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# Multilateral instrument to implement BEPS treaty-related recommendations almost final

10 October 2016

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## *In brief*

The OECD has been developing a Multilateral Instrument (MLI) that could amend bilateral treaties to swiftly implement the tax treaty measures developed in the course of the G20/ OECD BEPS Action Plan (the BEPS Action Plan). Recently the OECD announced that in the past months it made significant progress with respect to the MLI and that the main text of the MLI has been agreed in principle.

The MLI is an important element of the BEPS Action Plan. We think it likely that the MLI will ultimately be signed by most of the countries participating in the process. However, since no MLI drafts have been released thus far, some questions remain on its overall status and ultimate impact.

This note summarises our current knowledge of the MLI and how it could potentially impact your business.

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## *In detail*

### **Stage two of the BEPS Action Plan: implementing the BEPS Package**

With the release of the final reports on the 15 BEPS action items in October 2015 (the BEPS package), the OECD has finalised the first stage of the BEPS Action Plan. To kick-off the second stage of the BEPS Action Plan, the OECD announced on February 23, 2016, the establishment of an inclusive framework (the 'BEPS Inclusive Framework') that brings together over 100

countries and jurisdictions to collaborate on the BEPS Package implementation. The BEPS Inclusive Framework established a new forum, the BEPS Implementation Forum, which allows all interested countries and jurisdictions to participate as BEPS Associates on an equal footing with the OECD and G20 members.

In order to become a BEPS Associate, a participant must to commit to implementing the four BEPS minimum standards on harmful tax practices (BEPS Action 5), tax treaty abuse

(BEPS Action 6), Country-by-country reporting (BEPS Action 13) and cross-border tax dispute resolution (BEPS Action 14).

The mandate of the BEPS Implementation Forum includes:

- finalizing the remaining BEPS standard-setting work. This includes finalizing the BEPS Action Plan items for which the BEPS Package mentioned that further work was needed,

- reviewing implementation of the four BEPS Minimum Standards and the remainder of the BEPS Package, and
- ensuring ongoing data gathering on the tax challenges in the digital economy and measuring the impact of BEPS.

***Background on BEPS Action 15 (developing a multilateral instrument to modify bilateral tax treaties)***

The BEPS Package includes a number of recommendations that would have to be implemented through bilateral tax treaty amendments. If undertaken on a treaty-by-treaty basis, the sheer number of treaties in effect (currently there are an estimated 1,400 bilateral income tax treaties in place) would make such a process very lengthy. Recognizing the need for an efficient and effective mechanism to implement the tax-treaty related measures resulting from the BEPS project, Action 15 of the BEPS Action Plan called for the development of a multilateral instrument that could amend all existing bilateral tax treaties at once.

The report "Developing a Multilateral Instrument to Modify Bilateral Tax Treaties" concluded that such a multilateral instrument is not only feasible but also desirable, and that negotiations for the instrument should be convened quickly. A mandate to set up the Ad Hoc Group for the development of a multilateral instrument was developed by the OECD Committee on Fiscal Affairs and endorsed by the G20 Finance Ministers and Central Bank Governors at their February 2015 meeting. The Ad Hoc Group was established and had its first meeting on May 27, 2015.

***Which countries and jurisdictions are participating in developing and negotiating the MLI?***

As of 12 September 2016 the [Ad Hoc Group](#) included 98 countries, all participating on an equal footing. In addition, a number of non-State jurisdictions and international organisations are participating as Observers.

The MLI likely will be signed by most of the countries participating in the process. While the United States is part of this group, it previously expressed reservations about signing the MLI. The ability to opt in and opt out of provisions could open a means for the United States to sign the MLI, which would offer one benefit: a route to opting in to mandatory binding arbitration (MBA) in resolving cross-border disputes under existing bilateral treaties. The United States has been among the most vocal supporters of MBA. Even if the United States were to sign the MLI, it is unclear whether the US Senate would have sufficient ratify the instrument (see also details of the process below).

***What BEPS measures would the MLI cover?***

The MLI is expected to cover the tax treaty measures developed in the course of the OECD BEPS Project. The treaty measures that are expected to be covered include the following BEPS Minimum Standards:

- The BEPS Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances) minimum standard which requires the adoption of rules in bilateral tax treaties that effectively address treaty shopping, including:
  - First, treaties should include, in their title and preamble, a clear statement that the States that enter into a tax treaty

intend to avoid creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping.

