ul style="list-style-type: none"> • Australia nominated the bilateral tax agreement as a Covered Tax Agreement; • the relevant partner jurisdiction ratified the Multilateral Convention and notified the Depository 	<p>An Australian bilateral tax agreement has force of law according to its tenor.</p>

<p>accordingly; and</p> <ul style="list-style-type: none"> the partner jurisdiction also nominated the bilateral tax agreement with Australia as a Covered Tax Agreement. <p>Otherwise, the bilateral tax agreement will not be modified by the Multilateral Convention and will continue to have force of law according to its tenor.</p>	
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Detailed explanation of new law

1.28 This Bill amends the Tax Agreements Act to give the Multilateral Convention the force of law according to its tenor from the date that the Multilateral Convention enters into force for Australia. *[Schedule 1, item 2, subsection 5(1) of the Tax Agreements Act]*

1.29 The Multilateral Convention is designed to modify the application of jurisdictions' tax agreements to give effect to the BEPS tax treaty related integrity rules.

Which tax agreements will be modified?

1.30 The Multilateral Convention only modifies tax agreements that are Covered Tax Agreements. *[Article 1 of the Multilateral Convention]*

1.31 In relation to Australia, a 'Covered Tax Agreement' is a bilateral tax agreement if:

- it is nominated by Australia as a Covered Tax Agreement;
- Australia's bilateral partner jurisdiction ratified the Multilateral Convention and notified the Depository accordingly; and
- that partner jurisdiction also nominated the bilateral tax agreement with Australia as a Covered Tax Agreement.

[Articles 1 and 2 of the Multilateral Convention]

1.32 A jurisdiction makes such a nomination by providing a notification listing agreements and any amending or accompanying instruments that it wishes to be covered by the Multilateral Convention to the Depository (the Secretary-General of the OECD). *[Articles 2 and 39 of the Multilateral Convention]*

1.33 Australia has provisionally notified the Depository that all of its current bilateral tax agreements (described in section 3AAA of the Tax Agreements Act) are to be Covered Tax Agreements except the German

agreement, which generally already contains equivalent integrity rules to those contained in the Multilateral Convention.

1.34 Based on the known or proposed adoption positions of other Signatories to the Multilateral Convention, the Convention is expected to modify 30 of Australia's 44 bilateral tax agreements: 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.

1.35 This number could change, if more of Australia's partner jurisdictions sign and ratify the Multilateral Convention. Several of Australia's partner jurisdictions have not signed the Multilateral Convention, and several others have signed the Multilateral Convention but did not list their agreement with Australia as a Covered Tax Agreement.

1.36 As a bilateral tax agreement will only be modified by the Multilateral Convention once it has entered into force for both jurisdictions, each of the 43 bilateral tax agreements nominated by Australia will be modified at different times.

1.37 The Tax Agreements Act, including the provisions of the tax agreements it gives force to, are incorporated and read as one with the provisions of the ITAA 1936 and the ITAA 1997, and the FBT Assessment Act (see sections 4 and 4AA of the Tax Agreements Act respectively).

1.38 This mechanism will enable the modification to a bilateral tax agreement to occur automatically once the Multilateral Convention has entered into force for Australia and each relevant bilateral agreement partner.

1.39 That is, the Multilateral Convention only modifies Covered Tax Agreements. The concept of Covered Tax Agreement is incorporated into Australian domestic law along with other provisions of the Multilateral Convention by these amendments to the Tax Agreements Act. Thus, when a bilateral tax agreement becomes a Covered Tax Agreement the modifications by the Multilateral Convention will apply automatically.

1.40 The Multilateral Convention's ultimate effect on Australia's bilateral agreements 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.

1.41 Once these positions are formalised, the ATO will consider issuing appropriate additional guidance material to supplement existing explanations such as this explanatory memorandum and the Commentaries on the OECD Model about the way in which the Multilateral Convention is understood to modify Australia's affected bilateral tax agreements.

1.42 The Multilateral Convention modifies a Covered Tax Agreement without prejudice to any subsequent modifications to the underlying tax agreement as agreed between the parties to that agreement. *[Article 30 of the Multilateral Convention]*

1.43 That is, agreement partners are free to agree and amend or replace a bilateral tax agreement after it has been modified by the Multilateral Convention. Such action would supersede the modifications made to that agreement by the Multilateral Convention but only from the date on which the amended or new bilateral agreement enters into force.

How does the Multilateral Convention modify a Covered Tax Agreement?

1.44 Each substantive article of the Multilateral Convention comprises the relevant integrity rule(s), a compatibility clause, reservation options and notification requirements.

Compatibility clauses

1.45 The Multilateral Convention modifies the application of a Covered Tax Agreement in different ways. The ways in which the provisions of a Covered Tax Agreement can be modified are explained in the 'compatibility clauses' contained in each article of the Multilateral Convention, which use specific language to describe different mechanisms.

1.46 The different mechanisms described in the Multilateral Convention as follows:

- 'in place of' of an existing provision in a Covered Tax Agreement — the Multilateral Convention provision replaces an existing provision if there is one;
- 'applies to' or 'modifies' an existing provision in a Covered Tax Agreement — the Multilateral Convention provision changes the application of an existing provision without entirely replacing it;
- 'in the absence of' an existing provision in a Covered Tax Agreement — the Multilateral Convention provision is added to the Covered Tax Agreement if there is no existing provision; and

- ‘in place of or in the absence of’ an existing provision in a Covered Tax Agreement — the Multilateral Convention provision either replaces an existing provision or is added to the Covered Tax Agreement if there is no existing provision.

1.47 In all of the above cases, the existing Covered Tax Agreement is modified by the Multilateral Convention.

1.48 While some provisions of the Multilateral Convention are mandatory, most are optional. That is, jurisdictions can apply various article-by-article choices and/or reservations to limit their adoption of the Multilateral Convention, including the right for a provision not to apply at all.

1.49 Subject to these choices and reservations, jurisdictions are required to apply their chosen positions across all of the Covered Tax Agreements they have nominated. That is, their choices and reservations will apply to Multilateral Convention provisions rather than to individual bilateral agreements. Most provisions provide modifications to a Covered Tax Agreement will be effective only where jurisdictions have made matching and compatible choices and reservations. However, some provisions allow asymmetric application.

1.50 The effect of a reservation, including where a provision allows for asymmetric application, is discussed in the later chapters discussing the relevant provision.

Reservations and notifications

1.51 Generally, a reservation made by a jurisdiction modifies the application of the Multilateral Convention to the relevant provisions in all its Covered Tax Agreements. That is, the effect of the reservation applies equally to both Parties to a Covered Tax Agreement and indiscriminately across all of a jurisdiction’s Covered Tax Agreements. However, this is subject to any provision of the Multilateral Convention that explicitly provides otherwise. *[Article 28(3) of the Multilateral Convention]*

1.52 This approach is consistent with Article 21 of the Vienna Convention on the Law of Treaties.

1.53 A jurisdiction can make a reservation that is allowable under a provision listed in Article 28(1) of the Multilateral Convention. The provisions listed reflect the provisions of the Multilateral Convention that explicitly allow a reservation to be made. *[Article 28(1) of the Multilateral Convention]*

1.54 In addition, a jurisdiction can also formulate and make one or more reservations to limit the types of cases that can be submitted for arbitration under Part VI of the Multilateral Convention, which is subject to acceptance by the relevant partner jurisdiction. This is discussed in Chapter 6. *[Article 28(2) of the Multilateral Convention]*

1.55 Some reservations listed in Article 28(1) also require an accompanying notification of affected Covered Tax Agreements (and the relevant paragraph number of each relevant provision of the Covered Tax Agreement if required) that are within the scope of the reservation. Article 28(8) lists provisions requiring such notifications. The listed provisions reflect the provisions of the Multilateral Convention that explicitly require notification.

1.56 That is, a jurisdiction making a reservation under a provision listed in Article 28(8) must provide the notification at the time the reservation is made. Otherwise, the reservation will not apply to a Covered Tax Agreement that is not included in the notification. *[Article 28(8) of the Multilateral Convention]*

1.57 A jurisdiction can provide a notification under a provision of the Multilateral Convention that is listed in Article 29(1) and those provisions reflect the provisions of that explicitly require notification. *[Article 29(1) of the Multilateral Convention]*

1.58 These notifications are generally required:

- where a jurisdiction nominates its tax agreements to be covered by the Multilateral Convention (i.e. list of Covered Tax Agreements);
- if a jurisdiction has not made a reservation under the relevant Article of the Multilateral Convention; or
- if a jurisdiction is making a choice in respect of a provision.

1.59 The effect of such notification varies depending on the provision that requires the notification and thus is addressed in the later chapters discussing the relevant provision.

1.60 Jurisdictions can provide a list of reservations and/or notifications when signing the Multilateral Convention, either in provisional or final form. If a jurisdiction provides a provisional list of reservations and/or notifications upon signature it must confirm its final positions upon deposit of its instrument of ratification. *[Articles 28(5) to (7), and 29(1), (3) and (4) of the Multilateral Convention]*

1.61 Australia provided a provisional list of its reservations and notifications at signature and will need to confirm its final position when it deposits its instrument of ratification. Until that point, Australia's positions remain indicative.

1.62 Australia's final adoption positions will be formalised before the Multilateral Convention enters into force for Australia.

1.63 The effect of the Multilateral Convention on Australian domestic law is determined by the extent to which the application of Australia's Covered Tax Agreements is modified by the

Multilateral Convention subject to the reservations and notifications of Australia and the relevant partner jurisdiction.

1.64 That is, without knowing the respective partners' final positions, Australia's reservations and notifications effectively ring-fence the extent that the Multilateral Convention would modify Australia's Covered Tax Agreements. For example, if Australia makes a reservation not to apply an Article of the Multilateral Convention (i.e. opt out), the relevant provisions in each of Australia's existing bilateral tax agreements will continue to apply without modification regardless of any differing position that the respective partner jurisdiction adopts under the Multilateral Convention.

1.65 Jurisdictions that have entered reservations can subsequently withdraw them (or replace them with more limited reservations) to expand their adoption of the Multilateral Convention. However, they cannot, enter new reservations that will narrow their adoption. *[Article 28(9) of the Multilateral Convention]*

1.66 As such, while the scope of Australia's adoption of the Multilateral Convention may be expanded, it cannot become more limited. Therefore, where Australia has provisionally made a reservation and the removal or replacement of such reservation will expand the adoption of the Multilateral Convention, this explanatory memorandum explains what the provision is about and its effects.

1.67 A jurisdiction may add tax agreements to its list of Covered Tax Agreements by notifying the Depository. In doing so, a jurisdiction may update its reservations and notifications to include the additional tax agreements. *[Article 29(5) of the Multilateral Convention]*

1.68 Australia has provisionally nominated all of its existing bilateral tax agreements except the German agreement.

1.69 A jurisdiction may make additional notifications under a provision of the Multilateral Convention that is listed in Article 29(1) by notifying the Depository. This is not available for notifications made under Article 35 (i.e. customisation of entry into effect periods). *[Article 29(6) the Multilateral Convention]*

1.70 For example, Australia may need to make additional notifications if it withdraws one of its reservations. There is a notification requirement designed to inform jurisdictions that have not made a reservation allowable under that Article that would consequently be affected by Australia's withdrawal of reservation.

Interpretation of the Multilateral Convention and the Covered Tax Agreements

1.71 Some terms used in the Multilateral Convention are defined in Article 2(1), namely ‘Covered Tax Agreement’, ‘Party’, ‘Contracting Jurisdiction’ and ‘Signatory’. *[Article 2(1) of the Multilateral Convention]*

1.72 Unless the context of the term in the Multilateral Convention indicates otherwise, the meaning of the other terms used in the Multilateral Convention have the same meaning as used in the underlying Covered Tax Agreement. *[Article 2(2) of the Multilateral Convention]*

1.73 For questions relating to the interpretation or implementation of the Multilateral Convention, a Conference of the Parties may be convened to address the questions. *[Article 32(2) of the Multilateral Convention]*

1.74 Conversely, to questions relating to the interpretation or implementation of a Covered Tax Agreement are to be resolved according to the applicable provisions in the Covered Tax Agreement (e.g. by mutual agreement between the relevant competent authorities). *[Article 32(1) of the Multilateral Convention]*

1.75 That means the Multilateral Convention’s modifications to a Covered Tax Agreement should be interpreted using ordinary principles of treaty interpretation (i.e. in accordance with the Vienna Convention on the Law of Treaties).

1.76 This is reiterated in paragraph 12 of the Explanatory Statement to the Multilateral Convention:

While this Explanatory Statement is intended to clarify the operation of the Convention to modify Covered Tax Agreements, it is not intended to address the interpretation of the underlying BEPS measures (except with respect to the mandatory binding arbitration provision contained in Articles 18 through 26...). Accordingly, the provisions contained in Articles 3 through 17 should be interpreted in accordance with the ordinary principle of treaty interpretation, which is that a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose. In this regard, the object and purpose of the Convention is to implement the tax treaty-related BEPS measures. The commentary that was developed during the course of the BEPS Project and reflected in the Final BEPS Package has particular relevance in this regard.

1.77 As most of the integrity rules contained in the Multilateral Convention are included in the OECD Model, the Commentaries to the OECD Model largely reflect the content of the final BEPS reports.

1.78 Accordingly, any subsequent changes to the Commentaries on the OECD Model will continue to be relevant, unless the text of the Covered Tax Agreement or the OECD Model has changed (see

paragraphs 3 and 33 to 36.1 of the Introduction to the OECD Model). This is consistent with paragraph 108 of the ATO Taxation Ruling TR2001/13.

1.79 However, when interpreting the modifications to a Covered Tax Agreement in respect of Part VI of the Multilateral Convention (Arbitration, Articles 18 to 26), the Explanatory Statement to the Multilateral Convention provides relevant guidance.

1.80 The title and preamble of the Multilateral Convention recognise that the purpose of the Multilateral Convention is to implement tax treaty-related measures developed by the BEPS Project to address certain hybrid mismatch arrangements, prevent treaty abuse, address artificial avoidance of permanent establishment status, and improve dispute resolution.

1.81 The preamble forms part of the context of the Multilateral Convention and constitutes a general statement of the object and purpose of the Multilateral Convention (see Article 31(2) of the Vienna Convention on the Law of Treaties). Therefore, the preamble is important in interpreting the Multilateral Convention's modifications to a Covered Tax Agreement.

Effect of signature, ratification and withdrawal from the Multilateral Convention

1.82 The Multilateral Convention opened for signature on 31 December 2016. Any State, including Guernsey, the Isle of Man and Jersey, and any other jurisdictions authorised by a consensus of the Parties and Signatories to the Convention, can sign the Multilateral Convention. *[Article 27(1) of the Multilateral Convention]*

1.83 However, in order for the Multilateral Convention to enter into force for a jurisdiction, the jurisdiction's signature needs to be followed by ratification, acceptance or approval. *[Article 27(2) of the Multilateral Convention]*

1.84 Australia signed the Multilateral Convention on 7 June 2017 and will deposit its instrument of ratification with the Depository after this Bill receives the Royal Assent.

