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THE CEE LAW FIRM

The Multilateral Instrument ("MLI") is an OECD solution aimed at preventing the tax treaty abuse of shifting profits to countries with zero or low taxation. The MLI has been signed by over 70 governments. Over 1,100 bilateral tax treaties worldwide will be modified in a synchronized and efficient manner without standard negotiations and long-term approval procedures. This makes the MLI a unique, unprecedented measure. Prior to applying double tax treaties, taxpayers should pay special attention to this newly-introduced instrument in order to determine whether and how a particular tax treaty is amended by the MLI.

MLI: HOW AND WHEN WILL DOUBLE TAX TREATIES BE MODIFIED? THE MULTILATERAL INSTRUMENT WILL AMEND MORE THAN A THOUSAND TREATIES

Background

Recently in international taxation there have been more significant changes than there have been in the past several decades. The conclusion of the **Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting** ("Multilateral Instrument" or "**MLI**") marks a new turning point in tax treaty history.

The OECD plays a key role in the tax area at the global level. Base erosion and profit shifting (BEPS) refers to tax planning strategies that exploit gaps and mismatches in tax rules to shift profits artificially to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid. Local solutions at the state level do not work due to the international aspects of these structures. With the Google, Apple, Microsoft, Starbucks and other cases, the problem of cross border optimization (in many cases legal and legitimate) became a political issue.

BEPS

Within the OECD/G20 BEPS Project, 15 actions were developed to tackle tax avoidance, improve the coherence of international tax rules and ensure a more transparent tax environment.

On 5 October 2015, the final BEPS package was published and subsequently endorsed by the G20 Finance Ministers and Leaders and was comprised of reports on each of the 15 actions identified in the BEPS Action Plan.

- Action 1 Digital economy: ADDRESSING THE TAX CHALLENGES OF THE DIGITAL ECONOMY
- Action 2 Hybrids: NEUTRALIZING THE EFFECTS OF HYBRID MISMATCH ARRANGEMENTS
- Action 3 CFC rules: DESIGNING EFFECTIVE CONTROLLED FOREIGN COMPANY (CFC) RULES
- Action 4 Interest deductions: LIMITING BASE EROSION INVOLVING INTEREST DEDUCTIONS AND OTHER FINANCIAL PAYMENTS
- **Action 5 Harmful tax practices: COUNTERING HARMFUL TAX PRACTICES MORE EFFECTIVELY, TAKING INTO ACCOUNT TRANSPARENCY AND SUBSTANCE**
- **Action 6 Treaty abuse: PREVENTING THE GRANTING OF TREATY BENEFITS INAPPROPRIATE CIRCUMSTANCES**
- Action 7 Permanent establishment status: PREVENTING THE ARTIFICIAL AVOIDANCE OF PERMANENT ESTABLISHMENT STATUS
- Actions 8-10 Transfer pricing (Intangibles, Risk and capital, High-risk transactions): ALIGNING TRANSFER PRICING OUTCOMES WITH VALUE CREATION
- Action 11 BEPS data analysis: MEASURING AND MONITORING BEPS
- Action 12 Disclosure of aggressive tax planning: MANDATORY DISCLOSURE RULES

- Action 13 Transfer pricing documentation: TRANSFER PRICING DOCUMENTATION AND COUNTRY-BY-COUNTRY REPORTING
- **Action 14 Dispute resolution: MAKING DISPUTE RESOLUTION MECHANISMS MORE EFFECTIVE**
- **Action 15 Multilateral instrument: MULTILATERAL CONVENTION TO IMPLEMENT TAX TREATY RELATED MEASURES TO PREVENT BEPS[1]**

Leaders of the OECD and G20 countries, as well as other leaders, urged the timely implementation of this comprehensive BEPS package. **The Multilateral Instrument (MLI) specified in Action 15 of the BEPS plan responds to this call for swift action by implementing the BEPS measures which require changes to tax treaties.**

Signatories

On 7 June 2017, over 70 Ministers and other high-level representatives participated in the MLI signing ceremony, in which 67 countries signed the MLI. The signatories included jurisdictions from all continents and all levels of development. Nine jurisdictions also expressed their intention to sign the MLI as soon as possible and other jurisdictions are also actively working towards signature.
The signatories included the large economies of Australia, China, Canada, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Switzerland, Turkey, and the United Kingdom. Notably, the United States does not intend to sign the MLI. Signatories also include a number of states with risk of aggressive tax planning such as Andorra, Cyprus, Guernsey, the Isle of Man, Liechtenstein, Luxembourg, Malta, Monaco, the Netherlands, San Marino and Seychelles.

Tax treaties modified

The MLI modifies tax treaties that are "Covered Tax Agreements". A Covered Tax Agreement is an agreement for the avoidance of double taxation that is in force between parties to the MLI and for which both parties have made a notification that they wish to modify the agreement using the MLI. Lists of notified tax treaties can be found in the MLI Positions at: oe.cd/mli.[2]
The signatories listed 2,362 tax treaties to be covered by the MLI. Of these, over 1,100 treaties were listed by both parties-signatories. This means these "matched" treaties will be modified by the MLI. Naturally, the number of matched treaties will increase once new signatories join the MLI.

