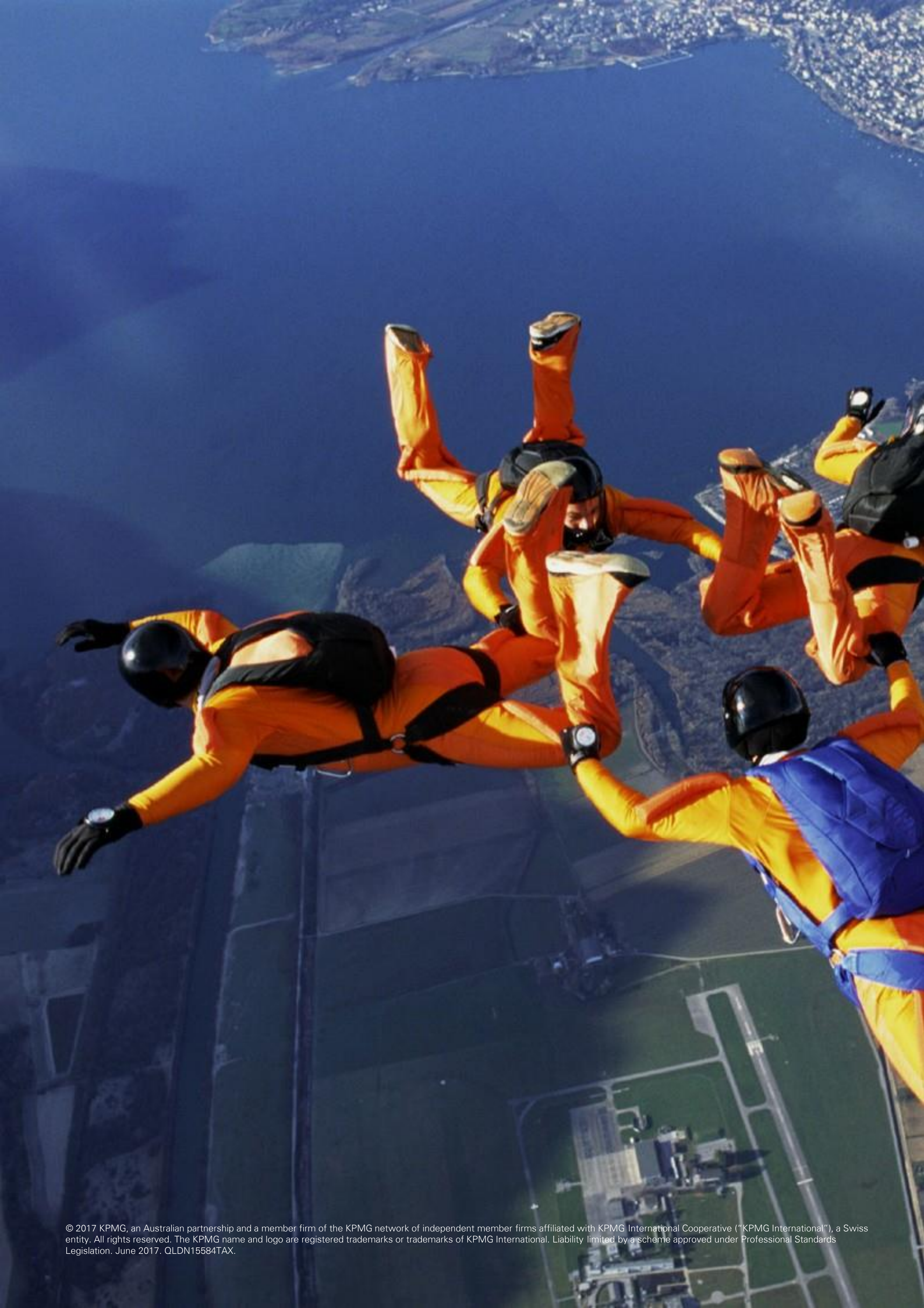
KPMG

ASPAC and the Multilateral Instrument

Implementing the Treaty Related BEPS Provisions



On 7 June 2017, the OECD hosted a signing ceremony in Paris for the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*. Commonly referred to as the 'Multilateral Instrument', or MLI, this convention was the subject matter of Action 15 of the BEPS Action Plan.