1.85 Once the Multilateral Convention enters into force for a jurisdiction, the jurisdiction can withdraw from the Multilateral Convention by notifying the Depository. The withdrawal is effective from the date the Depository receives the notification. *[Article 37 of the Multilateral Convention]*

1.86 If a partner jurisdiction to a Covered Tax Agreement withdraws from the Multilateral Convention after it has entered into force for both Parties, the application of the underlying Covered Tax Agreement will remain modified by the Multilateral Convention and further changes

would need to be negotiated bilaterally. *[Article 37(2) of the Multilateral Convention]*

Administration of the Multilateral Convention

Amending or supplementing the Multilateral Convention and the Conference of the Parties

1.87 Any jurisdiction that is a Party to the Multilateral Convention can propose an amendment by submitting the amendment to the Depositary and a Conference of the Parties may be convened to consider the amendment. *[Article 33 of the Multilateral Convention]*

1.88 The Conference of the Parties is not restricted to considering proposed amendments. It can be convened by any Party to the Multilateral Convention for purposes of making any decision or exercising functions that are required or appropriate under the Multilateral Convention. *[Article 31(1) of the Multilateral Convention]*

1.89 Any party to the Multilateral Convention may request a Conference of the Parties by communicating the request to the Depositary, which serves the Conference of the Parties. *[Articles 31(2) and (3) of the Multilateral Convention]*

1.90 The Depositary must convene a Conference of the Parties if, within six months of the Depositary communicating to the Parties to the Multilateral Convention the request, one-third of the Parties supports the request. *[Article 31(3) of the Multilateral Convention]*

1.91 The Multilateral Convention may be supplemented by protocols. *[Article 38(1) of the Multilateral Convention]*

1.92 Being a Party to the Multilateral Convention does not automatically bind the Party to also be a Party to a protocol. The Party would need to become a Party to the protocol in accordance with its provisions. To be a Party to the protocol, the jurisdiction must be a Party to the Multilateral Convention. *[Article 38(2) and (3) of the Multilateral Convention]*

Role of the Depositary

1.93 The Secretary-General of the OECD as Depositary of the Multilateral Convention and its protocols (if any) must notify the Parties and Signatories within one month of any communication related to the Multilateral Convention. *[Articles 39(1) and (2) of the Multilateral Convention]*

1.94 This includes any communication received by the Depositary in respect of reservations, notifications or withdraws.

1.95 The Depositary must also maintain a publically available list of Covered Tax Agreements and reservations and/or notifications made by

the Parties to the Multilateral Convention. [*Article 39(3) of the Multilateral Convention*]

1.96 Those lists can be found on the OECD website (<http://www.oecd.org>).

Consequential amendments

1.97 This Bill inserts the definition of *Multilateral Convention* into the Tax Agreements Act. [*Schedule 1, item 1, subsection 3AAA(1) of the Tax Agreements Act*]

Other technical amendments

1.98 The German agreement was given force of law under the Tax Agreements Act in 2016. This Bill inserts a note containing the Australian Treaty Series citation for that German agreement. [*Schedule 1, item 3, definition of ‘German agreement’ in subsection 3AAA(1) of Tax Agreements Act*]

Application and transitional provisions

1.99 The Multilateral Convention affects the application in Australia of its Covered Tax Agreements with respect to:

- withholding taxes – for amounts paid or deemed to be paid on or after 1 January occurring on or after the later date of entry into force of the Multilateral Convention for Australia and each of its relevant partner jurisdictions;
- other taxes – for taxable periods beginning on or after six months after the later date of entry into force of the Multilateral Convention for Australia and each of its relevant partner jurisdictions.

[*Article 35(1) of the Multilateral Convention*]

1.100 Article 35 also provides a jurisdiction with the ability to customise the entry into effect periods for its Covered Tax Agreements by making a reservation. Australia did not provisionally make any such reservation as the result of adopting Article 35 without reservation is consistent with Australia’s treaty practice.

1.101 The application provisions in respect of the arbitration rules of the Multilateral Convention (Articles 18 to 26) are discussed in Chapter 6 below.

1.102 If Australia or one of its partner jurisdictions to a Covered Tax Agreement withdraws or replaces a reservation that it had previously

made, the withdrawal or replacement is effective when the notification is received by the Depository for a reservation in respect of:

- withholding taxes – for amounts paid or deemed to be paid on or after 1 January of the following year that occurs six months after the notification is communicated by the Depository to all Parties and Signatories of the Multilateral Convention;
- other taxes – for taxable periods beginning on or after 1 January of the following year that occurs six months after the notification is communicated by the Depository to all Parties and Signatories of the Multilateral Convention.

[Article 28(9)(a) of the Multilateral Convention]

1.103 However, if the Depository receives such a notification prior to Australia or its bilateral agreement partner becoming a Party to the Multilateral Convention, then the withdrawal or replacement of the notification is effective on the later date of entry into force of the Multilateral Convention for Australia and its partner jurisdiction.

[Article 28(9)(b) of the Multilateral Convention]

1.104 If Australia or its relevant partner jurisdiction to a Covered Tax Agreement provides an additional notification under Article 29(6) of the Multilateral Convention, including as a result of withdrawing or replacing a reservation, the additional notification is effective according to the same timeframes as provided in Article 28(9) (i.e. withdrawing or replacing a reservation). *[Article 29(6) of the Multilateral Convention]*

When does the Multilateral Convention enter into force for Australia?

1.105 The Multilateral Convention 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. *[Article 34(2) of the Multilateral Convention]*

1.106 However, if Australia is one of the first five countries to deposit an instrument of ratification then the Multilateral Convention enters into force on the first day of the month following three months after the date of deposit of the fifth instrument of ratification. *[Article 34(1) of the Multilateral Convention]*

When does the Multilateral Convention start to modify the application of a Covered Tax Agreement?

1.107 The date on which the provisions of the Multilateral Convention take effect to modify the application of Australia's Covered Tax Agreements is contingent upon the completion by Australia's partner jurisdictions of their domestic ratification processes. This means that the

date of effect of the Multilateral Conventional on each of Australia's Covered Tax Agreements will vary.

Chapter 2

Hybrid mismatches

Outline of chapter

2.1 This Chapter explains the ways in which the Multilateral Convention will modify Australia's Covered Tax Agreements to ensure that those agreements produce appropriate outcomes when applied to fiscally transparent entities such as partnerships and trusts.

Context of amendments

2.2 Chapter 14 of the BEPS Final Report on Action 2 (Neutralising the Effects of Hybrid Mismatch Arrangements) recommended modifications to tax agreements to clarify the application of treaty benefits to income derived by or through fiscally transparent entities or arrangements.

2.3 A fiscally transparent entity is not taxed on its income. Rather, the entity's income is taxed in the hands of its members. Most partnerships and trusts are treated as fiscally transparent entities under Australia's domestic law.

2.4 Difficulties can arise under bilateral tax agreements where one jurisdiction treats an entity as fiscally transparent under its domestic law and the other jurisdiction treats the entity as fiscally opaque and taxes the entity itself.

2.5 The key treaty issues associated with income derived by or through fiscally transparent entities were considered in the 1999 OECD Partnership Report¹ (the Partnership Report), the conclusions of which were reflected in the Commentary on Article 1 (Persons covered) of the OECD Model. Chapter 14 of the BEPS Final Report on Action 2 recommended a new provision that both confirms the conclusions of the Partnership Report and extends the application of these conclusions to other fiscally transparent entities and arrangements, such as trusts.

2.6 In the 2017 revision of the OECD Model, OECD members adopted new Article 1(2) of the OECD Model, which reflects the recommendation contained in Chapter 14 of the BEPS Final Report on Action 2.

¹ *The Application of the OECD Model Tax Convention to Partnerships (1999)*.

2.7 Article 3(1) of the Multilateral Convention allows Parties to implement the Action 2 recommendation and adopt the new Article 1(2) Model provision in existing Covered Tax Agreements.

2.8 Article 3(2) is aimed at ensuring that excessive relief from double taxation is not granted where both jurisdictions that are parties to a tax agreement tax the same income in the hands of different taxpayers.

2.9 The BEPS Final Report on Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances) recommended modifications to tax agreements to clarify that treaty benefits are not granted in certain inappropriate circumstances. Article 3(2) of the Multilateral Convention implements the recommendation in paragraph 64 of the Action 6 Final Report for situations where both parties to a tax agreement seek to tax the same income as the income of one of their own residents. This can occur where one party taxes the worldwide income of a resident entity and the other party views that entity as fiscally transparent and therefore taxes the members of that entity who are that other party's residents on their respective share of the income.

2.10 Chapter 15 of the BEPS Final Report on Action 2 (Neutralising the Effects of Hybrid Mismatch Arrangements) recommended modifications to tax agreements to address concerns that the use of the exemption method (as opposed to the credit method) to eliminate double taxation could result in inappropriate outcomes. The exemption method can result in double non-taxation when applied to income that is not taxed in the source jurisdiction.

2.11 Article 4 of the Multilateral Convention allows competent authorities to determine by mutual agreement the residency of a person (other than an individual) that would be a resident of more than one jurisdiction due to the provisions of a Covered Tax Agreement (Article 4 is discussed in more detail in Chapter 3).

2.12 Article 5 of the Multilateral Convention allows Parties to modify their Covered Tax Agreements to replace provisions that apply the exemption method with provisions that instead apply the credit method. Australia has provisionally nominated not to adopt Article 5 on the basis that the credit method has been implemented in all Australia's tax agreements to date.

2.13 The Government has also announced it will amend Australia's domestic tax laws to address hybrid mismatch arrangements in line with the BEPS Final Report on Action 2. These amendments will be brought forward in a separate bill.

Summary of new law

2.14 Part II (Hybrid mismatches) of the Multilateral Convention contains three Articles:

- Article 3 — transparent entities;
- Article 4 — dual resident entities; and
- Article 5 — application of methods for elimination of double taxation.

2.15 Article 3 ensures that income derived by or through a fiscally transparent entity or arrangement is considered to be income of a resident of a Party to a Covered Tax Agreement for treaty purposes but only to the extent that that Party treats the income as income of one of its residents under its domestic law.

2.16 Australia has indicated it will adopt Article 3 and make the reservation permitted by Article 3(5)(d) to not modify its Covered Tax Agreements that already have a detailed fiscally transparent entity provision.

2.17 As noted in Chapter 1, Article 4 is discussed in detail in Chapter 3 of this explanatory memorandum.

2.18 Article 5 modifies Covered Tax Agreements that apply the exemption method for relieving double taxation. It provides three alternative approaches to guard against the possibility of avoiding income tax in both jurisdictions.

2.19 Australia has indicated that it will not adopt Article 5 as its tax agreements do not require Australia to apply the exemption method for relieving double taxation for Australian residents. Australia has also indicated that Australia will not prevent other jurisdictions from adopting Article 5 in relation to their own residents.

Detailed explanation of new law

Clarifying the treatment of fiscally transparent entities

2.20 Australia has provisionally adopted Article 3, but has indicated that it will make the reservation contained in Article 3(5)(d) to not modify Covered Tax Agreements that already have a detailed fiscally transparent entities provision.

2.21 Article 3 of the Multilateral Convention modifies applicable Covered Tax Agreements to ensure not only that benefits are granted in appropriate cases (where the relevant jurisdiction treats the income as income of one of its residents) but also ensures that these benefits are not

granted where neither jurisdiction treats the income of an entity or arrangement as the income of one of its residents.

2.22 Article 3 replaces existing bilateral provisions in jurisdictions' Covered Tax Agreements that apply to income derived by or through fiscally transparent entities or arrangements (or applies in the absence of such bilateral provisions). This modification is designed to provide the appropriate application of treaty benefits to fiscally transparent entities and their members. Income derived by or through a fiscally transparent entity, such as a partnership or a trust, will be considered income of a resident of a Contracting Jurisdiction for treaty purposes, but only to the extent that the Contracting Jurisdiction treats the income as income of a resident under its domestic law. In addition, Article 3 ensures that treaty benefits are not granted where neither jurisdiction treats, under its domestic law, the income derived by or through such an entity as the income of one of its residents. *[Articles 3(1) and (4) of the Multilateral Convention]*

2.23 An entity or arrangement is considered fiscally transparent if its income is not taxed at the level of the entity or arrangement but is instead taxed in the hands of the person who has an interest in the entity or arrangement (see paragraph 9 of the Commentary on Article 1 (Persons covered) of the OECD Model).

2.24 As per paragraph 4 of the Commentary on Article 1 (Persons covered) of the OECD Model, whether Article 3(1) applies to collective investment vehicles depends on whether there is a specific provision under a Covered Tax Agreement dealing with collective investment vehicles or the legal form (or type) of the collective investment vehicle. For example, Article 3(1) would not apply to income received by an Australian managed investment trust to which paragraph 7 of Article 4 (Resident) of the New Zealand Convention applies.

2.25 Article 3(1) is not intended to replace integrity rules clarifying how a provision in a Covered Tax Agreement applies to a particular item of income derived by a resident of a jurisdiction, such as deeming a beneficiary of a business trust to have a permanent establishment and attributing a share of profits to that permanent establishment (see paragraph 45 of the Explanatory Statement to the Multilateral Convention). For example, paragraph 7 of Article 7 (Business Profits) of the New Zealand Convention would not be affected.

2.26 Article 3(3) modifies Article 3(1) to clarify that it does not prevent either Party from taxing its own residents. This clause will only apply if a Party has made the reservation in Article 11(3)(a) of the Multilateral Convention to opt out of Article 11. Article 11 is discussed in more detail in Chapter 3. *[Article 3(3) of the Multilateral Convention]*

2.27 Australia has not indicated that it will make such a reservation as it has provisionally adopted Article 11 of the Multilateral Convention.

2.28 Article 3 also provides that a Party is not required to give relief for any tax imposed by the other Party solely on the basis that it is derived by a resident of the other Party. This will help prevent double non-taxation, where an entity's income is not taxed in either Party's jurisdiction, and will ensure excessive relief for double taxation is not granted where both Parties tax the same income in the hands of different taxpayers.

2.29 Article 3(2) states that a Party to a Covered Tax Agreement is not required to provide relief from double taxation to its residents under a provision in Covered Tax Agreement. This is broadly equivalent to Articles 23A or 23B (Methods for elimination of double taxation) of the OECD Model where the other Party imposes tax at source solely because the income was derived by a taxpayer that is a resident of that other Party. Article 3(2) ensures that a Party is only required to provide relief from double taxation to the extent that the relevant income is taxable in the partner jurisdiction in accordance with the source taxing rights allocated under the relevant tax agreement (for instance, where that partner jurisdiction is the jurisdiction of source of the relevant income or the jurisdiction where there is a permanent establishment to which the relevant income is attributable). *[Article 3(2) of the Multilateral Convention]*

2.30 Paragraph 64 of the BEPS Final Report on Action 6 included a draft proposal for changes to Article 23A (Exemption method) and Article 23B (Credit method) of the OECD Model and the Commentary on Articles 23A and 23B but noted the intention to finalise the work on the draft proposal subsequently. That subsequent work is reflected in the 2017 revision to the OECD Model and the guidance reflected in paragraphs 11.1 and 11.2 of the Commentary on Articles 23A and 23B of the OECD Model is therefore relevant in interpreting Article 3(3) of the Multilateral Convention.

