7 Background on the Action 6 minimum standard and peer review

Context of the peer review

84. Over the last decades, bilateral tax agreements, concluded by nearly every jurisdiction in the world, have served to prevent harmful double taxation and remove obstacles to cross-border trade in goods and services, and movements of capital, technology and persons. This extensive network of tax agreements has, however, also given rise to so-called "treaty-shopping" arrangements.

85. As set out in the Action 6 Final Report, treaty shopping typically involves the attempt by a person to indirectly access the benefits of a tax agreement between two jurisdictions without being a resident of one of those jurisdictions.[1]

86. Treaty shopping is undesirable for several reasons, including:

- Treaty benefits negotiated between the parties to an agreement are economically extended to residents of a third jurisdiction in a way the parties did not intend. The principle of reciprocity is therefore breached and the balance of concessions that the parties make is altered;
- Income may escape taxation altogether or be subject to inadequate taxation in a way the parties did not intend; and
- The jurisdiction of residence of the ultimate income beneficiary has less incentive to enter into a tax agreement with the jurisdiction of source, because residents of the jurisdiction of residence can indirectly receive treaty benefits from the jurisdiction of source without the need for the jurisdiction of residence to provide reciprocal benefits.

Some previous attempts to tackle treaty shopping

87. Concerns about treaty shopping are not new. For example, in 1977, the concept of "beneficial owner" was introduced into the dividends, interest, and royalties articles of the OECD Model Tax Convention to clarify the meaning of the words "paid to", and deal with simple treaty-shopping situations where income is paid to an intermediary resident of a treaty country who is not treated as the owner of that income for tax purposes (such as an agent or nominee).[2]

88. In 1977, the Commentary on Article 1 of the OECD Model Tax Convention was also updated to include a section on the improper use of tax agreements.[3] In 1986, the Committee on Fiscal Affairs (CFA) published two reports: *Double Taxation and the Use of Base Companies* and *Double Taxation and the Use of Conduit Companies*. In 2002, the Committee published the report, *Restricting the Entitlement to Treaty Benefits.* The Commentary on Article 1 of the OECD Model Tax Convention was expanded on several occasions, notably in 2003, with the inclusion of sample provisions that countries could use to counter treaty shopping.

89. A review of jurisdictions' practices shows that they have tried to address treaty shopping in the past and have used different approaches to do so. Some have relied on specific anti-abuse rules based

on the legal nature, ownership, and general activities of residents of a jurisdiction party to a tax agreement.[4] Others have favoured a general anti-abuse rule based on the purpose of transactions or arrangements.

BEPS and treaty shopping

90. The BEPS Action Plan[5], developed by the CFA and endorsed by the G20 Leaders in September 2013[6], identified 15 actions to address base erosion and profit shifting (BEPS). It identified treaty abuse, and in particular treaty shopping, as one of the most important sources of BEPS concerns.

91. Action 6 (Prevent Treaty Abuse) of the BEPS Action Plan called for the development of treaty provisions to prevent the granting of treaty benefits in inappropriate circumstances. In parallel, Action 15 of the BEPS Action Plan called for an analysis of the possible development of a multilateral instrument "to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties".

92. After two years of work, the CFA, in which OECD and G20 countries work on an equal footing, produced the final BEPS Package,[7] which was endorsed by the OECD Council and the G20 Leaders in November 2015.

93. Jurisdictions agreed that four of the BEPS measures would be minimum standards that participating jurisdictions would commit to implement. The Action 6 Report sets out one of these minimum standards. The Action 6 minimum standard requires jurisdictions to commit to include in their tax treaties provisions dealing with treaty shopping to ensure a minimum level of protection against treaty abuse.

The Action 6 minimum standard

94. The minimum standard on treaty shopping requires jurisdictions to include two components in their tax agreements: an express statement on non-taxation (generally in the preamble) and one of three methods of addressing treaty shopping.

95. The minimum standard does not provide how these two components should be implemented (i.e. through the MLI or amending instruments). It recognises, however, that these provisions need to be agreed bilaterally and that a jurisdiction will be required to implement the minimum standard when requested to do so by another member of the Inclusive Framework.

