THE IMPLEMENTATION OF THE BEPS MULTILATERAL INSTRUMENT IN SA

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INTRODUCTION

The implementation of the Base Erosion and Profit Shifting (BEPS) Multilateral Instrument in South Africa is progressing. On 5 October 2015, the OECD released its final reports in connection with its Action Plan, including its final report on Action 15 dealing with the development of a Multilateral Instrument to modify a host of bilateral tax treaties between numerous countries. This bilateral instrument will implement, in essence, certain specific anti-tax avoidance measures which apply in tax treaty situations.

On 24 November 2016, the OECD released the text of the Multilateral Instrument, more formally known as the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, and on 7 June 2017 the Multilateral Instrument was signed by 67 jurisdictions, of which South Africa is one. The OECD, also on 7 June 2017, released South Africa's reservation and notification statement (RSA Statement) to the Multilateral Instrument.

BEPS MEASURES

The Multilateral Instrument is a milestone for international taxation as it allows the modification of existing double tax treaties without requiring the jurisdictions to the "covered" tax treaty to engage and negotiate with each other. The Multilateral Instrument, which will co-exist with numerous double tax treaties concluded by South Africa, will implement the following tax treated related BEPS measures:

> Action 2 on the introduction of anti-treaty abuse provisions in relation to hybrid mismatch arrangements;
> Action 6 on the introduction of anti-treaty abuse provisions;
> Action 7 on changes to the definition of a permanent establishment; and
> Action 14 on improvements to dispute resolution procedures.

Each signatory to the Multilateral Instrument was required to submit its position, similar to the RSA Statement, before signing the Multilateral Instrument. In terms of the RSA Statement and the joint National Treasury and SARS preliminary briefing on the Multilateral Instrument which was held on 23 May 2017, South Africa will apply and adopt the above-listed actions against, amongst others, the following articles of the Multilateral Instrument in order to modify South Africa's existing double tax treaties as follows:

> Action 2 of BEPS *inter alia* addresses income earned through tax-transparent entities, such as a partnership, which are not treated as a taxpayer by either one or both jurisdictions that have entered into a double tax treaty. Action 2 has been compiled in Article 3 of the Multilateral Instrument which will be adopted to ensure that the benefits of tax treaties are granted in appropriate cases to the income of these entities.

- Action 6 *inter alia* recommends that cases of dual residence of corporate and other taxable entities under double tax treaties be resolved on a case-by-case basis. In this regard, Article 4 of the Multilateral Instrument will be adopted which proposes a new tie-breaker clause replacing the current rule based on place of effective management. Under this process, if a company is considered to be a resident of both countries, SARS and its foreign counterpart will between them discuss and agree which is the country of residence. If they cannot agree, the treaty will not apply to that particular company.
- Action 6 also requires countries to include rules in their double taxation agreements to address situations of treaty abuse. In this regard, the Multilateral Instruments provide three alternative rules. South Africa will adopt the so-called Principal Purpose Test as set out in Article 7 of the Multilateral Instrument which essentially is the existing standard language in many tax treaties which denies treaty benefits where one of the principal purposes of an arrangement or transaction is to directly or indirectly obtain the benefit. This action is designed to prevent treaty shopping, where companies are interposed in tax-friendly jurisdictions to obtain benefits of the treaty which the treaty of the country of the "real" investor does not offer. This will probably be the most far-reaching change as far as South African tax planners are concerned.
- Action 7 of BEPS deals *inter alia* with the artificial avoidance of permanent establishment status through commissionaire arrangements and similar strategies which is an arrangement where a person sells products in a jurisdiction in its own name but on behalf of a foreign enterprise that is the owner of the products. This has been compiled in Article 12 of the Multilateral Instrument. South Africa, however, entered into a reservation on Article 12 and Article 12 will therefore not apply to its existing double tax treaties, as this is not an issue in South African law.
- Action 7 also deals with the preparatory or auxiliary exemption from a permanent establishment contained in Article 5(4) of the OECD Model Tax Convention. In this regard, Article 13 of the Multilateral Instrument provides alternative options, Option A being that all the activities of Article 5(4) will be subject to the preparatory or auxiliary test, and Option B being the previous provision on Article 5(4). South Africa will apply Option A.
- Action 14 addresses the minimum standard for a dispute resolution process. Article 16(1) of the Multilateral Instrument allows for the mutual agreement procedure (i.e. where SARS and its foreign counterpart must agree between them how to resolve the dispute) to be submitted to both jurisdictions that have entered into a double tax treaty within a three year period from the first notification of the action resulting in taxation not in accordance with the double tax treaty. South Africa, however, entered into a reservation on Article 16(1). According to the RSA Statement, South Africa intends to meet the minimum standard for improving dispute resolution under the OECD/G20 BEPS Package, which means that a person can only submit a case to the jurisdiction of which the person is resident or a national and that such Contracting State will implement a bilateral notification or consultation process.

CONCLUSION

It is likely that the above modifications to double tax treaties concluded with South Africa will become effective in the course of 2018. Signatories must ratify the Multilateral Instrument in accordance with their domestic procedures and according to Article 34 of the Multilateral Instrument, the Multilateral Instrument will enter into force three months after the deposit of the fifth instrument of ratification. Hence, an exact implementation date is impossible to determine at this stage.

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Esther Geldenhuys joined Werksmans Attorneys as an Associate in 2016, working in the firm's Tax department. She has law firm experience in both local and international tax advisory services.

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