2.31 Australia has provisionally made the reservation allowable in Article 3(5)(d) to not modify Covered Tax Agreements that already contain a detailed fiscally transparent entity provision. Australia has indicated that its tax agreements with France and Japan already contain such a provision. *[Article 3(5) of the Multilateral Convention]*

2.32 The replacement of an existing bilateral 'fiscally transparent entity' provision is only effective if both Parties to a Covered Tax Agreement do not make the reservations contained in Articles 3(5)(a) and (b) (not to apply Article 3 at all or only apply Article 3 if the relevant Covered Tax Agreement does not already contain a transparent entities provision) and notify the Depository of the affected bilateral provisions to be replaced. *[Article 3(6) of the Multilateral Convention]*

2.33 Australia has provisionally indicated that Australia's tax agreements with Mexico, New Zealand and the United States contain a provision that would be modified.

2.34 Otherwise, the provision contained in Article 3(1) will modify Australia's Covered Tax Agreements to the extent of any inconsistency between Article 3(1) and the relevant provisions of those agreements, and provided that the relevant Parties to a Covered Tax Agreement have not opted out of Article 3 entirely. *[Article 3(6) of the Multilateral Convention]*

2.35 Based on the known or proposed adoption positions of other Signatories to the Multilateral Convention, 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.

Restricting methods for the elimination of double taxation

2.36 Australia has provisionally indicated it will not adopt Article 5. On this basis, Article 5 will not modify the provisions in Australia's Covered Tax Agreements that require Australia to provide Australian residents with relief from double taxation.

2.37 Article 5 allows a Party to the Multilateral Convention to replace a provision of a Covered Tax Agreement that would otherwise exempt foreign income from domestic tax (the exemption method) with a provision that instead relieves double taxation by crediting foreign tax paid against domestic tax imposed on the same foreign income (the credit method). The exemption method can lead to double non-taxation when applied to income that is not taxed in the source jurisdiction.

2.38 Article 5 provides three options to allow a Party to the Multilateral Convention to adopt a credit method to provide its residents with relief from double taxation for tax imposed in the other jurisdiction on:

- income the Covered Tax Agreement allows the other Party to exempt or tax at a reduced rate (Option A);
- dividends that are tax deductible in the other jurisdiction (Option B); or
- all types of income the Covered Tax agreement allows the other jurisdiction to tax (other than income that that other jurisdiction is taxing solely because the relevant income is also income derived by a resident of that jurisdiction) (Option C).

[Articles 5(1) to (7) of the Multilateral Convention]

2.39 It is unnecessary for Australia to choose any of the options provided in Article 5 because all of Australia's tax agreements already provide for Australia to apply the credit method to relieve double taxation for Australian residents.

2.40 Australia has provisionally indicated that it will not prevent its Covered Tax Agreement partner jurisdictions from applying their chosen option with respect to their own residents. That is, Australia has indicated that it will not make a reservation under Article 5(8) for Article 5 not to apply to its Covered Tax Agreements. *[Article 5(8) of the Multilateral Convention]*

Chapter 3

Treaty abuse

Outline of chapter

3.1 This Chapter explains the ways in which the Multilateral Convention will modify Australia's Covered Tax Agreements to address treaty abuse concerns, including treaty shopping, where persons seek to inappropriately obtain benefits afforded under a tax agreement.

Context of amendments

3.2 The BEPS Final Report on Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances) identified treaty shopping and other treaty abuse as a significant source of BEPS concerns.

3.3 Treaty shopping involves a person who is not a resident of either of the two jurisdictions that have signed a tax agreement using strategies to attempt to obtain benefits which should only be afforded to residents of the treaty partner jurisdictions.

3.4 Treaty abuse strategies undermine a jurisdiction's tax sovereignty by enabling benefits (such as tax reductions or exemptions) to be granted in situations where those benefits were not intended to be granted, causing a reduction in the jurisdiction's tax revenues.

3.5 The BEPS Final Report on Action 6 recommended the following approach to address treaty shopping:

- include in a tax agreement a clear statement that the partner jurisdictions intend to avoid creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance;
- include in the OECD Model a specific anti-abuse rule (the Limitations on Benefits rule) that limits the availability of benefits to entities that meet certain conditions ensuring there is a sufficient link between the entity and the jurisdiction from which the entity is seeking the benefits; and
- include in the OECD Model a more general anti-abuse rule (the Principal Purposes Test) that denies the benefits where one of the principal purposes of transactions or arrangements is to obtain those benefits, unless those benefits would be in

accordance with the object and purpose of the tax agreement's provisions.

3.6 Taking action to prevent treaty abuse is a BEPS minimum standard. Jurisdictions have committed to ensuring that at least a minimum standard of protection against treaty shopping is achieved, which means they must include in their tax agreements the clear statement referred to above as well as:

- the Principal Purposes Test;
- the Principal Purposes Test and the Limitations on Benefits rule; or
- the Limitations on Benefits rule supplemented by a mechanism that deals with conduit financing arrangements.

3.7 This is reflected in the mandatory nature of Articles 6 and 7 of the Multilateral Convention, which implement most of these Action 6 recommendations.

3.8 To address other forms of treaty abuse, the BEPS Final Report on Action 6 recommended including rules in tax agreements to target:

- situations where an entity is a resident of both jurisdictions of a tax agreement (dual resident);
- certain dividend transfer transactions that are intended to artificially lower withholding taxes on dividends;
- transactions that circumvent tax agreement rules that allow gains arising from the disposal of interests in land-rich entities to be taxed by the jurisdiction where the underlying property is located;
- certain situations where a resident of a partner jurisdiction receives a benefit in relation to income derived through a permanent establishment located in a third jurisdiction that exempts or lightly taxes that income; and
- the possibility that tax agreement provisions may be interpreted in a way that limits a jurisdiction's right to tax its own residents.

3.9 Articles 4 and 8 to 11 of the Multilateral Convention implement these Action 6 recommendations.

Summary of new law

3.10 Article 4 in Part II (Hybrid Mismatches) of the Multilateral Convention expands the criteria for determining a dual resident entity's

tax residence to include other factors (in addition to the place of effective management) and require the competent authorities to endeavour to agree on a single jurisdiction of residence. Competent authorities are persons (typically tax officials) identified in tax agreements to represent the respective jurisdictions. In the absence of such agreement by the competent authorities, the entity will not be entitled to treaty benefits (e.g. tax reductions or exemptions) except to the extent agreed by the competent authorities.

3.11 Australia has indicated that it will adopt Article 4 and make the reservation to deny treaty benefits where the two competent authorities have been unable to reach an agreement on the entity's jurisdiction of residence (i.e. the additional line referred to in paragraph 3.10 above that would otherwise allow the competent authorities to agree on the extent of treaty benefits would not apply).

3.12 Part III (Treaty Abuse) of the Multilateral Convention contains rules that aim to address treaty abuse including treaty shopping:

- Article 6 — purpose of a Covered Tax Agreement;
- Article 7 — prevention of treaty abuse;
- Article 8 — dividend transfer transactions;
- Article 9 — capital gains from alienation of shares or interests of entities deriving their value principally from immovable property;
- Article 10 — anti-abuse rule for permanent establishments situated in third jurisdictions; and
- Article 11 — application of tax agreements to restrict a Party's right to tax its own residents.

3.13 Article 6 inserts a new preamble into jurisdictions' Covered Tax Agreements which states that the purpose of a tax agreement is to eliminate double taxation with respect to the taxes covered by the agreement 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 the tax agreement for the indirect benefit of residents in third jurisdictions).

3.14 Adopting Article 6 is mandatory for jurisdictions that ratify the Multilateral Convention. Australia has indicated that it will also adopt the additional preamble language stating both Parties desire to further develop their bilateral economic relationship and enhance their cooperation in tax matters.

3.15 Article 7 provides new anti-abuse rules to enable revenue authorities to deny treaty benefits (such as tax reductions or exemptions)

in cases where one of the principal purposes of an arrangement was to inappropriately obtain such benefits (the Principal Purposes Test).

3.16 The Principal Purposes Test may be supplemented with a Simplified Limitation on Benefits rule, which would limit benefits to ‘qualified persons’ (i.e. individuals, government entities, listed companies, non-profit organisations, pension funds, entities engaged in active business and entities that meet specified ownership requirements).

3.17 Adopting Article 7 is mandatory for jurisdictions that ratify the Multilateral Convention. Australia has indicated that it will adopt the Principle Purposes Test only and not the Limitation on Benefits rule.

3.18 Article 8 inserts a 365 day shareholding period requirement that foreign resident corporate shareholders must satisfy in order to be eligible for any reduced tax rate provided for in a Covered Tax Agreement in relation to non-portfolio intercorporate dividends.

3.19 Australia has provisionally adopted Article 8 without reservation.

3.20 Article 9 introduces a 365 day period for testing whether an entity was land-rich to enable a jurisdiction to tax capital gains made by foreign residents from the disposal of shares or interests in land-rich entities where the underlying property is located in that jurisdiction.

3.21 Australia has provisionally adopted Article 9, and has indicated that it will make the reservation permitted by Article 9(6)(e) to not modify its Covered Tax Agreements that already contain corresponding rules on the alienation of interests comparable to shares (such as interests in a partnership or trust).

3.22 Article 10 denies treaty benefits where an entity that is a resident of a jurisdiction that is a party to a bilateral tax agreement derives certain income from the other jurisdiction through a permanent establishment located in a third jurisdiction, and that income is exempt in both the entity’s jurisdiction of residence and subject to reduced taxation in the third jurisdiction.

3.23 Australia has indicated that it will not adopt Article 10 for its Covered Tax Agreements. This means that Australia’s tax agreements will not be modified to include Article 10 of the Multilateral Convention.

3.24 Article 11 clarifies that a tax agreement does not generally restrict a jurisdiction’s right to tax its own residents.

3.25 Australia has provisionally adopted Article 11 without reservation.

Detailed explanation of new law

Determining a single residence for dual resident entities

3.26 Australia has provisionally adopted Article 4, but has indicated it will make the reservation contained in Article 4(3)(e) to deny a dual resident person's entitlement to any treaty benefits where the relevant competent authorities have not reached an agreement on a single jurisdiction of residence.

3.27 Tax agreements only apply to persons that are a tax resident of one or both jurisdictions under those jurisdictions' respective domestic laws. Where a person is a resident of both jurisdictions (i.e. a dual resident), most tax agreements have tiebreaker rules to determine that the person is a resident of a single jurisdiction for the purposes of the tax agreement.

3.28 The key tiebreaker rule that is generally applied in determining the residence of a dual resident entity (such as a company) is the entity's place of effective management.

3.29 Entities can customise the outcome of applying such a test, and potentially avoid tax in a particular jurisdiction, by relocating their place of effective management.

3.30 In respect of dual resident entities, Article 4 provides for the replacement of a tiebreaker rule (or addition of such a provision if there is no existing provision) in a Covered Tax Agreement so that the two competent authorities would endeavour to determine by mutual agreement which of the jurisdictions the dual resident is deemed to be a resident of by having regard to:

- its place of effective management;
- its place of incorporation or constitution; and
- any other relevant factors.

[Articles 4(1) and (2) of the Multilateral Convention]

3.31 As per paragraphs 24.1 and 24.3 of the Commentary on Article 4 (Resident) of the OECD Model, although the factors on which a determination is based may vary over time it is expected that the relevant factors taken into consideration will include:

- where the meetings of the entity's board of directors or equivalent body are usually held;
- where the chief executive officer and other senior executives usually carry on their activities;
- where the senior day-to-day management of the entity is carried on;

- where the entity's headquarters are located;
- which jurisdiction's laws govern the legal status of the entity;
- where its accounting records are kept; and
- whether determining that the entity is a resident of one jurisdiction but not of the other for the purpose of the tax agreement would carry the risk of an improper use of the provisions of the tax agreement.

3.32 That is, Article 4 expands the criteria for determining a dual resident entity's country of tax residence for tax agreement purposes. It includes other relevant factors in addition to the 'place of effective management' test previously solely relied upon in the OECD Model and requires the two competent authorities to agree on a single jurisdiction of residence.

3.33 Article 4's expansion of the criteria and agreement by the competent authorities is intended to improve the integrity of the tiebreaker rule. Requiring a case-by-case approach will help prevent entities employing a dual residency status to avoid tax.

3.34 In the absence of mutual agreement between the competent authorities, the dual resident entity is not entitled to any relief or exemption from tax provided by the Covered Tax Agreement, except to the extent agreed by the competent authorities. [*Article 4(1) of the Multilateral Convention*]

3.35 Australia has provisionally made the reservation in Article 4(3)(e) to exclude this exception to allow the competent authorities to agree on the extent to which relief or exemption will be granted. That is, the dual resident is not able to be granted any tax relief or exemption under a Covered Tax Agreement to which Australia is a Party unless the competent authorities agree on a single residency of the dual resident.

3.36 Where the other Party to a Covered Tax Agreement (to which Australia is a Party) has made the reservation in Article 4(3)(f), Article 4 will not modify that Covered Tax Agreement at all. That reservation allows a Party to opt out of the application of Article 4 entirely where another Party has made the reservation in Article 4(3)(e).

3.37 Article 4 will not affect existing provisions of a Covered Tax Agreement that deal with the tax residence of a company that is participating in a dual-listed company arrangement. For example, Article 4 of the Multilateral Convention will not affect paragraph 6 of Article 4 of the New Zealand Convention. [*Article 4(2) of the Multilateral Convention*]

3.38 The replacement of an existing tiebreaker provision or inclusion of a tiebreaker provision for non-individuals in a Covered Tax Agreement will occur if neither Party to a Covered Tax Agreement makes the

reservation in any of Articles 4(3)(a), (b), (c), (d) or (f) and notifies the Depositary of the affected bilateral provisions to be replaced. *[Article 4(4) of the Multilateral Convention]*

3.39 Australia has provisionally notified that all of Australia's agreements that it has nominated as Covered Tax Agreements, except those with Turkey and the United States, contain such an existing tiebreaker rule. Australia's tax agreements with Turkey and the United States do not contain tiebreaker rules for entities that are not individuals.

3.40 Otherwise, the tiebreaker rule contained in Article 4(1) will modify Australia's Covered Tax Agreements to the extent of any inconsistency between Article 4(1) and the relevant bilateral provisions, subject to any reservations made by the relevant Parties.

3.41 Based on the known or proposed adoption positions of other Signatories to the Multilateral Convention, 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.

Inserting a clear statement regarding intention to address BEPS

3.42 Article 6 is a mandatory provision of the Multilateral Convention for jurisdictions that ratify it that sets out a new preamble text for Covered Tax Agreements. This Article is to implement the recommendation of the BEPS Final Report on Action 6 for the inclusion of a clear statement that the parties to a tax agreement intend to avoid creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance.