The express statement

96. As set out in paragraphs 22 and 23 of the Final Report on Action 6, jurisdictions have agreed to include in their tax agreements an express statement that their common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty-shopping arrangements. The following provision now appears in the 2017 OECD Model Tax Convention:

> *Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States)*

Three methods of addressing treaty shopping

97. Jurisdictions have also committed to implement that "common intention" through the inclusion of treaty provisions in one of the following three forms:

- a principal purpose test (PPT) equivalent to paragraph 9 of Article 29 of the 2017 OECD Model Tax Convention together with either a simplified or a detailed version of the limitation on benefits (LOB) rule that appears in paragraphs 1 to 7 of the 2017 OECD Model Tax Convention; or
- the PPT alone; or
- a detailed version of the LOB rule together with a mechanism (such as a treaty rule that might take the form of a PPT rule restricted to conduit arrangements, or domestic anti-abuse rules or judicial doctrines that would achieve a similar result) that would deal with conduit arrangements not already dealt with in tax treaties.

The obligation to implement the minimum standard

98. The Action 6 Report recognised that "some flexibility in the implementation of the Action 6 minimum standard would be required, as these provisions need to be adapted to each country's specificities and to the circumstances of the negotiation of bilateral conventions." In particular:

- a jurisdiction is required to implement the minimum standard in a treaty only if asked to do so by another member of the Inclusive Framework;
- the way in which the minimum standard will be implemented in each bilateral treaty will need to be agreed to between the contracting jurisdictions.
- the commitment applies to existing and future treaties but since the conclusion of a new treaty and the modification of an existing treaty depend on the overall balance of the provisions of a treaty, this commitment should not be interpreted as a commitment to conclude new treaties or amend existing treaties within a specified period of time.
- if a jurisdiction is not itself concerned by the effect of treaty shopping on its own taxation rights as a jurisdiction of source, it will not be obliged to apply provisions such as the LOB or the PPT as long as it agrees to include in a treaty provisions that its treaty partner will be able to use for that purpose.

99. It is also understood from the Action 6 that, while the MLI provides an effective way for jurisdictions that choose to apply the PPT to implement the minimum standard swiftly, participation in the MLI is not mandatory and jurisdictions may have different preferences as to how the minimum standard should be met. However, jurisdictions that have signed the MLI are expected to take steps to ensure that it starts to take effect with respect to their Covered Tax Agreements. Where two parties to a tax treaty have signed the MLI but only one has listed the tax treaty, listing the tax treaty amounts to a request to implement the minimum standard.

100. In May 2017, the Inclusive Framework agreed the Terms of Reference for the peer review and its methodology (the 2017 Peer Review Documents) (OECD, 2017[1]) and decided that the methodology would be reviewed in 2020. In 2021, members of the Inclusive Framework on BEPS approved the 2021 Peer Review Document (OECD, 2021[2]) which is an updated version of the 2017 Peer Review Documents. The changes to the Peer Review Documents related to the methodology; changes to other sections of the Peer Review Documents were mostly conforming in nature. The Action 6 minimum standard and the way it is reflected in the Terms of Reference remained unchanged.

101. This 2021 Peer Review Document governs the conduct of the peer reviews of the Action 6 minimum standard as of 2021. It describes: the core output of the peer review and monitoring process; the process for the resolution of interpretation and application issues that might arise in the course of implementing the minimum standard on treaty-shopping; the process to be followed by jurisdictions that encounter difficulties in getting agreement from another jurisdiction member of the Inclusive Framework on BEPS in order to implement the Action 6 minimum standard; and the confidentiality of documents produced in the review process.

The 2018 peer review

102. The first peer review was conducted in 2018 and covered the 116 jurisdictions that were members of the Inclusive Framework on 30 June 2018. The Peer Review Report, which was adopted by the Inclusive Framework in January 2019, was published on 14 February 2019.

103. The 2018 peer review revealed that, as the provisions of the MLI had not taken effect at the time of the first peer review, nearly all of the agreements reviewed for this report did not at that time comply with the minimum standard. Substantial progress had, however, been made in 2017 and 2018 towards its implementation and a large majority of Inclusive Framework members had begun to translate their commitment on treaty shopping into actions and were in the process of modifying their treaty networks.