The MLI was intended to provide a simplified mechanism for implementation of the BEPS program which did not involve laborious negotiation of each treaty.

The MLI was signed by 67 signatories covering 68 jurisdictions. Of these 67 signatories, Norway signed the agreement but did not state any options or make any notifications as this required parliamentary approval and China signed the convention on behalf of Hong Kong. Adding to these numbers, Guatemala subsequently signed on 9 June and another 9 countries expressed a commitment to sign at a future date: Cameroon, Cote d'Ivoire, Estonia, Jamaica, Lebanon, Mauritius, Nigeria, Panama and Tunisia. It is expected that a second signing ceremony will occur later this calendar year. Notable absences from the list of signatories are the United States and Brazil. Brazil has, however, been a keen participant in the BEPS process and it is expected that the country will sign-up in due course.

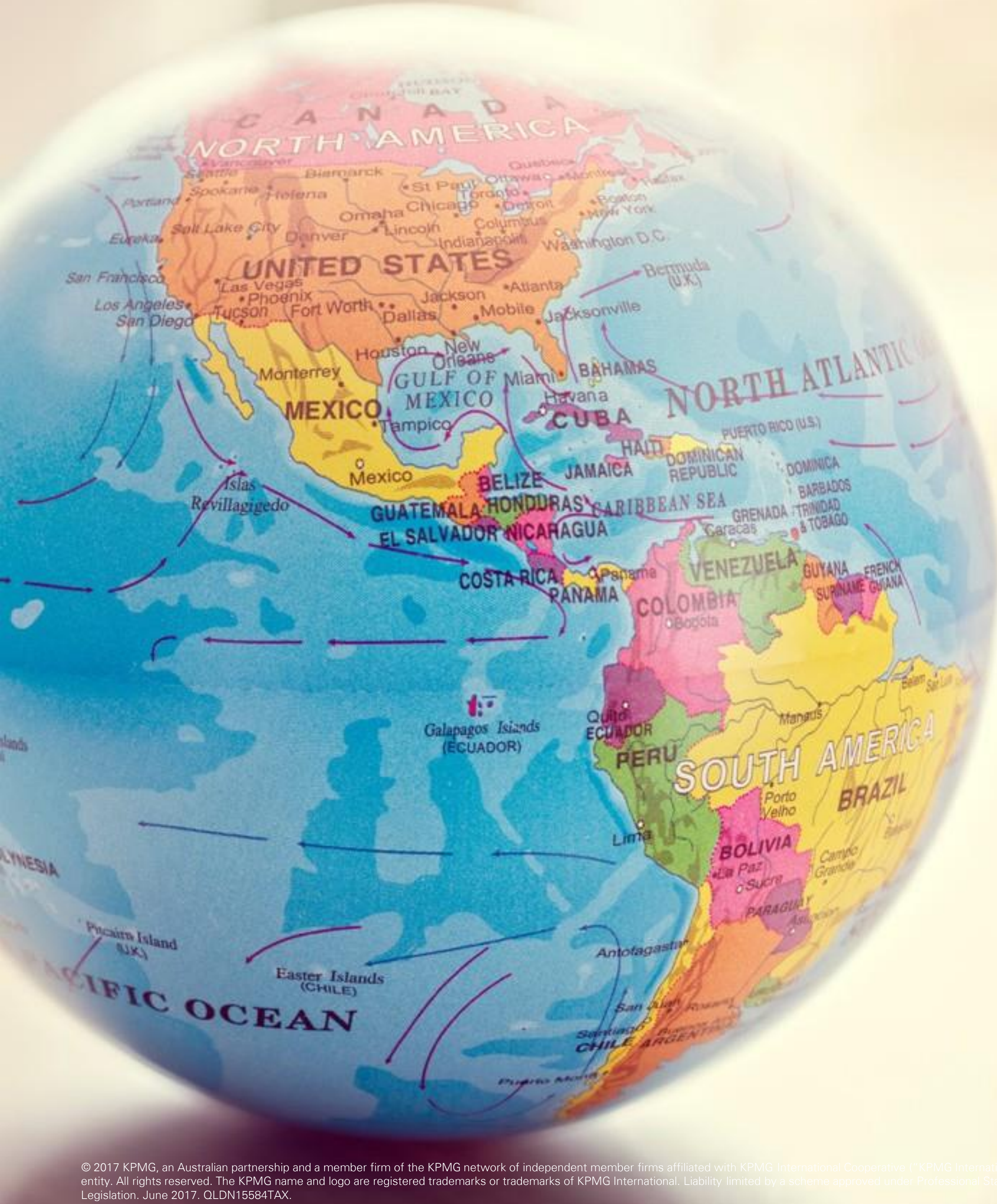

NORTH AMERICA
UNITED STATES
MEXICO
GULF OF MEXICO
NORTH ATLANTIC
CUBA
BAHAMAS
HAITI
DOMINICAN REPUBLIC
JAMAICA
BELIZE
GUATEMALA
HONDURAS
EL SALVADOR
NICARAGUA
COSTA RICA
PANAMA
CARIBBEAN SEA
VENEZUELA
COLOMBIA
GUYANA
ECUADOR
PERU
SOUTH AMERICA
BRAZIL
BOLIVIA
Galapagos Islands
(ECUADOR)
Easter Islands
(CHILE)
PACIFIC OCEAN

Table 1 outlines the countries covered by the MLI to date. There are 7 from the Americas, 8 from Africa and the Middle East, 11 from Asia-Pacific, 27 out of 28 EU Countries (with Estonia expected to sign soon) and 15 other European and Eurasian Countries.

Table 1: Signatories of MLI

Americas	Africa & Middle East	Asia-Pacific	EU		Other Europe – Eurasia
7 + 2	**8 + 6**	**11**	**27 + 1**		**15**
Argentina	Burkina Faso	Australia	Austria	Latvia	Andorra
Canada	Egypt	China	Belgium	Lithuania	Armenia
Chile	Gabon	Fiji	Bulgaria	Luxembourg	Georgia
Columbia	Israel	Hong Kong	Croatia	Malta	Guernsey
Costa Rica	Kuwait	India	Cyprus	Netherlands	Iceland
Mexico	Senegal	Indonesia	Czech Republic	Poland	Isle of Man
Uruguay	Seychelles	Japan	Denmark	Portugal	Jersey
Jamaica	South Africa	Korea	Finland	Romania	Liechtenstein
Panama	Cameroon	New Zealand	France	Slovakia	Monaco