3.43 If a Covered Tax Agreement contains preambular language referring to the intent to eliminate double taxation (regardless of whether the language refers to an intent not to create opportunities for non-taxation or reduced taxation), those words will be replaced with the new preamble text to include the express intention of eliminating double taxation with respect to the taxes covered by the agreement '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 the treaty for the indirect benefit of residents of third jurisdictions)'. *[Articles 6(1) and (2) of the Multilateral Convention]*

3.44 If a Covered Tax Agreement does not contain such preamble language, the new preamble text will be added to the agreement. *[Article 6(2) of the Multilateral Convention]*

3.45 The replacement of existing preamble language in a Covered Tax Agreement is only effective if both Parties to the Covered Tax Agreement do not make the reservation in Article 6(4) (to not apply Article 6 at all as the tax agreement already contains comparable preamble

language to Article 6(1)) and notify the Depositary of the affected preamble words to be replaced. In other cases, the preamble language in Article 6(1) is included in addition to existing preamble language.

[Article 6(5) of the Multilateral Convention]

3.46 Australia has provisionally notified that the relevant preambular words (i.e. referring to the intent to eliminate double taxation) are contained in all of Australia's agreements that it wishes to be Covered Tax Agreements, and will thus be replaced by the new preamble text contained in Article 6(1).

3.47 Based on the known or proposed adoption positions of other Signatories to the Multilateral Convention, 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.

3.48 If a Covered Tax Agreement does not contain preambular language that refers to the Parties' desire to further develop their economic relationship and enhance their co-operation in tax matters, a jurisdiction may choose to include such words. *[Article 6(3) of the Multilateral Convention]*

3.49 The inclusion of the additional preamble text is only effective if both Parties to a Covered Tax Agreement choose to do so and notify the Depositary accordingly.

3.50 Australia has chosen to include the additional preamble text contained in Article 6(3) and provisionally notified that the relevant words are not contained in any of Australia's agreements that it wishes to be Covered Tax Agreements.

3.51 Based on the known or proposed adoption positions of other Signatories to the Multilateral Convention, Article 6(3) is expected to modify Australia's tax agreements with: Argentina, Belgium, Chile, China, Fiji, France, Ireland, Japan, Malta, Mexico, the Netherlands, Norway, Romania, Russia, Singapore, the Slovak Republic, South Africa, Spain, Turkey and the United Kingdom.

3.52 The preamble is important for the interpretation of a tax agreement. Consistent with Article 31(1) of the Vienna Convention on the Law of Treaties, a tax agreement is to be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

3.53 Australia's adoption of Article 6 to the fullest extent possible will ensure that the intention to address BEPS concerns, as reflected in its

Covered Tax Agreements, will be considered when interpreting a Covered Tax Agreement.

Inserting a general anti-abuse rule

3.54 Article 7 is a mandatory provision of the Multilateral Convention for jurisdictions that ratify it that provides treaty-based anti-abuse rules (i.e. the Principal Purposes Test and the Simplified Limitation on Benefits rule).

3.55 The Principal Purposes Test provides that a benefit will not be granted (such as a tax reduction or exemption) where it is reasonable to conclude having regard to all relevant facts and circumstances that:

- one of the principal purposes of an arrangement or transaction was to obtain the benefit (directly or indirectly); and
- granting such a benefit in the circumstance would not accord with the object and purpose of the provisions of the Covered Tax Agreement.

[Article 7(1) of the Multilateral Convention]

3.56 As per paragraph 174 of the Commentary to Article 29 (Entitlement to Benefits) of the OCED Model, the Principal Purposes Test is intended:

...to ensure that tax conventions apply in accordance with the purpose for which they were entered into, i.e. to provide benefits in respect of bona fide exchanges of goods and services, and movements of capital and persons as opposed to arrangements whose principal objective is to secure a more favourable tax treatment.

3.57 In interpreting the various elements of Article 7(1) of the Multilateral Convention, paragraphs 175 to 187 of the Commentary to Article 29 (Entitlement to Benefits) of the OECD Model are of particular relevance. Those paragraphs discuss concepts such as ‘one of the principal purposes’, ‘arrangement or transaction’ and ‘benefit’ and provide relevant examples.

3.58 If a Covered Tax Agreement contains a provision that enables the denial of treaty benefits where an arrangement or transaction, or a person concerned with such an arrangement or transaction, had a principal purpose of obtaining the benefits (i.e. an existing principal purposes test), then that provision will be replaced by Article 7(1). *[Article 7(2) of the Multilateral Convention]*

3.59 If a Covered Tax Agreement does not contain such a provision, then Article 7(1) will be added to the agreement. *[Article 7(2) of the Multilateral Convention]*

3.60 However, a Party can reserve its right to not adopt the Principal Purposes Test under Article 7(1) if:

- the Party intends to take bilateral action to adopt a detailed Limitation on Benefits rule together with either the Principal Purposes Test or rules to address conduit financing structures to meet the minimum BEPS standard; or
- the Party's Covered Tax Agreements already contain a principal purposes test.

[Article 7(15) of the Multilateral Convention]

3.61 The replacement of an existing principal purposes test in a Covered Tax Agreement is only effective if both Parties to the Covered Tax Agreement do not make the reservation contained in Article 7(15)(a) (to not apply Article 7(1) as the Party intends to meet the minimum standard by taking bilateral action) and notify the Depository accordingly.

[Article 7(17)(a) of the Multilateral Convention]

3.62 Australia has provisionally indicated that Australia's tax agreements with Chile, China, Finland, Ireland, Japan, Mexico, New Zealand, Norway, South Africa, Switzerland and the United Kingdom contain provisions with principal purposes tests aimed at specific treaty benefits (see, for example, Articles 10(11) (Dividends), 11(10) (Interest) and 12(8) (Royalties) of the Japanese Convention).

3.63 The principal purposes test contained in Article 7(1) will replace these specific anti-abuse provisions and modify Australia's Covered Tax Agreements to the extent of any inconsistency between Article 7(1) and the relevant provisions of those agreements, provided that the relevant Parties to a Covered Tax Agreement have not made the reservation in Article 7(15)(a) or (b). *[Article 7(17)(a) of the Multilateral Convention]*

3.64 A Party may supplement the Principal Purposes Test with a Simplified Limitation on Benefits rule. This rule would limit treaty benefits to 'qualified persons' (such as individuals, government entities, listed companies, non-profit organisations, pension funds, entities engaged in active business and entities that meet specified ownership requirements). *[Article 7(6) of the Multilateral Convention]*

3.65 Australia has provisionally adopted the Principal Purposes Test only. This is broadly consistent with Australia's recent treaty practice.

3.66 A Party may also choose to supplement the application of Article 7(1) with an associated rule to enable a competent authority, in consultation with the competent authority of the other Party, to grant treaty benefits to a taxpayer (on request), despite a denial under the Principal Purposes Test, if those benefits would nevertheless have been granted in the absence of the arrangement that attracted that denial.

[Article 7(3) and (4) of the Multilateral Convention]

3.67 The associated rule will modify the application of a principal purposes test in a Covered Tax Agreement. *[Article 7(5) of the Multilateral Convention]*

3.68 Australia has provisionally adopted the associated rule.

3.69 The associated rule is only effective if both Parties to a Covered Tax Agreement choose to apply the associated rule in Article 7(4) and notify the Depository of their choice. *[Article 7(17)(b) of the Multilateral Convention]*

3.70 Based on the known or proposed adoption positions of other Signatories to the Multilateral Convention, 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.

Addressing dividend transfer transactions

3.71 Australia has provisionally adopted Article 8 without reservation for all of its agreements it wishes to be Covered Tax Agreements.

3.72 In order to encourage cross-border direct investment, many tax agreements provide for reduced tax rates on certain intercorporate dividends paid to foreign shareholders.

3.73 In some cases, foreign shareholders may attempt to secure the benefits of the reduced tax rate by increasing their shareholdings just before dividends are paid.

3.74 Where a provision of a Covered Tax Agreement exempts or provides a concessional tax rate for dividends paid by one company to another, Article 8 provides that the company receiving the dividend must hold the related shares for 365 days or more (including the day of payment) before any such exemption or concession applies. *[Article 8(1) of the Multilateral Convention]*

3.75 If such a provision in a Covered Tax Agreement includes a minimum holding period, the period will be replaced by the minimum holding period in Article 8(1). Otherwise, the 365 day minimum holding period will be added to the provision in the Covered Tax Agreement. *[Article 8(2) of the Multilateral Convention]*

3.76 The existing 12 month holding period provisions in the Dividends articles of some of Australia's tax agreements generally require that that period be satisfied at the time the dividend is declared whereas Article 8(1) of the Multilateral Convention provides that the 365 day period includes the day of the payment of the dividends. Thus, under Article 8(1), the holding period may straddle the dividend payment date.

3.77 The 365 day period is not affected by changes in ownership due to corporate reorganisations of either the domestic company paying the dividends or the foreign company receiving the dividends. These corporate reorganisations include mergers, corporate consolidations, and corporate divisions. *[Article 8(1) of the Multilateral Convention]*

3.78 The replacement or addition of a minimum holding period is only effective if both Parties to a Covered Tax Agreement do not make any of the reservations contained in Article 8(3)(a) and (b) and notify the Depository accordingly. *[Article 8(4) of the Multilateral Convention]*

3.79 Australia has provisionally notified that Australia's tax agreements with Argentina, Canada, Chile, Czech Republic, Finland, France, Japan, Malaysia, Mexico, New Zealand, Norway, Philippines, Romania, Russia, South Africa, Switzerland, Taipei, Turkey, the United Kingdom and the United States, contain a provision for a concessional tax rate for non-portfolio intercorporate dividends paid to foreign companies.

3.80 Article 8 will help prevent acquisitions and disposals of shares from being eligible for the reduced tax rate on non-portfolio intercorporate dividends.

3.81 Article 8 does not affect existing provisions in Covered Tax Agreements that give a preferential rate for dividends without the condition of a certain percentage of shareholding in the company paying the dividends.

3.82 The Article is intended to replace or add a minimum shareholding period to existing provisions in Covered Tax Agreements without modifying other elements of those provisions such as rates of tax, ownership thresholds and the form of ownership.

3.83 Based on the known or proposed adoption positions of other Signatories to the Multilateral Convention, Article 8 is expected to modify Australia's tax agreements with: Argentina, France, Mexico, New Zealand, Romania, Russia and South Africa.

Ensuring shares in land-rich entities are taxed at source

3.84 Australia has provisionally adopted Article 9, but has indicated it will make the reservation contained in Article 9(6)(e) to not modify Covered Tax Agreements that already contain corresponding rules on the alienation of interests in entities other than companies.

3.85 Tax agreements generally preserve a jurisdiction's right to tax capital gains attributable to the disposal of immovable property (primarily land) located in that jurisdiction. This taxing right applies to disposals of both direct holdings in immovable property and holdings held indirectly through interposed land-rich entities.

3.86 A land-rich entity is an entity that derives, directly or indirectly, more than 50 per cent of its value from immovable property.

3.87 In some cases, foreign residents may attempt to avoid the payment of capital gains tax by contributing other assets to a land-rich entity, thereby diluting the total assets within the entity so that it is no longer land-rich, shortly before disposing of their interests in the entity.

3.88 For the purposes of determining whether the 50 per cent threshold has been reached for an entity to be considered land-rich, Article 9 provides for the inclusion of a 365 day testing period. That is, a jurisdiction may tax capital gains arising from the disposal of interests in a land-rich entity if that entity was land-rich at any time during the 365 days preceding the date of disposal. These rules will replace any existing testing period in a Covered Tax Agreement or add such a period if there is no existing provision. *[Articles 9(1)(a) and (2) of the Multilateral Convention]*

3.89 Furthermore, the types of interests in the entity are expanded beyond shares in a company to include comparable interests in other types of entities. Comparable interests include interests in a partnership or trust in addition to any shares or rights already covered by the provisions of a Covered Tax Agreement. *[Article 9(1)(b) of the Multilateral Convention]*

3.90 As the relevant articles of many of Australia's tax agreements already apply to comparable interests in non-corporate entities, Australia has provisionally made the reservation allowable in Article 9(6)(e) to opt out of Article 9(1)(b). That is, those existing bilateral rules will continue to apply without modification by Article 9(1)(b).

3.91 Australia has indicated that its tax agreements with Argentina, Canada, Chile, Finland, France, Ireland, Japan, Malaysia, Mexico, New Zealand, Norway, Romania, Russia, Slovak Republic, South Africa, Switzerland, Turkey, the United Kingdom, and the United States already contain these corresponding rules.

3.92 The replacement of a testing period is only effective if both Parties to a Covered Tax Agreement do not make the reservation contained in Article 9(6)(a) (to not apply Article 9 at all) and notify the Depositary accordingly. *[Article 9(7) of the Multilateral Convention]*

3.93 Australia has provisionally indicated that it will adopt the 365 testing period for its Covered Tax Agreements.

3.94 A Party may choose to apply Article 9(4) to its Covered Tax Agreements. Article 9(4) would modify a Covered Tax Agreement to include a complete replacement provision that includes the 365 day testing period and covers disposals of comparable interests in non-corporate entities (i.e. Article 9(4) would essentially follow the text of Article 13(4) of the OECD Model). *[Article 9(4) of the Multilateral Convention]*

3.95 Australia has provisionally indicated that it will not to adopt Article 9(4).

3.96 Based on the known or proposed adoption positions of other Signatories to the Multilateral Convention, 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.

Addressing permanent establishments in third jurisdictions

3.97 Australia has provisionally made the reservation under Article 10(5)(a) to not adopt Article 10. On this basis, Article 10 will not form part of Australia's domestic laws and thus will not modify Australia's Covered Tax Agreements.

3.98 Tax agreements often limit the amount of tax that can be imposed on income derived from one jurisdiction by residents of another jurisdiction. However, a resident of a jurisdiction may attempt to inappropriately escape tax by attributing certain income (derived from the other jurisdiction partner) to a permanent establishment (a taxable presence) situated in a third jurisdiction that imposes little or no tax on the income. This could occur, for example, if the resident's home jurisdiction exempts the profits of the third jurisdiction permanent establishment.

3.99 Broadly, Article 10 would deny the benefits available under a tax agreement where an entity that is a resident of one jurisdiction derives income from another jurisdiction through a permanent establishment located in a third jurisdiction, and that income is both exempt in the entity's jurisdiction of residence and subject to reduced taxation in the third jurisdiction. The benefits are denied on income on which the tax in the third jurisdiction is less than 60 per cent of the tax that would be imposed in the first jurisdiction if the permanent establishment was a resident. [*Article 10(1) of the Multilateral Convention*]

3.100 It is possible for Australia to adopt Article 10 in the future by lifting its proposed reservation.

Clarifying ability to tax own residents

3.101 Australia has provisionally adopted Article 11 for all of its tax agreements.

3.102 Most provisions in tax agreements are designed to restrict a jurisdiction's right to tax income derived from within that jurisdiction by foreign residents. Concerns have been raised internationally, however, that some provisions could be interpreted so as to limit a jurisdiction's right to tax its own residents. This has led to the possibility of an entity circumventing its home jurisdiction's anti-avoidance rules.

