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Welcomes

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Significant international tax change in 2017?

2017 will bring with it significant change in the field of international taxation with the anticipated signing of a Multilateral Instrument designed to amend Bilateral Double Taxation Treaties for minimum standards and recommendations made by the G20/OECD following their Base Erosion and Profit Shifting Project (‘BEPS’). Treaty changes will essentially come into effect, at prescribed times, where two countries both agree to the same changes.

In December 2016, the UK helpfully, indicated its current position. This involves the adoption of simply the agreed minimum standards and other provisions where they are in line with existing policy. It means that some recommendations, such as the lowering of the permanent establishment threshold are not being adopted, and comments are being sought on this approach. The impact of the Multilateral Instrument on the UK’s Double Taxation Treaties will only be known when we know which changes other countries wish to sign up to. There has apparently been some form of ‘country speed dating’ to enable pairs of countries to decide which changes they can both agree to, and a signing ceremony is planned to take place in June 2017 in Paris. The UK approach seems a sensible one in what is a period of significant other change.

For UK parented multinationals the broader implications of the Multilateral Instrument, namely the position in relation to double taxation treaties between third countries in which they do business, which is also important, should also become clearer in the summer.

For the first time outside of double tax relief provisions, limited asymmetry is possible, in the area of Treaty Abuse. If, for instance, one county opts for the Principal Purpose Test and the other for the limited Limitation on Benefits Test, both countries would apply different tests in determining whether the treaty applies. The UK policy is to adopt the Principal Purpose Test and not to accept the limited Limitation on Benefits Test. However, the position of other countries remains to be seen. Where two countries do adopt different tests, taxpayers will need to be doubly careful before assuming that a Treaty applies to them.

In circumstances where countries do not adopt the agreed minimum standards via the Multilateral Instrument the expectation is that they will adopt them in negotiations to revise bilateral treaties. We will get a clearer idea in the summer how many treaties will need to be updated in this ‘old fashioned slower way’. In any event taxpayers will need to monitor changes to Treaties closely, identifying those changes that impact them, and precisely when such changes come into effect.

The Multilateral Instrument itself has no termination clause and is drafted in a manner that enables future changes to be made, so treaty interpretation is likely to increase in complexity going forwards. This is likely to be especially important where ‘most favoured nation’ clauses are involved, and in the area of withholding taxes.

For taxpayers, withholding taxes on income such as interest, dividends and royalties, are likely to again become a significant issue. Over the years, despite significant reductions in the rates of corporate taxes, the rates of withholding taxes have remained high (the US for example applies a 30% rate under domestic law). However, this rate is reduced, often to 0%, under tax treaties, essentially giving the resident state the sole or main right to tax. The renewed focus on treaty abuse means that taxpayers will need to consider even more carefully whether the country of the payer has such a tax, whether the reduced rate is available to the payment they are making, and whether the Treaty applies to them. This in addition to keeping an eye out for taxes, which in recent years some countries have introduced (for example ‘digital taxes’), which are specifically designed to be outside the scope of treaties altogether.

Disputes in relation to withholding tax, and disputes more generally, are likely to increase going forward. To end on a high, the good news is that the Multilateral Instrument brings with it the possibility that more countries may agree to arbitration, a recommendation rather than a minimum standard, to help resolve tax disputes going forward.

This is particularly welcome given the prospect of increasing numbers of transfer pricing disputes resulting partly from Country by Country Reporting. Such disputes are inevitable, given that transfer pricing is a relatively recent phenomenon (many countries did not introduce such rules until years after the publication of the 1995 Transfer Pricing Guidelines) and is not an exact science. The Guidelines have changed significantly over the years, for instance, moving from:

- a focus on an ‘arm’s length price’ to determining a price within an ‘arm’s length range’
- a focus on traditional methods (comparable uncontrolled price, cost plus, and resale minus) to accepting that other methods focused on profitability may be more appropriate; and
- an approach based on identifying who actually owns intangible assets to the new BEPS focus on where value is created (which could conceivably be in a number of places at different times)

So it is important to understand what the guidelines said at the time of the transaction, and easy to see that increasing numbers of disputes are likely to arise.

The bottom line is that in 2017 we are likely to see much change in the international tax world. Where countries agree to and implement treaty changes via the Multilateral Instrument, the changes will come into effect quickly and are likely to start impacting taxpayers in 2018. As most of the minimum standards are anti-avoidance measures the eyes will be on countries or pairs of countries that do not agree to make the minimum agreed changes in this way, and in their progress in renegotiating treaties.

With so much change on the horizon, a career in international tax law remains a good choice