104. In total, on 30 June 2018, the peer review showed that 82 jurisdictions had some agreements that were already compliant with the minimum standard or were subject to a complying instrument that would bring their agreements into compliance.[8] The first Peer Review highlighted the effectiveness of the MLI in implementing the treaty-related BEPS measures. It was by far the preferred tool of Inclusive Framework members for implementing the minimum standard.

105. In the course of the first peer review, all concerns raised by jurisdictions on the implementation of the minimum standard in their agreements had been resolved when the Report was approved by the Inclusive Framework and therefore no recommendation was made under the first peer review.

The 2019 peer review

106. The Second peer review was conducted in 2019 and covered the 129 jurisdictions that were members of the Inclusive Framework on 30 June 2019. The Peer Review Report, which was adopted by the Inclusive Framework in January 2020, was published on 24 March 2020.

107. The 2019 peer review revealed that, by 30 June 2019, 91 Inclusive Framework members had begun to update their bilateral treaty network and were implementing the minimum standard. The data compiled for this peer review demonstrated that the MLI had been the tool used by the vast majority of jurisdictions that had begun to implement the minimum standard.

108. By 30 June 2019, the MLI had already modified around 60 bilateral agreements. The MLI's impact was expected to increase quickly as jurisdictions ratified it.

109. In the course of the Second peer review, a jurisdiction had raised a concern with respect to the CARICOM Agreement, a multilateral agreement concluded by eleven jurisdictions, ten of which were members of the Inclusive Framework. The CARICOM Agreement had been concluded in 1994 to encourage regional trade and investment within the Community, and contains several unusual features,9 not found in the OECD Model Tax Convention or the UN Model Double Taxation Convention, which could lead to certain income flows escaping tax altogether. These departures from standard tax treaty provisions may have encouraged greater economic integration within the CARICOM Community at the time. But they may also have made the CARICOM Agreement more vulnerable to treaty shopping and other forms of abuse. Previous renegotiation attempts of the CARICOM Agreement had proven to be difficult.

The 2020 peer review

110. The Third peer review was conducted in 2021 and covered the 137 jurisdictions that were members of the Inclusive Framework on 30 June 2020. The Peer Review Report, which was adopted by the Inclusive Framework in February 2021, was published on 1 April 2021.

111. The 2020 peer review revealed that, by 30 June 2020, 98 Inclusive Framework members jurisdictions of the Inclusive Framework had some agreements that already complied with the minimum standard or that were subject to a complying instrument and would therefore become compliant shortly.

The data compiled for this peer review demonstrated that the MLI had been the tool used by the vast majority of jurisdictions that had begun to implement the minimum standard.

112. By 30 June 2020, the MLI had already modified around 350 bilateral agreements. The MLI's impact was expected to increase quickly as jurisdictions ratified it.

113. Concerning the CARICOM Agreement, the concern raised in 2019 remained as the parties to the CARICOM Agreement have not yet modernised it. All Jurisdictions that are parties to the CARICOM Agreement were encouraged to bring that agreement up to date by commencing talks among all the treaty partners.

114. Moreover, encouragements were made to members of the Inclusive Framework that were signatories to the MLI but that had not yet ratified it, as the agreements listed under the MLI would only start to become compliant after their ratification.

115. The 2020 Action 6 peer review report also identified gaps in MLI coverage, or "non-covered agreements" under the MLI (agreements concluded between pairs of signatories to the MLI where one treaty partner has not listed the agreement under the MLI; and agreements concluded between jurisdictions only one of which has signed the MLI).

Conduct of the 2021 peer review

116. The review started with a questionnaire sent to members of the Inclusive Framework in April 2021. This questionnaire contained many new features compared with previous years, reflecting the revised methodology in the 2021 Peer Review Document. Similar to the questionnaires issued for 2018, 2019, and 2020,[10] each jurisdiction was asked to list all of its comprehensive income tax agreements in force.

117. For each tax agreement listed, members indicate whether or not it complies with the minimum standard described in the terms of reference at paragraph 2 above. A tax agreement complies with the minimum standard if it does so as originally signed, if an amending instrument that implements the minimum standard in that tax agreement is in force, or if the relevant provisions of the MLI have started to take effect for that tax agreement (in accordance with Article 35 of the MLI).