3.103 Where a provision of a Covered Tax Agreement states that it does not affect the taxation by a jurisdiction of its residents, Article 11 provides for the replacement of such a provision (or the addition of such a provision if there is no existing provision) to clarify that a Covered Tax Agreement does not affect a Party's ability to tax its own residents, subject to the exceptions listed in Articles 11(1)(a) to (j). *[Articles 11(1) and (2) of the Multilateral Convention]*

3.104 The exceptions in Article 11(1) cover provisions that commonly appear in tax agreements and address:

- correlative or corresponding adjustments following an initial adjustment in accordance with the Covered Tax Agreement (e.g. Articles 7(3) (Business Profits) and 9(2) (Associated Enterprises) of the OECD Model);
- the taxation of income derived from government services (e.g. Article 19 (Government Service) of the OECD Model);
- the taxation of income derived by students and academics (e.g. Article 20 (Students) of the OECD Model);
- the provision of tax credits or exemptions for income taxed in the other jurisdiction (e.g. Articles 23A (Exemption Method) and 23B (Credit Method) of the OECD Model);
- the protection of taxpayers from discriminatory taxation practices (e.g. Article 24 (Non-discrimination) of the OECD Model);
- rules that permit taxpayers to request that the competent authorities consider tax cases not in accordance with a Covered Tax Agreement (e.g. Article 25 (Mutual Agreement Procedure) of the OECD Model);
- the taxation of income derived by members of diplomatic missions and consular posts (e.g. Article 28 (Members of Diplomatic Missions and Consular Posts) of the OECD Model);
- the taxation of pensions (e.g. Article 18 (Pensions) of the OECD Model) and other payments made under the social security legislation of the other jurisdiction;
- the taxation of payments under family law; and
- provisions that otherwise explicitly limit a jurisdiction's right to tax its own residents or allocate exclusive taxing rights over income to the source jurisdiction.

[Articles 11(1)(a) to (j) of the Multilateral Convention]

3.105 Thus the Commentary related to those Articles of the OECD Model are relevant in interpreting the provisions of Covered Tax Agreements listed in Articles 11(1)(a) to (g) of the Multilateral Convention.

3.106 Article 11 is a saving clause and will codify a widely accepted principle that is already understood to apply to Australia's tax agreements. Articles 11(1)(h) and 11(1)(i) of the Multilateral Convention have been included as additional exceptions to reflect other provisions that sometimes appear in tax agreements.

3.107 The replacement of a provision in a Covered Tax Agreement stating that it does not affect the taxation by a jurisdiction of its residents is only effective if both Parties to a Covered Tax Agreement do not make the reservation in Article 11(3) (to not apply Article 11 at all or to those that already contains the saving clause) and notify the Depositary of the affected bilateral provisions to be replaced. *[Article 11(4) of the Multilateral Convention]*

3.108 Australia has provisionally indicated that Australia's tax agreements with Belgium, Canada, Fiji, France, Ireland, Italy, Korea, the United Kingdom, and the United States contain such a provision.

3.109 Article 11(1) will modify Australia's Covered Tax Agreements to the extent of any inconsistency between Article 11(1) and the relevant provisions of those agreements, and provided that the relevant Parties to a particular Covered Tax Agreement have not opted out of Article 11 entirely. *[Article 11(4) of the Multilateral Convention]*

3.110 Based on the known or proposed adoption positions of other Signatories to the Multilateral Convention, 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.

Chapter 4

Avoidance of permanent establishment status

Outline of chapter

4.1 This Chapter explains the way in which the Multilateral Convention will modify Australia's Covered Tax Agreements to address the avoidance of permanent establishment status through:

- the use of certain intermediary arrangements;
- the use of specific activity exemptions; or
- splitting-up contracts.

Context of amendments

4.2 A permanent establishment is a taxable presence threshold for determining whether a jurisdiction can tax business profits derived by a foreign resident enterprise. Under tax agreements, a jurisdiction can generally only tax such profits to the extent they are attributable to a permanent establishment of that foreign enterprise located in that jurisdiction. Thus, a foreign enterprise can avoid local taxation of business profits by implementing arrangements that circumvent the existing treaty-based definition of permanent establishment.

4.3 Common strategies to frustrate the intended operation of the definition of permanent establishment include:

- using certain intermediary arrangements to perform functions that could have otherwise been undertaken by the enterprise itself;
- exploiting the existing exceptions from the definition of permanent establishment, including through fragmentation of activities that fall within those exceptions; and
- dividing a building site or construction or installation project contract into several parts amongst related persons so that each contract does not exceed the specified time period that deems a permanent establishment to exist.

4.4 The BEPS Final Report on Action 7 (Preventing the Artificial Avoidance of Permanent Establishment Status) recommended changes to

the definition of ‘permanent establishment’ in the OECD Model to address these strategies.

4.5 Articles 12 to 15 of the Multilateral Convention implement those Action 7 recommendations.

Summary of new law

4.6 Part IV (Avoidance of Permanent Establishment Status) of the Multilateral Convention contains rules that aim to restore source country taxation in a number of cases where cross-border income would otherwise go untaxed or would be taxed at very low rates as a result of existing tax agreement provisions that define permanent establishment:

- Article 12 — artificial avoidance of permanent establishment status through *commissionnaire* arrangements and similar strategies;
- Article 13 — artificial avoidance of permanent establishment status through the specific activity exemptions;
- Article 14 — splitting-up of contracts; and
- Article 15 — definition of a person closely related to an enterprise.

4.7 Article 12 ensures that where an intermediary habitually concludes contracts or habitually plays the principal role in concluding substantially finalised business contracts in a jurisdiction on behalf of a foreign enterprise, that arrangement will be deemed to constitute a permanent establishment.

4.8 Australia has indicated that it will reserve the right for Article 12 not to apply to its Covered Tax Agreements. This means that the ‘Permanent Establishment’ articles of Australia’s Covered Tax Agreements will not be modified by Article 12 of the Multilateral Convention.

4.9 Article 13 ensures that the specific activity exceptions from the definition of permanent establishment are limited to activities that are genuinely preparatory or auxiliary in nature and prevents the foreign enterprise, either alone or with its related entities, from fragmenting its activities to qualify for this exclusion.

4.10 Australia has indicated that it will adopt Article 13 and will choose to include the requirement that each of the specific activity exceptions must individually be of a preparatory or auxiliary character, and make a reservation to restrict the application of this requirement to its Covered Tax Agreements that do not already contain corresponding rules.

4.11 Article 14 prevents related entities from dividing building or construction-related contracts into several parts to avoid rules that apply specified time periods to deem a permanent establishment to exist in a jurisdiction.

4.12 Australia has indicated that it will adopt Article 14 and make a reservation for Article 14 not to apply to provisions in its Covered Tax Agreements relating to the exploration for or exploitation of natural resources.

4.13 Article 15 defines the circumstances in which a person is considered to be closely related to an enterprise for the purposes of Articles 12, 13 and 14. Adopting Article 15 is mandatory for jurisdictions that choose to adopt any of Articles 12, 13 or 14 (in part or in full).

Detailed explanation of new law

A person closely related to an enterprise

4.14 Some paragraphs of the Articles in Part IV of the Multilateral Convention refer to a person closely related to an enterprise.

4.15 For the purposes of those paragraphs, Article 15 provides that the phrase means a person who has control of another or both persons are under common control of the same persons or enterprises. This is assessed on a case-by-case basis, dependent on the facts and circumstances of each case. *[Article 15(1) of the Multilateral Convention]*

4.16 As per paragraph 120 of the Commentary on Article 5 (Permanent Establishment) of the OECD Model, this ‘would cover...situations where a person or enterprise controls an enterprise by virtue of a special arrangement that allows that person or enterprise to exercise rights that are similar to those that it would hold if it possessed directly or indirectly more than 50 per cent of the beneficial interests in the enterprise’.

4.17 Furthermore, a person is automatically considered to be closely related to an enterprise if:

- one possesses directly or indirectly more than 50 per cent of the beneficial interests the other; or
- another person possesses directly or indirectly more than 50 per cent of the beneficial interest in the person and the enterprise.

[Article 15(1) of the Multilateral Convention]

4.18 Where a person is a company, the total voting power and value of the company’s shares or of the beneficial equity interest in the company

is considered to be the amount of beneficial interest in the person.
[Article 15(1) of the Multilateral Convention]

4.19 Article 15(2) allows a jurisdiction to make the reservation not to apply Article 15 to its Covered Tax Agreements where it has made the reservations not to apply Articles 12, 13 and 14.

4.20 Australia recognises that adopting Article 15 is necessary for the coherent operation of Articles 12, 13 and 14 in Part IV of the Multilateral Convention.

4.21 Therefore, Australia has indicated that it will adopt Article 15 without reservation, which is consistent with its recent treaty practice.

Addressing use of intermediary arrangements

4.22 Australia has provisionally made the reservation allowable under Article 12(4) to not adopt Article 12. On this basis, Article 12 will not modify Australia's Covered Tax Agreements and thus not be part of Australian domestic law.

4.23 Broadly, Article 12 provides that a foreign enterprise is deemed to have a permanent establishment in a jurisdiction:

- if a person in the jurisdiction acting on behalf of the foreign enterprise habitually concludes contracts or habitually plays the principal role in concluding substantially finalised business contracts that are:
 - in the name of the foreign enterprise;
 - for the transfer of the ownership of, or the granting of the right to use, property owned by the foreign enterprise or which the enterprise has the right to use; or
 - for services provided by the foreign enterprise;
- unless the person carries on business in that jurisdiction and is an independent agent for the foreign enterprise acting in their/its ordinary course of business.

[Articles 12(1) and (2) of the Multilateral Convention]

4.24 A person is not considered to be an independent agent if the person acts exclusively or almost exclusively for an enterprise to which it is closely related. *[Article 12(2) of the Multilateral Convention]*

4.25 A jurisdiction that has not made the reservation allowable under Article 12(4) must adopt both paragraphs 1 and 2 of Article 12 to replace similar provisions in a Covered Tax Agreement and must notify the Depository of these provisions in its Covered Tax Agreements to be replaced. The replacement is effective only if both Parties to the Covered

Tax Agreement make the same notification. [*Articles 12(3), (5) and (6) of the Multilateral Convention*]

4.26 Australia will consider adopting the rules contained in Article 12 bilaterally in future tax agreements to enable bilateral clarification of their application in practice.

4.27 It would also be possible for Australia to adopt Article 12 in the future by lifting its proposed reservation, which would be subject to Australia's domestic treaty-making requirements.

Addressing use of specific activity exemptions

4.28 Australia has provisionally adopted Article 13 and has made the reservation allowable under Article 13(6)(b) to restrict its application to Covered Tax Agreements that do not already contain corresponding rules to those contained in Article 13(2) (Option A). Australia's tax agreements with Finland, New Zealand and South Africa already contain such rules.

4.29 Tax agreements generally contain a list of specific activities, such as warehousing or purchasing goods, that are exceptions to the definition of permanent establishment (the specific activity exemptions).

4.30 Consistent with the Commentary on Article 5 (Permanent Establishment) of the OECD Model, the listed specific activity exceptions are to reflect that even though the listed activities of a place of business 'contribute to the productivity of the enterprise...the services it performs are so remote from the actual realisation of profits that it is difficult to allocate any profit' to those activities, therefore they are not treated as permanent establishments (see paragraph 58 of the Commentary on Article 5 (Permanent Establishment) of the OECD Model).

Preparatory and auxiliary requirement

4.31 To address situations where the lists of excepted activities included in Article 5(4) (Permanent Establishment) of the OECD Model give rise to BEPS concerns, paragraph 12 of the BEPS Final Report on Action 7 recommended that the OECD Model provision be modified so that each of the exceptions included in that provision is restricted to activities that are otherwise of a 'preparatory or auxiliary' character.

4.32 An activity is generally considered to be of a preparatory or auxiliary character if it is not 'an essential and significant part of the activity of the enterprise as a whole', which is assessed on a case-by-case basis (see paragraph 59 of the Commentary on Article 5 (Permanent Establishment) of the OECD Model).

4.33 Article 13 provides a jurisdiction with three options in respect of a preparatory or auxiliary requirement for the specific activity exceptions in its Covered Tax Agreements. These options are:

- include the requirement that each of the specific activities must be of a preparatory or auxiliary character in order to be excluded (Option A);
- only add the preparatory or auxiliary requirement for any other activity (other than those specifically listed) or for any combination of the listed activities (Option B); or
- apply neither option (i.e. not choose Option A or B).

[Articles 13(1) and (5) of the Multilateral Convention]

4.34 Australia has provisionally chosen Option A to modify its Covered Tax Agreements except its tax agreements with Finland, New Zealand and South Africa.

4.35 However, the requirement choice is effective only if both Parties to a Covered Tax Agreement choose the same option and notify the Depository of the affected bilateral provisions to be subject to that choice.

[Article 13(7) of the Multilateral Convention]

Anti-fragmentation rule

4.36 In addition, those exceptions are open to exploitation by enterprises through fragmentation of activities in order to qualify for the exceptions.

4.37 Article 13 also provides that the specific activity exceptions will not apply where the business activities of the enterprise or a closely related enterprise are carried out, within the same jurisdiction, constituting complementary functions that are part of a cohesive business operation. The change in application prevents the fragmentation of activities by the foreign enterprise itself or with related entities to qualify for the specific activity exemptions (which would otherwise be a permanent establishment). *[Articles 13(4) and (5) of the Multilateral Convention]*

4.38 Australia has provisionally indicated that it will adopt the anti-fragmentation rule for its Covered Tax Agreements. The change in application is effective only if both Parties to a Covered Tax Agreement have not opted out of the anti-fragmentation rule and notified the Depository of the affected bilateral provisions to be subject to the change. *[Article 13(8) of the Multilateral Convention]*

4.39 Australia's provisional positions are consistent with its recent treaty practice.

4.40 Based on the known or proposed adoption positions of other Signatories to the Multilateral Convention, 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.

Addressing splitting-up of contracts

4.41 Australia has provisionally adopted Article 14 but has made the reservation allowable under Article 14(3)(b) to not apply Article 14 to Covered Tax Agreements that deem a permanent establishment to exist in relation to offshore natural resource activities.

4.42 Most tax agreements deem a permanent establishment to exist where a building site or a construction or installation project exceeds a specified time period. This can be circumvented by dividing a contract for a project into several contracts so that each contract does not exceed the specified time period, so that the building site or construction or installation project is not deemed to be a permanent establishment and any profits avoid local taxation where the project is located.

4.43 For the purpose of determining whether the specified time period threshold has been reached, Article 14 provides for the replacement of an anti-contract splitting provision in a tax agreement (or addition of such a provision if there is no existing provision) so that the time period is the total time period of:

- activities carried on by a foreign enterprise that total more than 30 days at a building site, construction or installation project, or supervisory or consultancy activities in connection with such sites or projects; and
- connected activities carried on by closely related persons of the foreign enterprise at the same site or project during different periods that are more than 30 days each.