	Cote d'Ivoire	Pakistan	Germany	Slovenia	Norway
	Lebanon	Singapore	Greece	Spain	Russia
	Mauritius		Hungary	Sweden	San Marino
	Nigeria		Ireland	UK	Serbia
	Tunisia		Italy	Estonia	Switzerland
					Turkey

= Intention to sign

MLI and optionality

On 24 November 2016 the OECD released a text version of the MLI with an accompanying *Explanatory Statement*. This document contains 39 articles which have been negotiated by an ad hoc group of 99 countries. The articles were divided into seven parts. Two parts involved scope, interpretation and implementation. One part – Part VI – involved an option for mandatory binding arbitration. The remaining four parts dealt with any recommendations to changes in treaties in the *OECD Action Plan*. This covered Hybrids (Action 2), Treaty Abuse (Action 6), Permanent Establishments (Action 7) and Dispute Resolution (Action 14).

Those recommendations contained significant flexibility. The MLI reflects this flexibility by providing for a large number of options, although those options are very specific and not open. The 7 June meeting and signing ceremony provided a forum in which countries could publicly state their positions on various options contained in the MLI by lodging a document outlining a provisional list of reservations and notifications (their "MLI Position") at the time of signature.

A key document released on 7 June contains three pages of links leading to a template of notifications completed by each country. These completed templates vary in size, but most are about thirty pages long. They can be accessed here: (http://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf).

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Covered Tax Agreements

The key choice each country has made involves selecting which treaties the country wishes to be covered by the MLI. This is provided for in *Article 2* and invokes the concept of a *Covered Tax Agreement (CTA)*.

The complication is that simply by listing a country in *Article 2* does not mean that a country has negotiated an agreement to change a treaty. There needs to be a match by the counter-party. This can only be determined by going to the counter-party notification under *Article 2*.

