

OECD 2017 Model Tax Convention (1) (3/6/18)

On 18 December 2017 the OECD released the latest edition of the Model Tax Convention (MTC) incorporating changes related to Base Erosion and Profit Shifting (BEPS).

Incorporation of BEPS

The OECD has completed a number of actions to incorporate BEPS aspects into international taxation, such as introducing the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS. We looked at this convention in our Flash News editions of 20 and 27 July 2017 (*BEPS: Multilateral Convention Bill*). While this multilateral convention offers solutions for existing bilateral tax treaties, the new MTC will form the basis for future ones.

The MTC is used by many nations as the basis for over 3,000 tax treaties. The MTC incorporates BEPS inputs in the following areas:

- Hybrid mismatches (Action 2: Neutralising the Effects of Hybrid Mismatch Arrangements);
- Preventing tax treaty shopping (Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances);
- Expanding the definition of permanent establishment (PE) (Action 7: Preventing the Artificial Avoidance of PE Status); and
- Improving the mutual agreement procedure for resolving tax disputes (Action 14: Making Dispute Resolution More Effective).

According to the OECD, the full version of the MTC, which includes commentaries, non-member country positions and historical notes, will be published in 2018.

In December 2017 the OECD confirmed the following changes to the MTC and related commentary:

Articles	Description	Relevant BEPS Action
Title and preamble	The title is changed to <i>Convention for the Elimination of Double Taxation with Respect to Taxes on Income and on Capital and for the Prevention of Tax Evasion and Avoidance</i> , and the preamble explains that the MTC aims to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance.	Report on Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances
Article 1	Changes to the transparent entity provision indicate that the Convention applies to wholly or partly fiscally transparent entities under the tax law of either Contracting State to the extent the income is treated for tax purposes as income of a resident. The Convention shall not affect the taxation by a Contracting State of its residents, except with respect to specified paragraphs (par. 3 of Article 7, par. 2 of Article 9, and Articles 19, 20, 23 [A] [B], 24, 25, and 28).	Report on Action 2: Neutralising the Effects of Hybrid Mismatch Arrangements

Article 3	Changes clarify the term “international traffic” and define “recognised pension fund” with related commentary changes concerning the treaty residence of pension funds to ensure that a pension fund is considered a resident of the State in which it is constituted regardless of whether it benefits from a limited or complete exemption from taxation in that State. Article 3 also incorporates changes relating to dispute resolution intended to remove any doubt that where the competent authorities have agreed on a common meaning of an undefined term, the domestic law meaning of that term will not apply.	Report on Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances Report on Action 14: Making Dispute Resolution Procedures More Effective
Article 4	Changes modify the tiebreaker rule for determining the treaty residence of dual-resident persons other than individuals, with related commentary changes. The “place of effective management” criterion has been changed to as mutually decided by the competent authorities having regard to the place of effective management, place of incorporation and any other relevant factors.	Report on Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances
Article 5	Changes introduce commentaries on the disposal test, business of short duration, secondment, contractors and subcontractors, construction PE, relevance of VAT/GST registration to PE, extension of the requirement of preparatory or auxiliary to all clauses in Article 5(4), introduction of anti-fragmentation rule - new Article 5(4.1), amendment to the dependent agency PE.	Report on Action 7: Preventing the Artificial Avoidance of PE Status

(to be completed)