[Article 14(1) and (2) of the Multilateral Convention]

4.44 Consistent with paragraph 53 of the Commentary on Article 5 (Permanent Establishment) of the OECD Model, whether an activity is a connected activity is assessed on a case-by-case basis. In making that assessment, the Commentary includes the following indicative list of relevant factors:

- whether the contracts for the different activities were concluded with the same person or related persons;
- whether the conclusion of additional contracts is a logical consequence of a previous contract concluded with the same person or related persons;
- whether the activities would have been covered by a single contract absent tax planning considerations;
- whether the nature of the work involved under the different contracts is the same or similar; and

- whether the same employees are performing the activities under the different contracts.

4.45 The same circumstances may also prompt the application a provision in a Covered Tax Agreement as modified by Article 7 of the Multilateral Convention (i.e. Principal Purposes Test). Article 7 is discussed above in Chapter 3 of this explanatory memorandum.

4.46 Article 14 does not affect the application of any bilateral anti-contract splitting provisions in Covered Tax Agreements that are applicable to activities other than those carried on at a building site, construction or installation project, or supervisory or consultancy activities in connection with those sites or projects.

4.47 The replacement of an existing anti-contract splitting provision in a Covered Tax Agreement is only effective if both Parties to a Covered Tax Agreement do not make the reservation in Article 14(3)(a) (to not apply Article 14 at all) and notify the Depository of the affected bilateral provisions to be replaced. *[Article 14(4) of the Multilateral Convention]*

4.48 Australia has provisionally indicated that Australia's tax agreements with Chile, Finland, France, Japan, New Zealand, Norway, South Africa, Switzerland, Turkey and the United Kingdom contain such a provision.

4.49 Otherwise, the anti-contract splitting provision contained in Article 14(1) will modify Australia's Covered Tax Agreements to the extent of any inconsistency between Article 14(1) and the relevant provisions of those Covered Tax Agreements, and provided that the relevant partner jurisdictions to a Covered Tax Agreement have not opted out of Article 14 entirely. *[Article 14(4) of the Multilateral Convention]*

4.50 However, Australia has provisionally made the reservation to not apply Article 14 to provisions in Covered Tax Agreements that deem a permanent establishment to exist in relation to exploration for or exploitation of natural resources and indicated that Australia's tax agreement with Norway contains such a provision.

4.51 On this basis, the application of Article 20(3) of Australia's tax agreement with Norway will not be affected by the Multilateral Convention.

4.52 Australia's provisional position to adopt Article 14 is consistent with its recent treaty practice.

4.53 Based on the known or proposed adoption positions of other Signatories to the Multilateral Convention, 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.

Chapter 5

Improving dispute resolution

Outline of chapter

5.1 This Chapter explains the way in which the Multilateral Convention will modify Australia's Covered Tax Agreements to strengthen the effectiveness and efficiency of the mutual agreement procedure (MAP) with respect to the resolution of disputes arising under tax agreements.

Context of amendments

5.2 The 2013 OECD/G20 BEPS Action Plan recognised that measures taken to address BEPS needed to be complemented with methods to provide greater certainty and predictability for business.

5.3 Recognising that improving the MAP in resolving treaty-related disputes is an integral component of the work on BEPS, the BEPS Final Report on Action 14 (Making Dispute Resolution Mechanisms More Effective) identified the following elements of a minimum standard to ensure the timely, effective and efficient resolution of treaty-related disputes:

- jurisdictions should ensure that obligations under a tax agreement related to the MAP are fully implemented in good faith and that MAP cases are resolved in a timely manner;
- jurisdictions should ensure that administrative processes promote the prevention and timely resolution of treaty-related disputes; and
- jurisdictions should ensure that taxpayers can access the MAP when eligible.

5.4 The minimum standard is complemented by a set of best practices that jurisdictions are encouraged to adopt. The best practices are not mandatory because they are predominantly subjective or qualitative in nature, rather than involving clear and objective criteria for implementation.

5.5 The BEPS Final Report on Action 14 also considered the implementation of mandatory binding arbitration in jurisdictions' tax agreements to complement the MAP. Chapter 6 of this explanatory memorandum covers mandatory binding arbitration.

5.6 The BEPS Final Report on Action 14 recommended that to ensure its MAP obligations are fully implemented in good faith and in a timely manner, jurisdictions should:

- include Articles 25(1) to (3) (MAP) of the OECD Model in their tax agreements; and
- provide access to the MAP in transfer pricing cases and implement the resulting mutual agreements.

5.7 Article 16 of the Multilateral Convention implement these Action 14 recommendations and is a BEPS minimum standard.

5.8 Article 17 implements the Best Practice of providing a mechanism to make corresponding adjustments unilaterally (i.e. without MAP).

Summary of new law

5.9 Part V (Improving Dispute Resolution) of the Multilateral Convention contains the following rules to provide a more effective dispute resolution procedure so that actions to counter BEPS do not inadvertently lead to double taxation or cause unnecessary uncertainty for taxpayers. These rules are:

- Article 16 — MAP; and
- Article 17 — corresponding adjustments.

5.10 Article 16 allows taxpayers to present cases involving the application of a Covered Tax Agreement to the competent authority of either jurisdiction, regardless of any domestic law remedies.

5.11 Adopting Article 16 is mandatory. Australia has indicated that it will adopt the Article without reservation.

5.12 Article 17 obliges the competent authority of a Contracting Jurisdiction to make an appropriate adjustment to the tax of a resident enterprise. Such adjustments are made to reflect an adjustment to the profits (and resultant tax) of an associated enterprise resident of the other Contracting Jurisdiction that is made by the competent authority of that other jurisdiction.

5.13 Australia has indicated that it will make the reservation contained in Article 17(3)(a) to prevent Article 17 from applying to Covered Tax Agreements that already contain equivalent rules.

Detailed explanation of new law

Improving MAP

5.14 Article 16 is a mandatory provision of the Multilateral Convention that aims to ensure the effective and timely resolution of disputes regarding the interpretation or application of tax agreements.

5.15 Article 16 contains the following six elements:

- Element one (first sentence of Article 16(1)) — allows a taxpayer the option to present a case to the competent authority of either Covered Tax Agreement partner jurisdiction if the taxpayer believes they are not (or will not be) taxed in accordance with the terms of the Covered Tax Agreement, irrespective of any domestic law remedies;
- Element two (second sentence of Article 16(1)) — limits the time in which taxpayers can request MAP assistance to a period of three years. This period commences on the first notification of the action that results in taxation that is not accordance with the Covered Tax Agreement;
- Element three (first sentence of Article 16(2)) — obliges the respective competent authorities to endeavour to resolve the case by mutual agreement. This obligation only applies where the competent authority that is presented with the case considers the case to be justified and is unable to arrive at a satisfactory solution itself;
- Element four (second sentence of Article 16(2)) — obliges any resulting mutual agreement be implemented notwithstanding any time limits in the domestic law;
- Element five (first sentence of Article 16(3)) — obliges the respective competent authorities to endeavour to resolve by mutual agreement any difficulties or doubts arising from the interpretation or application of the Covered Tax Agreement; and
- Element six (second sentence of Article 16(3)) — allows the competent authorities to consult for the elimination of double taxation in cases not provided for in the Covered Tax Agreement.

[Articles 16(1) to (3) of the Multilateral Convention]

5.16 Articles 16(1) to (3) broadly replicate Articles 25(1) to (3) (MAP) of the OECD Model.

5.17 The effect of each of those elements on each of Australia's Covered Tax Agreements depends on the symmetrical application of the different compatibility clauses, reservations and associated notification requirements.

Element one — Presentation of a case to either competent authority if taxpayer considers they are not (or will not be) taxed in accordance with the terms of the Covered Tax Agreement

5.18 The first sentence of Article 16(1) of the Multilateral Convention enables a person (a taxpayer) to present a case under the MAP to either of the two competent authorities under a Covered Tax Agreement. That sentence will replace provisions of Covered Tax Agreements that only allow a person to present a case to the competent authority of the person's jurisdiction of residence (as is currently the case in all of Australia's proposed Covered Tax Agreements). That sentence will also replace provisions of Covered Tax Agreements that only allow a person to present such a case to the competent authority of the person's jurisdiction of nationality. *[Article 16(4)(a)(i) of the Multilateral Convention]*

5.19 If a Covered Tax Agreement does not contain such a provision, the first sentence in Article 16(1) of the Multilateral Convention will be added to the Covered Tax Agreement. *[Article 16(4)(a)(i) of the Multilateral Convention]*

5.20 Australia has provisionally indicated that the relevant provisions are contained in all of Australia's tax agreements and therefore could be replaced by the first sentence of Article 16(1).

5.21 The replacement of such a provision is only effective if both Parties to a Covered Tax Agreement do not make the reservation in Article 16(5)(a) (to not apply the first sentence of Article 16(1) to its Covered Tax Agreements) and notify the Depository of the affected provisions to be replaced. *[Article 16(6)(a) of the Multilateral Convention]*

Element two — Three year limit to request MAP where taxpayer believes they are not (or will not be) taxed in accordance with the terms of the Covered Tax Agreement

5.22 The second sentence of Article 16(1) of the Multilateral Convention provides that a person must present a case under the MAP within three years from the date on which the person was first notified of an action resulting in taxation not in accordance with the relevant tax agreement. That sentence will replace provisions of Covered Tax Agreements that provide for a time period (during which cases may be presented) of less than three years or that do not provide for any time period. *[Article 16(4)(a)(ii) of the Multilateral Convention]*

5.23 The provision will be replaced if each Party to the Covered Tax Agreement does not make the reservation in Article 16(5)(b) (to not apply

the second sentence of Article 16(1) to its Covered Tax Agreements) and notifies the Depository of the provisions to be replaced. Such reservations can only be made where the jurisdiction will nevertheless allow the person to present the case within a period of at three years. *[Article 16(6)(b)(i) of the Multilateral Convention]*

5.24 Australia has provisionally indicated that provisions providing for a time period (during which cases may be presented) of less than three years are contained in Australia's tax agreements with Italy, Malaysia and Philippines and, thus, those provisions would be replaced by the second sentence of Article 16(1).

5.25 However, the second sentence of Article 16(1) will not modify Australia's Covered Tax Agreements that contain provisions that allow a person a period of at least three years to present such a case to the competent authority, if Australia notifies the Depository of those Covered Tax Agreements and the relevant provisions. *[Article 16(6)(b)(ii) of the Multilateral Convention]*

5.26 Australia has provisionally indicated that all of its tax agreements except those with Canada, Italy, Malaysia, Philippines, Singapore and the United Kingdom have provisions that require taxpayers to present such cases within a period of at least three years.

5.27 Subject to other jurisdictions' reservations, the rules contained in the second sentence of Article 16(1) ensure that taxpayers have three years (or a longer period provided by a Covered Tax Agreement) to present such a case to the competent authority of either jurisdiction of a Covered Tax Agreement.

Element three — Obligation to endeavour to resolve an objection

5.28 The first sentence of Article 16(2) of the Multilateral Convention obliges a competent authority to endeavour to resolve a case by mutual agreement with the competent authority of the partner jurisdiction where the receiving competent authority considers the case to be justified and is unable to arrive at a satisfactory solution itself. That sentence will be added to Covered Tax Agreements that do not contain corresponding provisions. *[Article 16(4)(b)(i) of the Multilateral Convention]*

5.29 The first sentence of Article 16(2) will only be added to a Covered Tax Agreement if both Parties to the Covered Tax Agreement notify the Depository of the affected Covered Tax Agreements. *[Article 16(6)(c)(i) of the Multilateral Convention]*

5.30 Australia has provisionally indicated that the relevant provision is not contained in its tax agreements with Mexico, Singapore and the United States. Thus those tax agreements could be modified to include the first sentence of Article 16(2), to ensure that relevant disputes are considered jointly by the two competent authorities.

5.31 As per paragraph 8 of the Commentary on Article 25 (MAP) of the OECD Model, the MAP is a special procedure outside the domestic law. As such a taxpayer's decision to present a case to a competent authority does not deprive a taxpayer of any review or appeal rights available under domestic law (see also paragraph 7 of the Commentary on Article 25 of the OECD Model).

Element four – Disregard time limit when implementing a resulting mutual agreement

5.32 The second sentence of Article 16(2) of the Multilateral Convention obliges the relevant competent authorities to implement a mutual agreement arising from a taxpayer's case without regard to any domestic law time limits that might otherwise apply to such tax disputes. That sentence will be added to a Covered Tax Agreement that does not contain a corresponding rule. *[Article 16(4)(b)(ii) of the Multilateral Convention]*

5.33 The addition of that provision is only effective if both Parties to the Covered Tax Agreement do not make the reservation contained in Article 16(5)(c) (to not apply the second sentence of Article 16(2) to its Covered Tax Agreements) and notify the Depository of the affected Covered Tax Agreements. Such reservations can be made if the jurisdiction will implement the mutual agreement notwithstanding any domestic time limits or accept, through its bilateral tax agreement negotiations, provisions applying time limits to initiating transfer pricing adjustments. *[Article 16(6)(c)(ii) of the Multilateral Convention]*

5.34 Australia has provisionally indicated that the relevant provision is not contained in Australia's tax agreements with Belgium, Canada, Chile, Fiji, Ireland, Italy, Malaysia, Mexico, Philippines, Singapore, Switzerland, Thailand and the United Kingdom. Thus those tax agreements could be modified to include the second sentence of Article 16(2).

Element five – Obligation to endeavour to resolve interpretation or application of a Covered Tax Agreement

5.35 The first sentence of Article 16(3) of the Multilateral Convention obliges the competent authorities to endeavour to mutually resolve any difficulties or doubts concerning the interpretation or application of the relevant Covered Tax Agreement. That sentence will be added to Covered Tax Agreements that do not contain corresponding provisions. *[Article 16(4)(c)(i) of the Multilateral Convention]*

5.36 The addition of such a provision is only effective if both Parties to a Covered Tax Agreement notify the Depository of the affected Covered Tax Agreements. *[Article 16(6)(d)(i) of the Multilateral Convention]*

5.37 Australia has provisionally indicated that all of its tax agreements contain such a provision. Thus none of Australia's Covered Tax Agreements will be modified to include the first sentence of Article 16(3).

Element six — Consultation in cases not provided for in a Covered Tax Agreement

5.38 The second sentence of Article 16(3) of the Multilateral Convention authorises the competent authorities to consult together in order to eliminate double taxation in cases not provided for by the relevant Covered Tax Agreement. That sentence will be added to Covered Tax Agreements that do not contain a corresponding provision.

[Article 16(4)(c)(ii) of the Multilateral Convention]

5.39 The addition of such a provision is only effective if both Parties to a Covered Tax Agreement notify the Depositary of the affected Covered Tax Agreements. *[Article 16(6)(d)(ii) of the Multilateral Convention]*

5.40 Australia has provisionally indicated that relevant provisions are not contained in Australia's tax agreements with Austria, Belgium, Chile, China, Czech Republic, Denmark, Fiji, India, Indonesia, Ireland, Italy, Kiribati, Korea, Malaysia, Malta, Netherlands, Papua New Guinea, Philippines, Poland, Romania, Singapore, Slovak Republic, Spain, Sri Lanka, Sweden, Thailand, the United States and Vietnam. Thus those tax agreements could be modified to include the second sentence of Article 16(3).