118. For each tax agreement listed that is non-compliant with the minimum standard, members indicate whether it is on course to become compliant with the minimum standard (i.e. whether it is subject to a complying instrument). This is satisfied if a member has signed the MLI and both jurisdictions have listed the agreement as one to be covered. It is also satisfied if an amending bilateral tax agreement implementing the minimum standard in the agreement has been signed or if a completely new treaty that complies with the Action 6 minimum standard and that would replace that treaty has been signed.

119. Members were requested to provide additional information for tax agreements that are not compliant and not subject to a complying instrument:

- *Plan to implement a detailed LOB provision*: If a member intends to use the detailed LOB as part of its commitment to implement the minimum standard in all of its bilateral tax agreements, the additional information to be provided would be a general statement that it intends to implement the minimum standard bilaterally by negotiating a detailed LOB provision and that the negotiation of its agreements will take place as time and resources permit.
- *Steps taken to enable the tax treaty to become subject to a complying instrument*: A member that does not intend to use the detailed LOB as part of its commitment to implement the minimum standard in all of its bilateral tax agreements to implement the minimum standard would provide information on the steps it has taken to implement the minimum standard for each tax agreement not compliant with the minimum standard or not subject to a complying instrument.
- *Other tax treaties*: For tax agreements not dealt with above and concluded with other members of the Inclusive Framework, a member would provide reasons why, for that member, the tax

agreement does not give rise to material treaty-shopping concerns. Where, for a tax treaty, a jurisdiction does not provide such information, it would formulate a plan to include the minimum standard in that tax agreement.

120. Each jurisdiction was invited to complete the questionnaire taking into account the agreements that were in force, or expected to be in force, by 31 May 2021.

121. Each jurisdiction was also asked to answer additional questions on ratification of complying instruments and issues described in Sections D and E of the Peer Review Document on difficulties encountered in getting agreement from another jurisdiction to implement the minimum standard. Jurisdictions were also free to add any further comments. The list of the 139 jurisdictions that were subject to the peer review and full details by jurisdiction are contained in Chapter 8.

122. The Secretariat analysed jurisdictions' responses to verify and reconcile any divergent information and produced a first draft of this report.

References

OECD (2021), *BEPS Action 6 on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances – Revised Peer Review Documents*, OECD/G20 Base Erosion and Profit Shifting Project, OECD, Paris, www.oecd.org/tax/beps/beps-action-6-preventing-the-granting-of-treaty-benefits-in-inappropriatecircumstances-revised-peer-review-documents.pdf. [2]

OECD (2017), *BEPS Action 6 on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances – Peer Review Documents*, OECD/G20 Base Erosion and Profit Shifting Project, OECD, Paris. www.oecd.org/tax/beps/beps-action-6-preventing-the-granting-of-treaty-benefits-in-inappropriatecircumstance-peer-review-documents.pdf. [1]

Notes

[1] See paragraph 17 of the BEPS Action 6 Final Report (2015). As the Report also notes, cases where a resident of the Contracting State in which income originates seeks to obtain treaty benefits (e.g. through a transfer of residence to the other Contracting State or through the use of an entity established in that other State) could also be considered a form of treaty shopping.

[2]See paragraph 2 of Articles 10 and 11, and paragraph 1 of Article 12 of the OECD Model Tax Convention.

[3] See paragraphs 7-10 of the Commentary on Article 1 of the 1977 Model Tax Convention.

[4] "Limitation on benefits" provisions commonly found in agreements concluded by the United States are the best-known example.

[5] https://www.oecd.org/ctp/BEPSActionPlan.pdf.

[6] http://www.g20.utoronto.ca/2013/2013-0906-declaration.html.

[7] In October 2015, the CFA, including OECD and G20 countries working on an equal footing, produced the Final BEPS Package, in the form of reports on each of the 15 actions accompanied by an Explanatory Statement. The Final BEPS Package gives countries and economies the tools they need to ensure that profits are taxed where economic activities generating the profits are performed and where value is created, while at the same time giving businesses greater certainty by reducing disputes over the application of international tax rules and standardising compliance requirements.

[8] A further seven jurisdictions had no comprehensive tax agreements and were outside the scope of this exercise.

[9] The CARICOM Agreement provides for an almost exclusive source-based taxation of all income, gains and profits. Some income – for instance dividends – are also entirely exempted from tax under the CARICOM Agreement.

[10] See, for example, the 2018 Action 6 peer review questionnaire.