OECD BEPS - Multilateral Instrument: Treaty Abuse
Principal Purpose Test
The OECD’s Multilateral Instrument (MLI), which as of 1 January 2020 has been signed by 93 countries has the potential to impact significantly the ability of groups to rely on double tax treaties to manage and reduce taxes imposed across borders, such as withholding tax. The MLI is expected to affect the interpretation and application of more than 1600 tax treaties without the need for any bilateral negotiations between countries.

One of the key provisions included in the MLI, to assist tax authorities to prevent any “treaty abuse” pursuant to Action 6 of the Base Erosion and Profit Shifting (BEPS) project, is the Principal Purpose Test (PPT).

What is the PPT?
This is a subjective anti-avoidance measure based upon the relative purposes of the relevant parties. The PPT is included in Article 7 (Prevention of Treaty Abuse) of the MLI. Where both countries which are party to a double tax treaty (Contracting Jurisdictions) have signed up to the MLI then the PPT modifies the double tax treaty.

Number of double tax treaties impacted (all numbers at June 2017):
Principal Purpose Test >1100
Simplified LOB and PPT >40

The PPT will have the effect of denying treaty benefits, such as the reduction of withholding tax on interest royalties and dividends, where it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that treaty benefit is one of the principal purposes of the party seeking to rely on the relevant double tax treaty. There is a carve out where granting the treaty benefit is nonetheless, irrespective of the principal purpose of the taxpayer, in accordance with the object and purpose of the relevant double tax treaty.

Signatory countries that have agreed to incorporate the PPT in their double tax treaties include the UK, Netherlands and most EU countries, but not the USA. A smaller number of countries have signed up to a simplified limitation on benefits (LOB) test as well as the PPT – Kazakhstan, Russia and other.
The PPT applies where the relevant double tax treaty does not contain a provision such as the PPT or, where a similar anti-avoidance provision is included in the treaty, in the place of such provision.

With respect to withholding taxes

- As of the latest date on which the MLI enters into force for each of the Contracting Jurisdictions
- MLI provisions take effect from the first day of the next calendar year.
- As at 1 January 2021 effective in Kazakhstan

With respect to other taxes

- As of the latest date on which the MLI enters into force for each of the Contracting Jurisdictions
- Expiration of a period of six months
- Expected start date: 1 April 2021

MLI constitutes a major change to international taxation and enables international tax authorities around the world to challenge transactions and structures on a new basis.

Proposed changes to tax legislation of Kazakhstan as a result of MLI

**Application of WHT exemption according to double tax treaty (DTT)**

Under the proposed changes, a tax agent would be entitled to apply WHT exemption of income under the DTT as follows:

- in case a non-resident is a resident of a state, which DTT with Kazakhstan is affected by MLI, a tax agent would be entitled to apply WHT exemption if income paid to a non-resident is subject to tax in its state of residence at a nominal rate of no less than 15%;
- in case a non-resident is related to a tax agent and is a resident of a state, which DTT with Kazakhstan is not affected by MLI, a tax agent would be entitled to apply WHT exemption if a non-resident is a beneficial owner of income.
- in all other cases, a tax agent would be entitled to apply WHT exemption in case standard treaty clearance procedures (i.e. provision of tax residency certificate, founding documents in certain cases, etc.) are duly complied with.
How Deloitte can help

Deloitte can help you understand the extent and impact of this change, assess the impact on your business and whether restructuring is required, and assist you to manage the disruption that may be caused to your cross-border operating model.

We can also help you implement a robust compliance and governance programme as well as identify any potential commercial opportunities.

Assessing the impact

Step 1: Identify and quantify the objective treaty benefit versus a realistic counterfactual scenario

Step 2: Identify and quantify the business (i.e. non-tax) reason for the arrangements and the choice of location of the entity

Step 3: Critically evaluate the evidence to assess the weight of the business versus tax-related purposes

Step 4: Determine whether, even if obtaining a treaty benefit is a principal purpose for the arrangement or transaction, granting the treaty benefit in the relevant circumstances is in accordance with the object and purpose of the provision of the treaty.

Business / risk area

The OECD has provided some examples of what is expected to be impacted, e.g. insertion of an arrangement or entity to benefit from lower withholding tax rates on interest, royalties or dividends. Some of the aspects that might therefore require consideration in the context of the PPT include:

- Expected changes in domestic law provision to address PPT
- Taxation in respect of companies with immoveable property
- Contractual arrangements in the context of the PPT requirements
- Agents’ WHT exemption process review
- Corporate lending – treasury functions and back to back lending
- Change of ownership structure or percentage or type of shareholding
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