5.41 Based on the known or proposed adoption positions of other Signatories to the Multilateral Convention, Article 16 is expected to modify Australia's tax agreements with: Argentina, Belgium, Canada, Chile, China, the Czech Republic, Denmark, Fiji, Finland, France, India, Ireland, Italy, Japan, Malta, Mexico, the Netherlands, New Zealand, Norway, Poland, Romania, Russia, Singapore, the Slovak Republic, Spain, Turkey and the United Kingdom.

Making corresponding adjustments in relation to transfer pricing

5.42 Article 17 of the Multilateral Convention applies to the taxation of cross-border business transactions between associated entities. All of Australia's tax agreements include an article dealing with the profits of associated enterprises and also describe the circumstances in which two enterprises are considered to be associated.

5.43 Article 17(1) of the Multilateral Convention obliges the competent authority of a Party to make an appropriate downward adjustment to the profits (and resulting tax charged) of a resident enterprise to reflect a corresponding upward adjustment by the competent authority of the other Party to the profits (and resulting tax charged) of an

associated enterprise resident in that other Party that is involved in the relevant transaction. *[Article 17(1) of the Multilateral Convention]*

5.44 This obligation only applies if the upward adjustment is made in accordance with the arm's length principle. *[Article 17(1) of the Multilateral Convention]*

5.45 Furthermore, in determining the corresponding adjustment, consideration must be given to other provisions of the relevant Covered Tax Agreement and the competent authorities are to consult each other if necessary. *[Article 17(1) of the Multilateral Convention]*

5.46 The obligation in Article 17(1) will replace a comparable provision in a Covered Tax Agreement or add such a provision if there is no existing provision. *[Article 17(2) of the Multilateral Convention]*

5.47 Australia has indicated that it will reserve the right for Article 17 to not apply to its Covered Tax Agreements that already contain such a provision (i.e. all of Australia's Covered Tax Agreements except the agreement with Italy). *[Article 17(3)(a) of the Multilateral Convention]*

5.48 Based on Australia and Italy's provisional notifications, Article 17 is expected to modify Australia's tax agreement with Italy.

Chapter 6

Arbitration

Outline of chapter

6.1 This Chapter explains the way in which the Multilateral Convention will modify Australia's Covered Tax Agreements to include rules that will provide taxpayers with the option of referring certain unresolved tax disputes to independent and mandatory binding arbitration.

Context of amendments

6.2 As discussed in Chapter 5 of this explanatory memorandum, the BEPS Final Report on Action 14 (Making Dispute Resolution Mechanisms More Effective) responded to the recognition in the 2013 OECD/G20 BEPS Action Plan that actions addressing BEPS must be complemented with actions to ensure tax certainty and predictability for business.

6.3 In addition to the commitment by all jurisdictions to implement the minimum standard for resolving treaty-related tax disputes, the BEPS Final Report on Action 14 noted that 20 jurisdictions (including Australia) also committed to providing for mandatory binding MAP arbitration (mandatory binding arbitration) in their bilateral tax agreements. This mechanism will help guarantee that such disputes will be resolved within a specified timeframe.

6.4 Articles 18 to 26 of the Multilateral Convention provide for mandatory binding arbitration. Article 28(2) of the Multilateral Convention allows Parties to formulate reservations with respect to the scope of cases that will be eligible for arbitration.

Summary of new law

6.5 Part VI (Arbitration) of the Multilateral Convention contains the mechanisms to support mandatory binding arbitration and its interaction with other dispute resolution provisions:

- Article 18 — choice to apply Part VI;
- Article 19 — mandatory binding arbitration;
- Article 20 — appointment of arbitrators;

- Article 21 — confidentiality of arbitration proceedings;
- Article 22 — resolution of a case prior to the conclusion of the arbitration;
- Article 23 — type of arbitration process;
- Article 24 — agreement on a different resolution;
- Article 25 — costs of arbitration proceedings; and
- Article 26 — compatibility.

6.6 Article 18 allows jurisdictions to choose to apply the arbitration provisions in Part VI of the Multilateral Convention.

6.7 The application of Part VI may be subject to a Party's formulated reservation (or reservations) on the scope of cases eligible for arbitration under Article 28(2)(a) in Part VII (Final Provisions) of the Multilateral Convention. The reservation is subject to acceptance by the other Party to the relevant Covered Tax Agreement.

6.8 Consistent with Australia's commitment to implement arbitration, Australia has indicated that it will choose to apply the arbitration provisions in Part VI.

6.9 However, as permitted by Article 28(2)(a), Australia has indicated that it will formulate a reservation to exclude any case from the scope of Part VI to the extent that it involves the application of Australia's general anti-avoidance rules contained in Part IVA of the ITAA 1936 and section 67 of the FBT Assessment Act. Articles 18 to 26 of the Multilateral Convention will not apply to modify a Covered Tax Agreement if the other Party does not accept this reservation.

6.10 Once a jurisdiction chooses to apply the arbitration provisions, the adoption of Articles 19 to 26 is mandatory, but their application may be varied by another Party's invocation of a relevant reservation.

6.11 Article 19 prescribes the circumstances in which mandatory binding arbitration may be initiated and the status of an arbitration decision.

6.12 Australia has indicated that it will make the following reservations:

- to exclude issues that have been decided by a court or administrative tribunal of either of the two jurisdictions; and
- to terminate cases referred for arbitration if the substantive underlying issue is decided by a court or administrative tribunal of either of the two jurisdictions before the arbitration panel delivers its decision.

6.13 Articles 20 and 21 address the appointment of arbitrators and the confidentiality of arbitration proceedings.

6.14 Article 22 provides for the termination of a MAP and the associated arbitration proceedings if the case is resolved or withdrawn before the arbitration concludes.

6.15 Article 23 sets out the default rules for arbitration processes (the ‘final offer’ or ‘independent opinion approach’) that may apply.

6.16 Article 24 authorises jurisdictions to choose to allow their competent authorities to agree on a different resolution (to the resolution determined under the arbitration process) within the three months following the delivery of the arbitration decision.

6.17 Article 25 provides for the sharing of the costs of the arbitration proceedings between the two jurisdictions and allows for the competent authorities to agree on different rules.

6.18 Article 26 prescribes the way in which Part VI of the Multilateral Convention will modify Covered Tax Agreements and interact with any existing arbitration provisions contained in those agreements that apply in relation to MAP cases.

6.19 As discussed in Chapter 1 of this explanatory memorandum, the Explanatory Statement accompanying the Multilateral Convention describes the functioning of the operative provisions in Part VI, and is therefore relevant for the interpretation of Articles 18 to 26.

Detailed explanation of new law

6.20 Part VI (Arbitration) of the Multilateral Convention (Articles 18 to 26) allows for mandatory binding arbitration where the competent authorities (in Australia’s case, the Commissioner of Taxation or an authorised representative of the Commissioner) have been unable to resolve a case presented by a taxpayer under the MAP within two years.

Choosing to apply arbitration to MAP cases

6.21 A jurisdiction can choose to apply Part VI (Arbitration) of the Multilateral Convention with respect its Covered Tax Agreements by notifying the Depository of their choice. *[Article 18 of the Multilateral Convention]*

6.22 Australia has provisionally indicated that it will choose to apply Part VI.

Modifying Covered Tax Agreements to include arbitration rules

6.23 If a Covered Tax Agreement already contains a provision that provides for arbitration of unresolved issues arising from a MAP case, then that provision will be replaced by the rules contained in Part VI of the Multilateral Convention. *[Article 26(1) of the Multilateral Convention]*

6.24 Such replacements will occur if both Parties to a Covered Tax Agreement choose to apply Part VI (as per Article 18) and make the necessary notifications about the affected provision to be replaced. *[Article 26(1) of the Multilateral Convention]*

6.25 Australia has provisionally indicated that the relevant provisions are contained in Australia's tax agreements with New Zealand and Switzerland.

6.26 If a Covered Tax Agreement does not contain such a provision, then Part VI will be added to that Covered Tax Agreement. *[Article 26(1) of the Multilateral Convention]*

6.27 Based on the known or proposed adoption positions of other Signatories to the Multilateral Convention, Australia's tax agreements with Belgium, Canada, Fiji, Finland, France, Ireland, Italy, Malta, the Netherlands, New Zealand, Singapore, Spain and the United Kingdom are expected to be modified to provide for mandatory binding arbitration.

6.28 However, Part VI is not intended to impact a Party's other obligations with respect to arbitration of unresolved issues arising from MAP cases under other conventions to which the Party is or will become a signatory or a party. *[Article 26(3) of the Multilateral Convention]*

6.29 That is, Part VI will only affect Covered Tax Agreements modified by the Multilateral Convention and only apply to issues or cases covered by Part VI.

Excluding cases previously subject to arbitration

6.30 Where an arbitration panel (or similar body) had previously been set up in accordance with a bilateral or multilateral convention to decide a case, any unresolved issues from that case are not to be submitted for mandatory binding arbitration under Part VI of the Multilateral Convention. *[Article 26(2) of the Multilateral Convention]*

6.31 This is to avoid potential duplication of efforts in resolving an issue arising from a MAP that was previously subject to arbitration under a provision of an international agreement (including a Covered Tax Agreement prior to being modified by the Multilateral Convention).

Excluding cases involving the application of Part IVA of the ITAA 1936 and section 67 of the FBT Assessment Act

6.32 As discussed in Chapter 1 of this explanatory memorandum, Article 28 outlines the reservations permitted by the Multilateral Convention.

6.33 Article 28(2) allows a Party to formulate and make one or more reservations to limit the types of cases that can be submitted for arbitration under Part VI of the Multilateral Convention. *[Article 28(2)(a) of the Multilateral Convention]*

6.34 Unlike other reservations allowed by the Multilateral Convention, this reservation is subject to the acceptance of the relevant partner jurisdiction to a Covered Tax Agreement. Such a reservation is deemed to have been accepted if the relevant partner jurisdiction has not objected to the reservation, by the later date of:

- 12 months after the Depository notifies the Parties of the reservation; or
- the date that the relevant partner jurisdiction deposits its instrument of ratification of the Multilateral Convention.

[Article 28(2)(b) of the Multilateral Convention]

6.35 The effect of raising an objection is that Part VI will not apply between the Parties (i.e. Articles 18 to 26 will not apply in relation to the Covered Tax Agreement). *[Article 28(2)(b) of the Multilateral Convention]*

6.36 Australia has provisionally formulated and made the reservation allowable under Article 28(2)(a) to exclude from the scope of Part VI any case to the extent that it involves the application of Australia's general anti-avoidance rules contained in Part IVA of the ITAA 1936 and section 67 of the FBT Assessment Act, including any provisions that replace, amend or update those rules.

6.37 That is, binding arbitration is unavailable for any cases to the extent that they involve the application of Australia's general anti-avoidance rules that apply to income tax and FBT.

6.38 This approach is consistent with Australia's practice of applying its general anti-avoidance rules despite any obligation in its bilateral tax agreements, which is reflected in the ordering rules contained in subsections 4(2) and 4AA(2) of the Tax Agreements Act.

Requesting mandatory binding arbitration

6.39 Article 19(1) permits a taxpayer to submit any unresolved issues arising from a MAP case, in writing, for arbitration. Such submissions must be made in accordance with any rules and procedures agreed upon

by the relevant competent authorities. *[Article 19(1) of the Multilateral Convention]*

6.40 These rules and procedures arise from the competent authorities' obligation to settle, by mutual agreement, the mode of application of the provisions of Part VI, including the minimum information necessary for each competent authority to undertake a substantive consideration of the case. *[Article 19(10) of the Multilateral Convention]*

6.41 In order for the rules and procedures to be available to taxpayers upon submission, the relevant competent authorities must settle the mode of application of the provisions of Part VI before the date on which unresolved issues are first eligible to be submitted to arbitration (see paragraph 229 of the Explanatory Statement to the Multilateral Convention).

6.42 The issues that could be submitted for arbitration are:

- those arising from a MAP case presented to a competent authority on the basis that the action of either or both Parties have resulted (or will result) in the taxpayer being taxed not in accordance with the provisions of a Covered Tax Agreement; and
- the competent authorities were not able to reach an agreement to resolve the case within two years (or a different length of time as agreed to by the competent authorities before the expiration of two years).

[Article 19(1)(a) and (b) of the Multilateral Convention]

Calculating the two year period

6.43 The two year period (or other length of time as agreed to by the competent authorities) commences from:

- if the competent authorities have not requested additional information — the earlier of:
 - the date on which both competent authorities notified the taxpayer of receipt of the information necessary to undertake substantive consideration of the case; and
 - the date that is three months after the competent authority that received the initial request for a MAP notifies the other competent authority of the receipt of the request; or
- if the competent authorities have requested additional information — the earlier of:
 - the latest date on which the competent authorities that requested the additional information notified the taxpayer

and the other competent authority of the receipt of the information requested; and

- the date that is three months after both competent authorities have received all information requested from the taxpayer by either competent authority.

[Article 19(8) and (9) of the Multilateral Convention]

6.44 The two year (or other) period of time stops running if the MAP is suspended by a competent authority because one or more of the same issues are before a domestic court or administrative tribunal. The suspension will be lifted once the court or tribunal has delivered its final decision or the case in the court or tribunal is suspended or withdrawn.

[Article 19(2) of the Multilateral Convention]

6.45 This rule is designed to ensure that separate resolutions of the same issues do not occur concurrently (see paragraph 217 of the Explanatory Statement to the Multilateral Convention).

6.46 Article 19(11) allows a jurisdiction to make the reservation to replace the two year period with a period of three years. Where this reservation is made by one Party to a Covered Tax Agreement, the period is varied for both Parties. *[Article 19(11) of the Multilateral Convention]*

6.47 Australia has provisionally indicated that it will not make this reservation.

6.48 Where the taxpayer and a competent authority have agreed to suspend the MAP, the two year (or other) period will stop running until the suspension is lifted. *[Article 19(2) of the Multilateral Convention]*

6.49 The two year (or other) period of time will be extended if both competent authorities agree that the taxpayer has failed to provide the additional material information requested by either competent authority in a timely manner. In such circumstances, the relevant period of time will be extended by the same amount of time taken by the taxpayer to provide the additional material information. *[Article 19(3) of the Multilateral Convention]*

Acknowledging an initial request for a MAP and requesting additional information

6.50 To ensure the effective and efficient resolution of treaty-related tax disputes, time limits are imposed on competent authorities to acknowledge the receipt of MAP requests and related information requirements.

6.51 The competent authority that received the initial request has two months from the date of receipt to:

- notify the taxpayer and the other competent authority that the request has been received; and

- provide a copy of the request to the other competent authority.

[Article 19(5) of the Multilateral Convention]

6.52 In relation to the information needed to support a MAP, the competent authority that received the initial request (or copy thereof) must, within three months:

- notify the taxpayer and the other competent authority of the receipt of the information necessary to undertake substantive consideration of the case; or
- request additional information from the taxpayer.

