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BEPS Action 15: 68 jurisdictions sign the multilateral instrument to modify bilateral tax treaties

On 7 June 2017, representatives covering 68 jurisdictions gathered at the OECD's headquarters in Paris for the signing of the *Multilateral Convention to Implement Tax Treaty-Related Measures to Prevent Base Erosion and Profit Shifting* (**'the Convention' or 'MLI'**).

The Convention is designed to implement swiftly the tax treaty-related measures arising from the G20/OECD Base Erosion and Profit Shifting ('BEPS') Project. 'Minimum standard' changes to the functioning of existing double tax conventions in the areas of **treaty abuse**, **mutual agreement procedures** and **treaty preambles** will be implemented through the Convention and, depending on the reservations and notifications made by each party, optional changes to modify tax treaties in respect of **permanent establishments** (taxable presence), **transparent entities**, **residency tie-breakers**, **double tax relief**, **minimum shareholding periods**, **capital gains derived from immovable property** and a jurisdiction's **right to tax its own residents** will also be facilitated.

A subgroup of 26 jurisdictions, including 16 EU member states, have opted in to the **mandatory binding arbitration** provisions, based on the principles set out in the *2015 BEPS Action 14 Final Report on Making Dispute Resolution Mechanisms More Effective*.

Deloitte comments

This convention is an important milestone in global agreement on international corporate taxation. It sends a signal that countries are determined to co-operate on corporate taxation to minimise base erosion whilst working to avoid economically damaging double taxation.

The participation of 68 jurisdictions in the signing ceremony is expected to result in the amendment of over 1,100 treaties in line with BEPS recommendations – about one third of the global total. The Convention remains open to interested parties and the OECD Secretariat hopes that 90 jurisdictions will have signed by the end of 2017.

Many countries have listed significant numbers of treaties in their provisional notification: UK (119); China (102); Belgium (98); India (93); France (88); Netherlands (83); Luxembourg (81). Widespread adoption should help to ensure consistency in the implementation of the BEPS project, resulting in more certainty for businesses and tax authorities. The next step is for the signatories to complete their domestic ratification procedures; this will determine when the changes have effect for each tax treaty – likely to be from 2019.

All members of the BEPS Inclusive Framework are committed to endeavouring that treaties will comply with the minimum standard requirements. The United States did not participate in the signing ceremony, but does have robust limitation on benefits provisions in existing treaties. The Inclusive Framework on BEPS will undertake a peer review and monitor whether its members' treaties satisfy the BEPS minimum standards.

The Principal Purpose Test will be introduced in all 1,100 treaties covered by the Convention, although 12 signatories, including India and Russia, have chosen to supplement this with a simplified Limitation on Benefit clause. Japan has opted for principal purpose.

The proposed changes in respect of permanent establishments have not been adopted as widely. Within the EU, only France and the Netherlands will broadly adopt all of the permanent establishment changes and the UK will only adopt the anti-fragmentation rule. These provisions may need to be revisited by the Inclusive Framework to increase consistency.

The effective resolution of disputes that could lead to double taxation remains an essential objective of double tax treaties and key to removing one of the barriers to international trade. The number of disputes between tax authorities globally continues to rise and the adoption of the optional mandatory binding arbitration rules by 26 jurisdictions, including the UK, will be welcomed by business.

The OECD, in its capacity as Depositary, has published on its website a number of useful tools along with provisional lists of treaties, options and reservations for each of the signatories. Businesses which currently benefit from double tax treaties between the initial signatories can now begin to analyse the impact of the changes published. Careful analysis will be needed as the information available is long and complex – with Ireland's position alone amounting to 49 pages. The public online matching tool expected to be launched in October 2017 will be welcomed.

Although there is no requirement to do so, many governments may produce some form of consolidated treaties once the positions are finalised on ratification.

