BEPS: Multilateral Convention Bill (2/2) (2/30/17)

This article completes what we wrote on this topic last last week.

The minimum standard in applying the Convention

According to the minimum standard of the Convention, its signatories are to apply the following provisions with respect to their covered tax treaties:

- Article 6 of the Convention – the Preamble;
- Article 7 of the Convention – Anti-Avoidance Rules;
- Requirements in Article 16 of the Convention – Mutual Agreement Procedure; and
- Article 17 of the Convention – Appropriate Adjustments.

Article 6 of the Convention – the Preamble

According to BEPS Action 6 the preamble deals with misapplication of provisions of covered tax treaties, which is recognised as a BEPS risk. To address this issue, with respect to covered tax treaties, BEPS Action 6 intends to provide that by means of their covered tax treaties, the jurisdictions wish to prevent tax evasion, particularly treaty abuse (known as treaty shopping).

The preamble specified in Article 6(1) of the Convention will apply to all of Latvia's covered tax treaties, because the preamble in this wording has been included in the tax treaty between Latvia and Switzerland, amended only by a protocol. The new preamble aims to provide that eliminating double taxation will simultaneously make it impossible to use any of the benefits available under the covered tax treaties for tax evasion purposes.

Article 7 of the Convention – Anti-Avoidance Rules

According to BEPS Action 6, a principal purpose test (PPT) is the most effective way of preventing abuse of covered tax treaties. The Convention permits any jurisdiction wishing to apply a simplified limitation of benefits to apply the PPT as well. The outcome to be achieved under the Convention is to deny benefits available under covered tax treaties where it is established that agreements and transactions have been entered into with the sole intention of obtaining benefits available under a covered tax treaty.

Latvia will apply the provision made by Article 7 of the Convention relating to the PPT. According to the report on BEPS Action 6, the PPT is a key mechanism for preventing misapplication of covered tax treaties. Benefits available under covered tax treaties will not be awarded with respect to any type of income or capital if, after considering all the relevant facts and circumstances, there are grounds to believe that obtaining a benefit was one of the main goals of any agreement or transaction, which directly or indirectly resulted in that benefit being taken, unless it is established that awarding the benefit under those circumstances fits the purpose of the relevant provisions of the covered tax treaty. So this provision will apply to all of Latvia's covered tax treaties, which in fact means that the competent authority will need to assess whether a benefit is available in a particular situation.

Requirements in Article 16 of the Convention – Mutual Agreement Procedure

Article 16(1) of the Convention permits the taxpayer to approach any competent authority of the parties to a covered tax treaty within three years after filing the first notification, regardless of time limits laid down by their national laws. The Convention permits the countries to waive this provision as long as they ensure that the minimum standard is satisfied through a mechanism of bilateral notification or consultation.

Latvia has opted for a derogation with respect to the taxpayer's right to approach any competent authority. Latvia will ensure that with respect to all of its covered tax treaties, the Latvian competent authority will make notifications or begin a consultation process with the competent authority of the other contracting jurisdiction on matters where the Latvian competent authority does not believe the taxpayer's objections are valid. At the same time, in line with the BEPS action plan, Latvia will ensure that with respect to all taxpayers resident in the signatories of the covered tax treaties, it will be possible to file a complaint within three years after the first notification of any act that has caused misapplication of provisions of the covered tax treaties.

Article 16(2) of the Convention, which states that an agreement the competent authorities have mutually reached to prevent misapplication of taxes specified by a covered tax treaty should be performed regardless of time limits laid down by the national laws of the contracting jurisdictions. Since Latvia's covered tax treaties with Italy, Canada, Mexico and the UK do not contain such a provision, Latvia will apply the Convention's provision to these countries in order to meet the minimum standard.

The provision for the competent authorities' power to mutually consult in order to eliminate double taxation in cases that are not foreseen by their covered tax treaties, included in Article 16(3) of the Convention, will apply to Latvia's covered tax treaties with Belgium, Ireland, Italy, Ukraine, and the UK.

Article 17 of the Convention – Appropriate Adjustments

The minimum standard of BEPS Action 14 provides that a jurisdiction should adopt mutual agreement procedures with respect to transfer pricing and apply their agreements through making appropriate adjustments. The report on Action 14 notes that the minimum standard could be satisfied in a more effective way if the countries were permitted to unilaterally make appropriate adjustments where they believe the taxpayer's objections are valid. So the report states that the countries need to include in their covered tax treaties a provision which, where one of the contracting jurisdictions includes a profit in the profits of its domestic entity and charges it to tax, with respect to which an entity of the other contracting jurisdiction has been taxed in the other contracting jurisdiction, and this included profit is one that an entity of the first contracting jurisdiction would have made had the relationship between the entities been one that exists between two independent entities, requires that the first contracting jurisdiction should appropriately adjust the amount of the tax it levies on the profits of its domestic entity.

With respect to the Convention's provision for appropriate adjustments (Article 17), Latvia has listed its covered tax treaties that already include a provision for making appropriate adjustments, and with respect to any of the covered tax treaties that do not contain such a condition, by choosing to make a notification to the Depositary, Latvia will ensure that the provision of Article 17(1) of the Convention will apply to all of its covered tax treaties.