[Article 19(6) of the Multilateral Convention]

6.53 Within three months of receiving any additional information from a taxpayer, the competent authority that requested that information must notify the taxpayer and the other competent authority of the receipt of the information or whether some of the requested information is still missing. *[Article 19(7) of the Multilateral Convention]*

Arbitration not available if issue decided by a court or tribunal

6.54 Australia has indicated that it will make the reservations allowable under Article 19(12):

- to not allow taxpayers to submit for arbitration any unresolved issues arising from a MAP that has been decided by a domestic court or an administrative tribunal of Australia or the relevant partner jurisdiction to a Covered Tax Agreement; and
- to terminate cases referred for arbitration if the relevant issue is decided by a court or an administrative tribunal of Australia or the relevant partner jurisdiction to a Covered Tax Agreement before the arbitration panel delivers its decision.

6.55 That is, if a court or tribunal of either Party decides on an unresolved issue arising from a MAP case before an arbitration panel delivers its decision, an arbitration decision on the same issue will not be provided.

Status of arbitration decision

6.56 Decisions delivered by the arbitration panel are final and binding, subject to the exceptions contained in Article 19(4)(b).
[Article 19(4)(a) of the Multilateral Convention]

6.57 The decision will not be binding if:

- the taxpayer does not accept the mutual agreement implementing the arbitration decision;
- the decision is found to be invalid by a final decision of the domestic courts of either Party; or
- the taxpayer pursues litigation on the issues in a court or an administrative tribunal.

[Article 19(4)(b) of the Multilateral Convention]

Decision not binding – non-acceptance of the decision

6.58 Where the taxpayer does not accept the arbitration decision, the case will not be able to be considered further by the competent authorities.

6.59 The mutual agreement implementing the decision is considered to be not accepted by the taxpayer if, within 60 days after sending the notification of the mutual agreement to the taxpayer, the taxpayer:

- does not withdraw all issues resolved in the mutual agreement implementing the arbitration decision from consideration by domestic courts or administrative tribunals; or
- does not terminate any relevant pending domestic legal or administrative proceedings.

[Article 19(4)(b)(i) of the Multilateral Convention]

6.60 Deeming non-acceptance is relevant in circumstances where the competent authorities require the taxpayer to waive its rights to domestic legal remedies as a condition for finalising the mutual agreement, if the mutual agreement has exhausted all domestic remedies.

6.61 Australia's current practice in relation to agreements reached between competent authorities is that taxpayers must, if they accept the agreement, agree to the withdrawal of any objections. If an objection decision has been reached, the taxpayer must agree not to seek review at the Administrative Appeals Tribunal or Federal Court.

Decision not binding – invalidity

6.62 Where the arbitration decision is found to be invalid by a final decision of the domestic courts of a Party to a Covered Tax Agreement, the request for arbitration is considered to not have been made and the arbitration procedure is considered to not have taken place. This allows a new request for arbitration to be submitted unless the competent authorities agree to not allow a new request. *[Article 19(4)(b)(ii) of the Multilateral Convention]*

6.63 'Final decision' means a non-interim decision of a court. It is not intended to imply a requirement for exhaustion of domestic legal remedies

or for the highest court in the jurisdiction to deliver the judgment of invalidity.

6.64 These rules are not intended to provide independent grounds for invalidating an arbitration decision, but instead ensure that the invalidation of a decision by a court of one Party to a Covered Tax Agreement does not bind the other Party to the Agreement (see paragraph 223 of the Explanatory Statement to the Multilateral Convention).

6.65 Despite considering the arbitration process to not have taken place, to provision does not impact the requirements in respect of confidentiality of the proceedings or sharing costs of the arbitration (Articles 21 and 25 of the Multilateral Convention). *[Article 19(4)(b)(ii) of the Multilateral Convention]*

Decision not binding — litigation

6.66 Where the taxpayer pursues litigation on the issues that were resolved by the mutual agreement implementing the arbitration decision, the decision arising from any such litigation is not binding on either Party. *[Article 19(4)(b)(iii) of the Multilateral Convention]*

6.67 This provision makes it clear that a taxpayer cannot assert that an arbitration decision binds one Party while the outcome of the litigation binds the other Party.

Decision not binding — agreement to different resolution

6.68 Regardless of Article 19(4), a Party can choose to allow the competent authorities to agree on a different resolution within a period of three months after the arbitration decision has been delivered. *[Article 24(1) and (2) of the Multilateral Convention]*

6.69 In such a situation, the arbitration decision is not binding and does not need to be implemented by the Parties. *[Article 24(2) of the Multilateral Convention]*

6.70 This choice is only effective if both Parties to the Covered Tax Agreement make the choice and notify the Depositary accordingly. *[Article 24(1) of the Multilateral Convention]*

6.71 Australia has indicated that it will not make this choice. Thus, an arbitration decision will remain binding subject to the circumstances outlined in Article 19(4)(b) of the Multilateral Convention (taxpayer does not accept the decision, invalidity of the decision, or taxpayer litigates decision).

Procedural rules***Rules for arbitration process – ‘final offer’ approach***

6.72 Article 23(1) provides for the ‘final offer’ arbitration process as the default type of arbitration process. This process applies unless the competent authorities mutually agree on different rules, with such agreement permitted on a case by case basis.

6.73 Under the final offer arbitration process:

- the competent authority of each Party would submit a proposed resolution to the arbitration panel addressing all unresolved issues in the case;
- a competent authority may also submit a supporting position paper as well if it so decides; and
- the arbitration panel will select one of the proposed resolutions as the arbitration decision.

[Article 23(1) of the Multilateral Convention]

6.74 The proposed resolution is to only include:

- for each adjustment or similar issue — the disposition of specific amounts (such as income or expense) or maximum rate of tax charged pursuant to a Covered Tax Agreement;
- for an issue (or issues) regarding questions about the conditions that must be satisfied for a provision of a Covered Tax Agreement to apply (i.e. a threshold question) — proposed answers to those questions.
 - Such questions may include, for example, whether an entity is a resident of a Party or whether an entity has a permanent establishment in a jurisdiction.

[Article 23(1)(a) of the Multilateral Convention]

6.75 A competent authority must provide a copy of its proposed resolution, and supporting position paper where relevant, to the other competent authority by the date that the documents are due to be submitted to the arbitration panel. *[Article 23(1)(b) of the Multilateral Convention]*

6.76 In addition to providing those documents, each competent authority can also submit to the arbitration panel a reply submission to address the other competent authority’s proposed resolution and supporting position paper. A copy of a reply submission is to be provided to the other competent authority by the date that the reply submission is due to be submitted to the arbitration panel, which is set by agreement as

part of setting the mode of application of the Part VI provisions under Article 19(10). *[Article 23(1)(b) of the Multilateral Convention]*

6.77 The reply submission and its supporting paper are meant to address only the positions and arguments of the other competent authority, and are not intended as an opportunity for a competent authority to advance additional arguments in favour of its own position (see paragraph 243 of the Explanatory Statement to the Multilateral Convention).

6.78 The proposed resolution that the arbitration panel selects must be adopted by at least two (of the three) arbitration panel members (i.e. a simple majority). The arbitration panel will deliver its decision to the competent authorities in writing. *[Article 23(1)(c) of the Multilateral Convention]*

6.79 The decision will not include the rationale or other explanation of the reasons for the decision. *[Article 23(1)(c) of the Multilateral Convention]*

6.80 The arbitration decision will not have any precedential value. *[Article 23(1)(c) of the Multilateral Convention]*

6.81 Based on the known or proposed adoption positions of other Signatories to the Multilateral Convention, the ‘final offer’ approach will apply to all of Australia’s tax agreements other than its agreement with Malta.

Rules for arbitration process – ‘independent opinion’ approach

6.82 A Party may reserve the right to not apply the default process of ‘final offer’ arbitration. In such a case, except to extent that the competent authorities of the Parties mutually agree on different rules, the ‘independent opinion approach’ will apply. *[Article 23(2) of the Multilateral Convention]*

6.83 Under this approach, after the submission of a case to arbitration, the competent authority of each Party must provide any necessary information to the arbitration panel without undue delay. Information that was unavailable to both competent authorities before the receipt of the arbitration request is not to be taken into account, unless both competent authorities agree otherwise. *[Article 23(2)(a) of the Multilateral Convention]*

6.84 The arbitration panel must decide the relevant issues in accordance with the relevant provisions of the applicable Covered Tax Agreement, and subject to those provisions, the relevant domestic laws of the Parties. The competent authorities may also mutually agree to identify other sources of law or authority to be considered by the arbitration panel. *[Article 23(2)(b) of the Multilateral Convention]*

6.85 The arbitration decision must be delivered to both competent authorities in writing, stating the sources of law relied upon and the panel’s reasoning. *[Article 23(2)(c) of the Multilateral Convention]*

6.86 The arbitration decision needs to be reached by at least two (of the three) arbitration panel members (i.e. a simple majority). *[Article 23(2)(c) of the Multilateral Convention]*

6.87 The arbitration decision will not have any precedential value. *[Article 23(2)(c) of the Multilateral Convention]*

6.88 Based on the known or proposed adoption positions of other Signatories to the Multilateral Convention, the ‘independent opinion’ approach will apply to Australia’s tax agreement with Malta.

Rules for arbitration process – non-disclosure

6.89 A Party can choose to apply Article 23(5) in relation to both Parties to a Covered Tax Agreement. This will occur if either Party notifies the Depository of their choice to apply Article 23(5). *[Article 23(4) of the Multilateral Convention]*

6.90 Article 23(5) requires the competent authorities to ensure, before the arbitration proceedings commence, that the taxpayer and its advisors agree in writing not to disclose to any other person any information received during the arbitration proceedings from either competent authority or the arbitration panel. *[Article 23(5) of the Multilateral Convention]*

6.91 Arbitration and the MAP cases will be terminated where there is a material breach of a non-disclosure agreement by the taxpayer, or its advisers, before the arbitration decision is delivered to the competent authorities. *[Article 23(5) of the Multilateral Convention]*

6.92 Australia has provisionally indicated that it will choose to apply Article 23(5) to its proposed Covered Tax Agreements.

6.93 However, Article 23(6) allows a Party that has not chosen to apply Article 23(5) to make a reservation so that Article 23(5) will not apply to its Covered Tax Agreements. *[Article 23(6) of the Multilateral Convention]*

6.94 Australia has provisionally indicated that it will not make such a reservation. That means, unless Australia’s partner jurisdiction to a Covered Tax Agreement makes such a reservation, the taxpayer and their advisors will be required to agree to these non-disclosure rules.

Appointment of arbitrators

6.95 The competent authorities of each Party can determine the rules for the appointment of arbitrators by mutual agreement. *[Article 20(1) of the Multilateral Convention]*

6.96 However, in the absence of such mutual agreement Article 20(2) to (4) provide the following default rules. *[Article 20(1) of the Multilateral Convention]*

6.97 An arbitration panel must consist of three individual members who have expertise or experience in international tax matters. *[Article 20(2)(a) of the Multilateral Convention]*

6.98 Each competent authority must appoint one panel member within 60 days of a taxpayer requesting the referral of a dispute to arbitration. *[Article 20(2)(b) of Act the Multilateral Convention]*

6.99 If a competent authority fails to do so within the 60 day period (or another period as agreed to by the competent authorities), the highest ranking official of the OECD's Centre for Tax Policy and Administration, who is not a national of either Party, must appoint a panel member on behalf of that competent authority. *[Article 20(3) of the Multilateral Convention]*

6.100 The two panel members must appoint another person to be the Chair of the arbitration panel within 60 days of the appointment of the second member of the arbitration panel. *[Article 20(2)(b) of the Multilateral Convention]*

6.101 If the two panel members fail to do so within the 60 day period (or other period as agreed to by the competent authorities), the highest ranking official of the OECD's Centre for Tax Policy and Administration, who is not a national of either Party, must appoint the Chair of the arbitration panel. *[Article 20(4) of the Multilateral Convention]*

6.102 The Chair of the arbitration panel must not be a national or resident of either Party. *[Article 20(2)(b) of the Multilateral Convention]*

6.103 At the time of appointment, each panel member must be impartial and independent of the competent authorities, tax administrations and ministries of finance of the Parties, and of all persons directly affected by the case (including their advisers). *[Article 20(2)(c) of the Multilateral Convention]*

6.104 Each panel member must maintain their impartiality and independence during the arbitration proceedings and avoid any conduct that may damage the appearance of impartiality and independence for a reasonable period after the conclusion of the arbitration proceedings. *[Article 20(2)(c) of the Multilateral Convention]*

Costs of arbitration proceeding

6.105 The competent authorities are to mutually agree as to how to bear the fees and expenses of the arbitration panel members and any costs incurred in connection with the arbitration proceedings. *[Article 25 of the Multilateral Convention]*

6.106 If there is no such mutual agreement, then each Party bears the following:

- their own costs;

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- the fees and expenses for the panel member that the Party appointed;
 - half of the fees and expenses of the Chair of the arbitration panel; and
 - half of all other expenses associated with the conduct of the arbitration proceedings.

[Article 25 of the Multilateral Convention]

Confidentiality of arbitration proceedings

6.107 For the purposes of Part VI, provisions of a Covered Tax Agreement and domestic laws related to exchange of information, confidentiality and administrative assistance, the disclosure of information to the arbitration panel members and their staff (up to a maximum of three staff per member) is permitted. This includes disclosures to prospective arbitrators to the extent necessary to verify their ability to fulfil the relevant requirements. *[Article 21(1) of the Multilateral Convention]*

6.108 Any information disclosed is to be considered as information exchanged under the Covered Tax Agreement provisions relating to the exchange of information and administrative assistance. *[Article 21(1) of the Multilateral Convention]*

6.109 Prior to the arbitration proceedings, the competent authorities of the Parties must obtain agreement in writing from the panel members and their staff that they will treat information relating to the proceedings in line with confidentiality and non-disclosure obligations as per:

- the exchange of information and administrative assistance provisions of the Covered Tax Agreement; and
- the domestic laws of both Parties.

[Article 21(2) of the Multilateral Convention]

Resolving a case before arbitration concludes

6.110 Before the arbitration panel delivers its decision on a case, the case will be terminated if:

- the competent authorities of the Parties reach a mutual agreement to resolve the case; or
- the relevant taxpayer withdraws the request for arbitration or the request for a MAP.

[Article 22 of the Multilateral Convention]

6.111 The termination is effective for both the arbitration proceedings and the relevant MAP. *[Article 22 of the Multilateral Convention]*

Application and transitional provisions

6.112 Article 36 prescribes when Part VI (Arbitration) of the Multilateral Convention will affect the application of Australia's Covered Tax Agreements.

6.113 Part VI will affect Australia's relevant Covered Tax Agreements in relation to mandatory binding arbitration cases presented to a competent authority on or after the later date of entry into force of the Multilateral Convention for Australia and each of its relevant partner jurisdictions. *[Article 36(1)(a) of the Multilateral Convention]*

6.114 However, for cases presented before that date, Part VI will affect Australia's relevant Covered Tax Agreements from the date when Australia and each of its relevant partner jurisdictions notify the Depository that they have agreed on the mode of application of Part VI (as per Article 19(10)), along with information regarding the date(s) on which such cases will be considered to have been presented to the relevant competent authority. *[Article 36(1)(b) of the Multilateral Convention]*