CAN B.E.P.S. SURVIVE WITHOUT U.S. SUPPORT?

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On May 28, 2015, the O.E.C.D. announced the countries that will participate in a meeting to begin substantive work on drafting a multilateral instrument under B.E.P.S. Action 15. Currently, more than 83 countries have expressed interest in joining the discussion, which will take place on November 5 and 6, 2015. The United States was noticeably absent from the list. However, the O.E.C.D. hopes that support will continue to grow in the intervening months and that the meeting may ultimately include as many as 100 countries.

The U.S. Treasury chose not to participate in negotiating a multilateral instrument under B.E.P.S. Action 15. After a careful review of the agenda for the discussion on the multilateral instrument, the U.S. Teasury felt that participation did not seem like a good use of its scarce resources. This decision was prompted by the question, "What is there for U.S. to gain by participating in the discussions?"

The U.S. Treasury believes that a Limitation on Benefits ("L.O.B.") clause is sufficient to prevent "treaty shopping" and that the multilateral instrument would not offer any new mechanisms. The L.O.B. provision in most U.S. treaties limits treaty shopping by requiring that meaningful contact must exist between a corporation and its country of residence before tax treaty benefits are extended.

That contact may include any of the following fact patterns:

- The corporaton's shares are publicly traded on a local exchange and those shares are reglarly traded in substantial volume;
- The corporation is a subsdiary of a corporation that has publicly traded shares, as described above;
- The corporation is (i) predominantly owned by one or more local residents, U.S. residents and U.S. citizens, and (ii) the company is not a conduit to residents in third countries, except in certain well defined circumstances;
- The company is owned by the national government or a local authority;
- The company serves as a headquarters company for a multinational corporate group;
- The company is engaged in an active trade or business that is substantial in relation to the business activity conducted in the U.S. and is not a conduit to residents in third countries, except in certain well-defined circumstances (in which chase only income connected to the business qualifies for treaty benefits); or
- The competent authorities agree that neither the formation of the company nor the fact that it is availed of to carry out a transaction has as one of its principal purposes the avoidance of tax.

Treaty shopping is, in essence, an attempt by a resident of a third country to derive the benefits of a particular treaty by channeling investments through an entity that is in a particular jurisdiction but has no meaningful contact with that country.[1] The L.O.B. provision in a treaty is designed to reduce or eliminate such abusive practices by requiring the taxpayer to have sufficient connection with that country in order to justify entitlement to treaty benefits.

The principal purpose test ("P.P.T.") is to have transactions vetted under a broadly drafted general purpose rule. It is subjective, less precise, and in relation to a typical L.O.B. provision, has the potential to be have a lower or higher threshold for accessing the benefits of an incomet tax treaty. The U.S. Treasury has recognized that a company that is a resident of a Contracting State for valid business purposes may be primarily owned by residents of third countries, and/or may make substantial deductible payments to residents of third countries, in the ordinary course of business; the P.P.T. is designed to permit such a company to enjoy treaty benefits.[2] The L.O.B. provision can reach the same result, as indicated by the meaningful contact requirements listed above. The difference, however, is that good facts with a bad intention may prevent a treaty obligation from being obtained under a P.P.T., whereas bad facts with good intentions may not be a hindrance where competent authority relief is granted.

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The U.S. Treasury's decision has been welcomed by Catherine Schultz, the president of the National Foreign Trade Council ("N.F.T.C."), an organization that represents the global interests of 250 major U.S. companies. Ms. Schultz believes that if other counties are given the choice of between an L.O.B. or a P.P.T., they will not choose the more stringent L.O.B. provisions – which in fact will cause more tax revenues to go to countries other than the U.S. based on nebulous principal purpose reasoning.[3]

It is believed that the U.S. may sign the multilateral instrument if it includes mandatory binding arbitration. On June 8, 2015, G-7 leaders encouraged more countries to join in its commitment to mandatory binding arbitration. At this stage, it is not clear what will happen or if the U.S. Treasury will eventually join other countries in the negotiation of a multilateral instrument.

Even if the U.S. Treasury signs onto the multilateral instrument, it would still be subject to the guidance, oversight, and ratification by the U.S. Senate. Historically, the U.S. Senate has refused to ratify a treaty that contained a P.P.T. The rejection has been based on the fact that the P.P.T. adds uncertainty to results under a treaty because it is subjective and vague. The test is dependent upon the intent of the taxpayer, which is difficult to evaluate, and exclusive reliance on intent is inconsistent with present U.S. treaty policy.

What would be the fate of the B.E.P.S. deliverables without U.S. support? Will the project survive? We may get the answer to these questions very soon. Even if the B.E.P.S. project were to fail as a global attack on abusive tax planning, it may already be a success in light of the number of countries that have signed on to the multilateral instrument and to the adoption of local laws to implement B.E.P.S. principles.

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1 Rev. Rul. 84-15, 1984-2 C.B.

2 Treas. Technical Explanation, U.S.-Indonesia treaty.

3 Bell, Kevin A., "NFTC Offical Welcomes U.S. Refusal to Join Multilateral Instrument Negotiation," *BNA Snapshot*.