Technically the concept of a CTA is one where there is a match. That is one where each party has notified the Depository, being the OECD, that it wishes that agreement to be covered by the MLI.

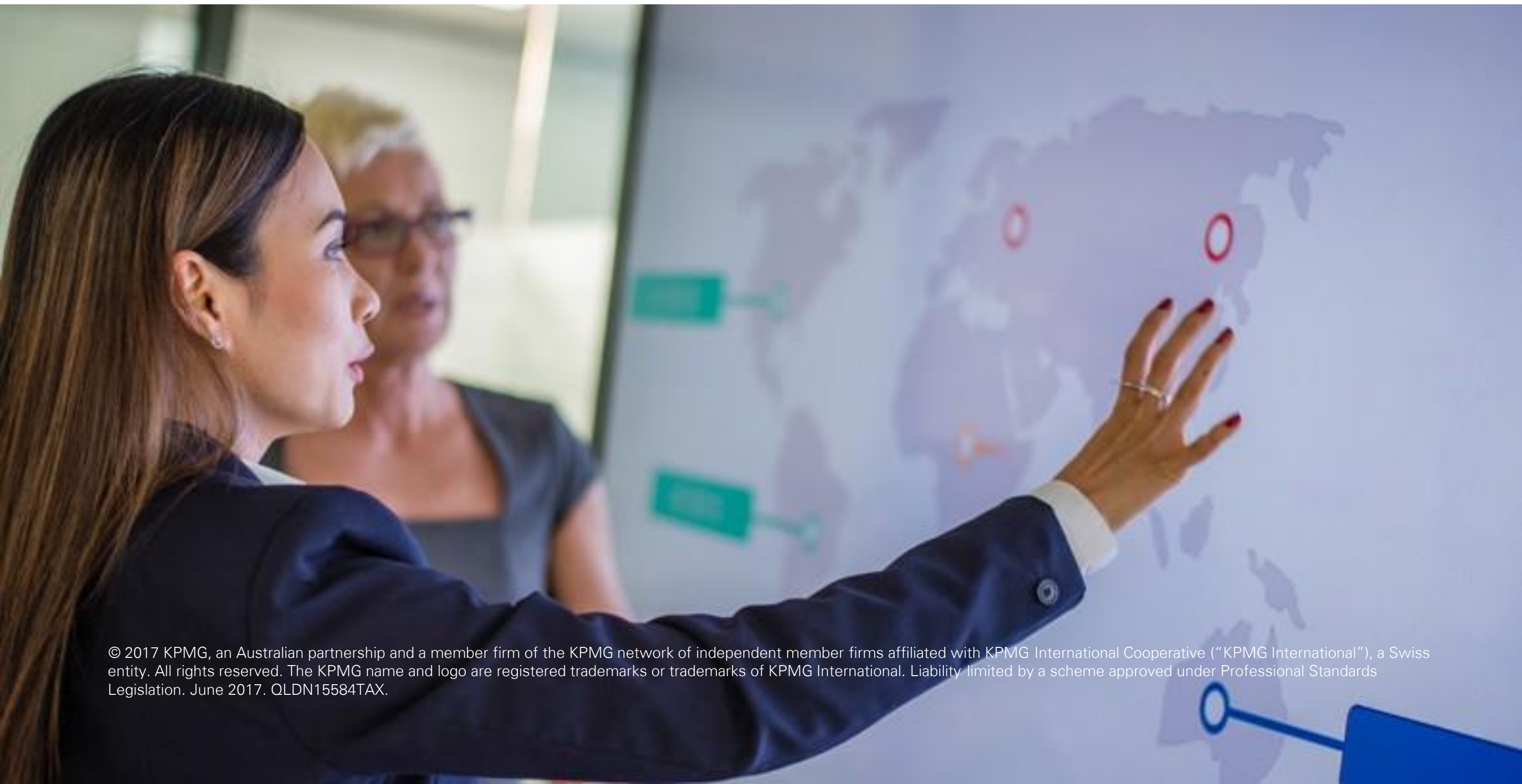
Thus, a distinction needs to be drawn between a country listing a Double Tax Agreement (DTA) with another country as a CTA and their being an actual match that forms a CTA.