Signing jurisdictions and treaties covered

The 68 parties to the Convention are:

- Andorra
- Argentina
- Armenia
- Australia
- Austria
- Belgium
- Bulgaria
- Burkina Faso
- Canada
- Chile
- China
- Colombia
- Costa Rica
- Croatia
- Cyprus
- Czech Republic
- Denmark
- Egypt
- Fiji
- Finland
- France
- Gabon
- Georgia
- Germany
- Greece
- Guernsey
- Hong Kong
- Hungary
- Iceland
- India
- Indonesia
- Ireland
- Isle of Man
- Israel
- Italy
- Japan
- Jersey
- Korea
- Kuwait
- Latvia
- Liechtenstein
- Lithuania
- Luxembourg
- Malta
- Mexico
- Monaco
- Netherlands
- New Zealand
- Norway
- Pakistan
- Poland
- Portugal
- Romania
- Russia
- San Marino
- Senegal
- Serbia
- Seychelles
- Singapore
- Slovak Republic
- Slovenia
- South Africa
- Spain
- Sweden
- Switzerland
- Turkey
- United Kingdom
- Uruguay

Eight other jurisdictions have expressed their intent to sign the Convention, including Mauritius and Estonia, the only EU/EEA state remaining to sign. The Ireland-Netherlands tax treaty does not appear to be included as an agreement covered by the Convention.

The OECD, in its role as **Depositary**, has **published on its website** http://oe.cd/mli provisional lists of the treaties they intend to bring within the scope of the Convention along with their reservations and notifications (**'MLI Positions'**). A treaty will only be modified if the parties to it agree (**Covered Tax Agreement**). Signatories may amend their MLI Positions until ratification. After ratification, signatories can choose to opt in with respect to optional provisions (such as arbitration) or to withdraw reservations. They cannot add reservations.

Mechanism for modifying covered tax agreements

The Convention does not function in the same way as an amending protocol to an existing bilateral treaty; it does not directly change the underlying text but will be **applied alongside the existing treaty**, modifying its application.

Flexibility and transparency

In some cases, the BEPS recommendations included multiple alternative ways to address an issue and in other cases provided for a main provision to be supplemented with optional additional provisions. The Convention is **flexible** enough to support all previously agreed BEPS approaches by allowing jurisdictions to select from **alternative options** and by filing **standardised technical reservations** which identify their choices.

The extent to which the Convention modifies an existing tax treaty depends on the MLI Positions of the parties to the treaty and the corresponding application of the mechanical provisions of the Convention. The OECD has published a toolkit, including interactive flowcharts, to assist in the application of the Convention to existing tax treaties. A public online matching tool, to simulate the likely matching outcome based on MLI Positions is under development and a beta version is expected to be available by October.

In general, any reservations or choices made by jurisdictions will apply to all its covered tax agreements, but can be restricted to a **subset** of its covered tax agreements **based on objective criteria**. For further information on the Irish positions, please refer to our previous alert here.

- **Treaty Abuse** (minimum standard): Addresses concerns that double tax treaties could be used to make available treaty benefits in unintended circumstances. Optionality is given to support the different approaches permitted under the minimum standard; **principal purpose tests** ('PPT') or **simplified limitation on benefits rules** ('LOB') supplemented with a PPT. Alternatively, the use of ***detailed*** **limitation on benefits rules** (supplemented by a mechanism to deal with conduit arrangements) is permitted. A multitude of outcomes can arise where the approaches differ and asymmetric results are possible if both jurisdictions approve.

  All 68 jurisdictions have opted to include the principal purpose test within their covered tax agreements. Twelve have also chosen to opt for the supplementary limitations on benefits rules: Argentina, Armenia, Bulgaria, Chile, Colombia, India, Indonesia, Mexico, Russia, Senegal, the Slovak Republic and Uruguay.

  Where only one of the parties has opted for the simplified limitations on benefits rules, the specific notifications and reservations must be considered to determine the specific outcome.