MLI implementation

Selected actions and recommendations of BEPS concern approximately 3,600 complex and not fully harmonized international double taxation treaties worldwide. In a standard way, each minor change in each bilateral treaty requires long-term negotiations, approval procedures and a ratification process. If BEPS recommendations and best practices would be implemented in the renegotiated or newly negotiated treaties only, the short-term effect would be insignificant.

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[1] Peer review documents, final reports and further details can be found at the OECD website: http://www.oecd.org/tax/beps/beps-actions.htm

[2] The text of MLI, its Explanatory Statement, Signatories and their MLI Positions, Application Toolkit and FAQ can be found at the OECD website: http://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm

The MLI is the tool to implement the proposed changes in the OECD Model Convention into the existing treaties in a synchronized and efficient manner.
Each signatory was obliged to prepare and submit its MLI position before signing the MLI. The provisional (i.e., before the ratification) position of each signatory indicates the tax treaties it intends to cover, the options it has chosen and the reservations it has made. MLI positions are published online at the OECD website and are documents of 10 to 60 pages, the length of which varies depending on the number of treaties the jurisdiction wishes to modify with the MLI and its policy choices.

How it will work in practice

In fact, the implementation will be complicated. The different wording of tax treaties, the MLI ratification process, the extensive provisional lists of reservations and notifications of each signatory and the lists of treaties covered by each signatory make the practical application of tax treaties more difficult.
The MLI does not amend treaties like a protocol. Instead, the MLI modifies treaties by sitting alongside them. In many countries no consolidated version of modified treaties will be available. This means that taxpayers, when applying a particular double tax treaty, have to search whether the other contracting state signed the MLI, whether the particular tax treaty is covered, what provisions were implemented and whether the modifications have become effective.

It is likely that the first modifications to the covered treaties will become effective in 2018. There is no deadline for the MLI ratification procedure.

Structure and content of the MLI

The MLI is a document of 50 pages with the following structure:

- Scope and interpretation of terms (Part I, Articles 1-2)
- Hybrid mismatches (Part II, Articles 3-5)
- Treaty abuse (Part III, Articles 6-11)
- Avoidance of permanent establishment status (Part IV, Articles 12-15)
- Improving dispute resolution (Part V, Articles 16-17)
- Arbitration (Part VI, Articles 18-26)
- Final provisions (Part VII, Articles 27-39)

Minimum provisions and optional provisions

The MLI is flexible enough to accommodate a variety of tax policies while still ensuring that the tax treaty related BEPS measures are effectively implemented.
The MLI is not an a la carte instrument. The MLI does not permit jurisdictions to make treaty-by-treaty choices when they decide how they want the MLI to affect their treaties. Instead, before signature, jurisdictions were required to express how they want the MLI to modify their Covered Tax Agreements.
The MLI consists of two types of provisions: minimum standard provisions and optional provisions. The minimum standard provisions have to be implemented in all tax treaties as agreed as part of the BEPS-Package in November 2015. The optional provisions depend on the agreement of the contractual parties and do not have to be implemented at all, if the parties concur.

The minimum standards include:

- The rule to prevent treaty abuse, i.e., **the Principal Purpose Test** (Action 6 – Preventing the Granting of Treaty Benefits in Inappropriate Circumstances) and
- The rule for more effective resolution of disputes by mutual agreement (Action 14 – More Effective Dispute Resolution Mechanisms).

Action 6

Article 6 of the MLI – Purpose of a Covered Tax Agreement:

A Covered Tax Agreement shall be modified to include the following preamble text: "Intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions),".

Article 7 of the MLI – Prevention of Treaty Abuse:

Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was ***one of the principal purposes*** *of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement.*

To conclude, the anti-abuse rules are valid for decades. However, the new PPT test is stricter when compared to the "guiding principle" stated in Art 9.5 of the Commentary on Article 1 of the OECD Model Tax Convention:

A guiding principle is that the benefits of a double taxation convention should not be available where ***a main purpose*** *for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions.*

The Action 6 Report of the BEPS Package includes detailed guidance and examples in the form of the commentary that was developed during the BEPS Project and has particular relevance in this regard.

Action 14

The minimum standard on dispute resolution will ensure that treaty obligations related to the mutual agreement are fully implemented in good faith and that administrative processes promote the prevention and timely resolution of treaty-related disputes.

Among others, the minimum standard provides that countries have to commit themselves to resolving cases within an average time-frame of 24 months. The progress towards meeting this target will be periodically reviewed.

Conclusion

The MLI is a milestone for international taxation and treaty law as it allows all interested jurisdictions to update tax treaties with provisions reflecting internationally agreed standards. It is likely that the first modifications to covered treaties will become effective in 2018. As of today, over 70 jurisdictions have signed the MLI and 1,100 tax treaties will be modified. The minimum standard provisions, especially the new stricter anti-abuse test called the Principle Purposes Test (the PPT), have to be implemented in all tax treaties. The optional provisions depend on the agreement of the contractual parties and do not have to be implemented at all, if the parties concur. In many countries no consolidated version of modified treaties will be available. This means that taxpayers applying double taxation treaties must check the MLI and the eventual consequences.

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