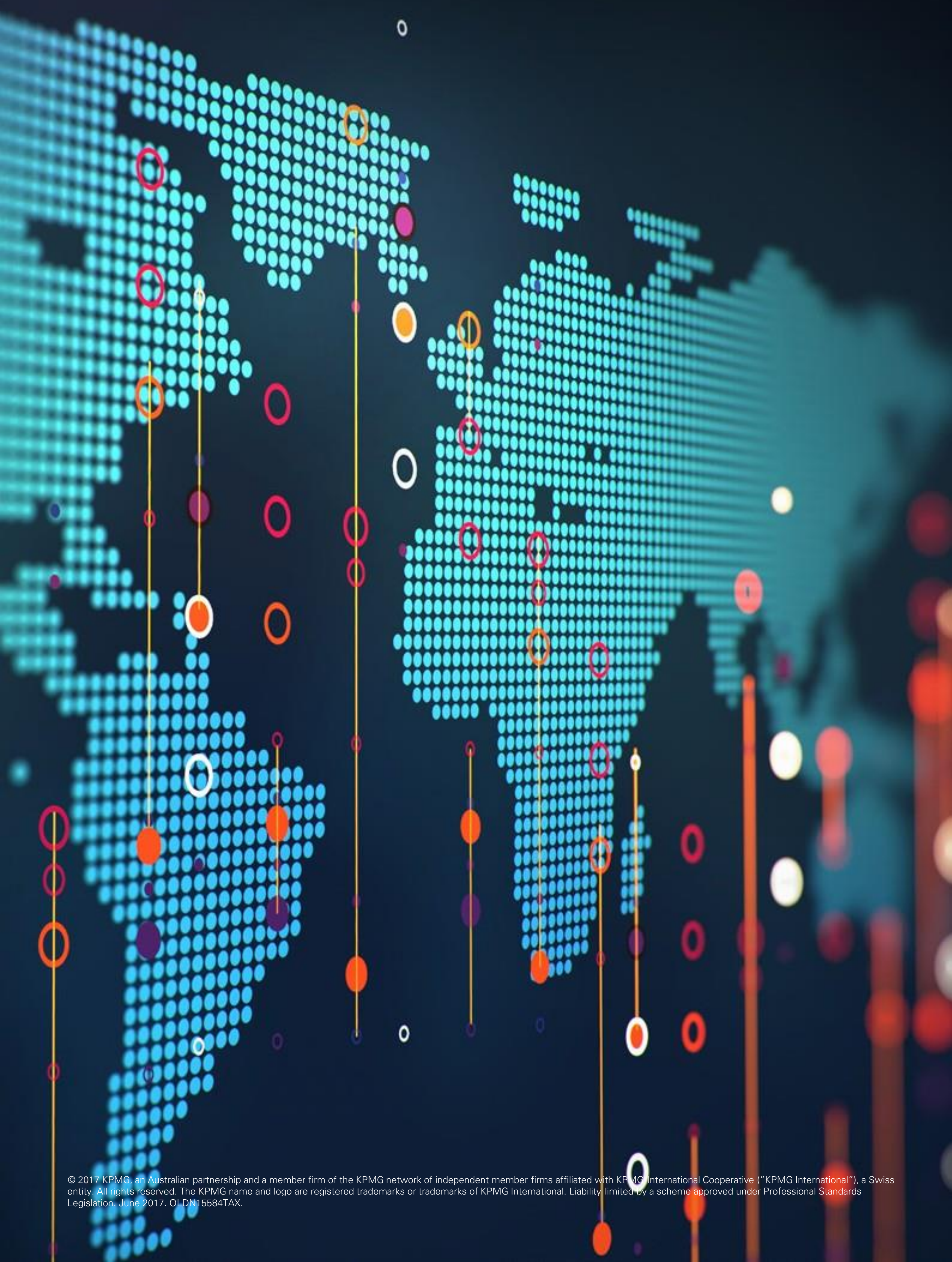
The distinction is significant. The 67 signatories have listed 2,365 treaties. There are however, only 1,103 matches.

Many countries have listed treaties where the counter-party has not signed the MLI. Thus China, India and Australia have all listed the United States as a CTA despite it being well known that the United States has no current intention of signing the MLI. Japan, by contrast, has not listed the United States as a CTA.