- Second, countries should include in their treaties, either a (i) a combination of a 'limitation-on-benefits' (LOB) rule and a 'principal purpose test' (PPT) rule; (2) a PPT rule, or (3) a LOB rule supplemented by a mechanism that deals with conduit arrangements, such as a restricted PPT rule applicable to conduit financing arrangements in which an entity otherwise entitled to treaty benefits acts as a conduit for payments to third-country investors.
  - The BEPS Action 14 (Making Dispute Resolution Mechanisms More Effective) which requires countries to fully implement, in good faith, a dispute resolution mechanism clause in their tax treaties, including the changes to paragraphs 1 through 3 of Article 25 of the OECD Model, as well as the inclusion of paragraph 2 of Article 9 of the OECD Model.
- In addition, the Multilateral Instrument is expected to cover the following tax treaty best practices developed in the course of the OECD BEPS Project:
- The treaty provisions developed under *BEPS Action 2 (Neutralising the Effects of Hybrid Mismatch Arrangements)*, including provisions to address fiscally transparent entities under Article 1 (Persons Covered) and the measures to address issues with

applying the exemption method to relieve double taxation in situations where dividends or other income are not subject to source-state taxation;

- The other treaty provisions developed under *BEPS Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances)*, including a 'saving clause' to make explicit that treaties do not restrict a State's right to tax its own residents, and specific anti-abuse rules related to certain dividend transfer transactions, transactions involving immovable property holding companies, situations of dual-resident entities, and treaty shopping using third-country permanent establishments ("PEs");
- The changes to treaty provisions developed under *BEPS Action 7 (Preventing the Artificial Avoidance of PE Status)*, including measures to address commissionaire arrangements and similar strategies, modifications of the specific activity exemptions under Article 5(4) of the OECD Model Treaty and the addition of an anti-fragmentation rule in Article 5(4), and measures to address the splitting-up of contracts to abuse the exception in Article 5(3) of the OECD Model Treaty for construction and installation projects that do not last for more than twelve months.

#### **How will the MLI work?**

So far no drafts of the MLI have been made available to the public. However, the OECD did share information on how the MLI will work. The MLI will be called the 'Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and

Profit Shifting'. The MLI will be modular with alternatives (e.g., with respect to the anti-treaty shopping provisions) and participating states will have the ability to opt in and out the MLI's different provisions. With respect to the treaty measures that are BEPS minimum standards, the flexibility for states to opt-out will be limited.

With respect to the interaction between the MLI and existing treaties, the MLI will provide for compatibility clauses. Further, an explanatory statement will be issued that will cover how the MLI interacts with existing bilateral treaties. The OECD will be the depository and will collect and make public notifications about the effect on existing treaties.

#### **Timing and current status of the MLI**

The OECD expects to conclude its work and open the MLI for signature by 31 December 2016. Thereafter, a signing ceremony likely will be held during the first half of 2017. On 22 September 2016 the OECD announced that the main text of the MLI has been agreed in principle, and that now it is just a matter of fine tuning and translating the language.

After signing, the MLI will have to be ratified by the participating states for it to come into effect. This will take varying lengths of time depending on the state. In this respect, we expect that the MLI will enter into force when a certain minimum number of countries (which still has to be determined) have ratified it. After the MLI has entered into force, we understand that the OECD envisages that the MLI would impact existing bilateral treaties when the two states that are party to a treaty have ratified the MLI. As such, we would expect that if everything goes according to plan that the first countries may ratify the MLI in 2017 and that the MLI

could impact the first treaties in 2017 at the earliest.

We understand that the MLI will be discussed again in November. We expect that more details, including the availability of the MLI's first draft, will be released after that meeting.

#### **The takeaway**

Based on the MLI information revealed by the OECD thus far, the MLI likely would override the relevant parts of existing bilateral treaties. However, given the optionality in the MLI, this would require that participating countries and jurisdictions specify at the MLI's ratification which provisions of the MLI they would opt into and out of. With the help of notifications by such countries, the OECD would then carry out a matching exercise and publicize information on which clauses in which treaties have actually been modified.

In this respect, note that for example under the recently agreed EU Directive, Member States will be required to adopt a PPT in their treaties, as an LOB could give rise to EU law concerns.

To put things in perspective, with the optionality that the MLI and some of the recommended measures in the BEPS Package provide, the OECD has taken a step back compared to its earliest proposals made in the context of the BEPS Action Plan. For example, the initial proposals on minimum standards to address treaty shopping effectively in the context of BEPS Action 6 included only one alternative (instead of the three alternatives that ultimately have been agreed upon) that consisted of a recommendation to countries to adopt in all their treaties, amongst others, a LOB rule combined with a PPT rule.

Further, with respect to some of the proposed treaty provisions developed under the BEPS Action Plan, further work is still being done at the BEPS Implementation Forum with respect to certain elements of the proposed rules. The outcome of this further work may affect the MLI's impact on taxpayers. For example, in the context of BEPS Action 6, changes to the proposed provisions and commentary are still being discussed with respect to:

- whether to make any changes to the proposed anti-abuse provisions, including the proposed LOB test and 'special tax regimes' provisions, in light of the release of the US 2016 Model Treaty
- treaty eligibility of investment fund entities (i.e., 'Non-CIVs' in the terminology of the OECD), and
- treaty residence of pension funds.

Taxpayers should monitor which provisions of the MLI countries will opt in to or out of, as well as which of various alternative provisions they choose to apply and any reservations they add in order to determine the MLI's impact in practice.

## ***Let's talk***

For a deeper discussion of how these proposals might impact your business, please call your usual PwC contact. If you do not have a contact or would prefer to speak to one of our global specialists, please contact one of these individuals:

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