- **Permanent Establishment**: Lowers the threshold at which a permanent establishment (taxable presence) arises through: (i) broadening the scope of dependent agent permanent establishments (capturing the use of commissionnaire arrangements and other matters); (ii) narrowing exemptions for fixed place of business permanent establishments by requiring activities to be 'preparatory or auxiliary' in character and/or by introducing an anti-fragmentation rule; and (iii) countering avoidance where long-duration construction contracts are split into a series of shorter contracts.

  Within the EU, only eight countries have opted for the dependent agent/commissionnaire changes: Croatia, France, Lithuania, the Netherlands, Romania, the Slovak Republic, Slovenia and Spain.

  14 EU member states have opted for the narrower 'preparatory or auxiliary' provisions: Austria, Belgium, Croatia, France, Germany, Italy, Lithuania, Luxembourg, the Netherlands, Romania, the Slovak Republic, Slovenia and Spain.

  13 member states have opted for the anti-fragmentation measures: Belgium, Croatia, France, Ireland, Italy, Lithuania, the Netherlands, Portugal, Romania, the Slovak Republic, Slovenia, Spain and the United Kingdom.

  The splitting up of contracts anti-avoidance has only been fully adopted within the EU by France and the Slovak Republic.

  Bulgaria, Cyprus, the Czech Republic, Denmark, Finland, Greece, Hungary, Latvia, Malta, Poland and Sweden have reserved against all of the above changes to the permanent establishment threshold.

- **Mandatory Binding Arbitration** (optional): The rules will **only apply if both parties to a treaty opt in**. Unlike in most other areas of the Convention where reservations are standardised, parties are **free to determine the scope of cases** that will be eligible for arbitration (subject to acceptance by the other relevant parties).

  Typically, a taxpayer can request arbitration where a case has been subject to mutual agreement procedures for at least two years without resolution. Two different types of decision-making processes are facilitated: **'final offer'** rules, whereby each Competent Authority presents their own proposed resolutions and the arbitrators choose their preferred outcome; and the **'independent opinion'** approach, which results in a decision written by the arbitrators based on their analysis of the information provided to them.

The 26 jurisdictions which have opted in are: Andorra, Australia, Austria, Belgium, Canada, Fiji, Finland, France, Germany, Greece, Ireland, Italy, Japan, Liechtenstein, Luxembourg, Malta, the Netherlands, New Zealand, Portugal, Singapore, Slovenia, Spain, Sweden, Switzerland and the United Kingdom. Most have opted for the default option of final offer arbitration.

The UK has reserved the right for existing arbitration provisions in 18 specified treaties not to be affected by the MLI, including those in Belgium, Canada, France, Germany and the Netherlands. No reservations restricting the scope of matters acceptable for arbitration have been entered by the UK.

Entry into force and into effect

Individual signatories will need to ratify the Convention in line with their domestic constitutional arrangements. The Convention must be ratified by at least five jurisdictions before it first enters into force. Following a period of three months after the date of ratification by the fifth state, the Convention will enter into force for those first five jurisdictions at the start of the subsequent calendar month. A three month period will also apply for all other jurisdictions who subsequently ratify the Convention.

The Convention can enter into effect for a specific covered tax agreement only after the three month period has expired for all parties to the covered tax agreement. The default timings are:

- Modified withholding tax provisions will have effect for payments made after the first day of the following calendar year;
- Changes relating to taxes levied with respect to taxable periods will have effect for taxable periods beginning on or after a period of six calendar months has elapsed (or less if both parties agree).

Jurisdictions can unilaterally replace the term 'calendar year' with 'taxable period' and vice versa (potentially leading to asymmetry).

Different provisions apply for dispute resolution and cases could be eligible even where the dispute relates to a period before the Convention was in force.

The next step is for the signatories to complete their domestic ratification procedures; this will determine when the changes have effect for each tax treaty – likely to be from 2019.