Sometimes a treaty is listed by one country and not another. China, for instance, has chosen not to list India as a CTA, although India has listed China. Of the eleven countries signing the MLI in the ASPAC region, Switzerland has listed only India as a CTA although it has treaties with all the others except Fiji.

Of the treaties between the 67 signatories approximately 85 percent are matched.





Asia-Pacific

Eleven countries have signed the MLI in the Asia Pacific. They are generally the larger countries. Six are in the Top 20 economies in terms of GDP: China, Japan, India, Korea, Australia and Indonesia. The remainder are Fiji, Hong Kong, New Zealand, Pakistan and Singapore.

Eleven Asia-Pacific countries chose not to sign the MLI. They are Bangladesh, Cambodia, Laos, Malaysia, Mongolia, Myanmar, Papua New Guinea, Philippines, Sri Lanka, Thailand and Vietnam.

Amongst the eleven Asia-Pacific countries who signed the MLI there are forty-four treaties. Thirty-seven treaties are matched CTAs. This is about 84 percent which is similar to the global average. The seven treaties which are not matched CTAs are China-India, Korea-Australia, Korea-Indonesia, Korea-Singapore, Indonesia-Pakistan, New Zealand-Fiji and Hong Kong-China. This is displayed in Table 2.

Table 2 also outlines the matching of Asia-Pacific countries with ten other selected countries. Generally, with the exception of Germany and Switzerland, where there is a treaty there has been a CTA match. This is not the case with the Indonesia-Ireland, Indonesia-Mexico and Japan-Chile treaties. By way of contrast, the Swiss treaties with all of the Asia-Pacific signatories are not matched CTAs except for the India-Swiss treaty. Germany has selected four CTAs and declined five including the German-India, German-Indonesia, German-Pakistan and German-Singapore treaties. The German-Australian treaty has recently been renegotiated to include BEPS provisions.

Table 2: Intra-ASPAC & Selected Countries – CTA Matches

	Australia	China	Fiji	Hong Kong	India	Indonesia	Japan	Korea	New Zealand	Pakistan	Singapore	France	Germany	Ireland	Luxembourg	Netherlands	Switzerland	United Kingdom	Canada	Chile	Mexico
Australia		CTA Match	CTA Match	No DTA	CTA Match	CTA Match	CTA Match	Treaty but no CTA match	CTA Match	No DTA	CTA Match	CTA Match	Treaty but no CTA match	CTA Match	No DTA	CTA Match	Treaty but no CTA match	CTA Match	CTA Match	CTA Match	CTA Match
China	CTA Match		No DTA	Treaty but no CTA match	Treaty but no CTA match	CTA Match	CTA Match	CTA Match	CTA Match	CTA Match	CTA Match	CTA Match	CTA Match	CTA Match	CTA Match	CTA Match	Treaty but no CTA match	CTA Match	CTA Match	CTA Match	CTA Match
Fiji	CTA Match	No DTA		No DTA	CTA Match	No DTA	CTA Match	No DTA	Treaty but no CTA match	No DTA	CTA Match	No DTA	No DTA	No DTA	No DTA	No DTA	No DTA	CTA Match	No DTA	No DTA	No DTA
Hong Kong	No DTA	Treaty but no CTA match	No DTA		No DTA	CTA Match	CTA Match	CTA Match	CTA Match	CTA Match	No DTA	CTA Match	No DTA	CTA Match	CTA Match	CTA Match	Treaty but no CTA match	CTA Match	CTA Match	No DTA	CTA Match
India	CTA Match	Treaty but no CTA match	CTA Match	No DTA		CTA Match	CTA Match	CTA Match	CTA Match	No DTA	CTA Match	CTA Match	Treaty but no CTA match	CTA Match	CTA Match	CTA Match	CTA Match	CTA Match	CTA Match	No DTA	CTA Match
Indonesia	CTA Match	CTA Match	No DTA	CTA Match	CTA Match		CTA Match	Treaty but no CTA match	CTA Match	Treaty but no CTA match	CTA Match	CTA Match	Treaty but no CTA match	Treaty but no CTA match	CTA Match	CTA Match	Treaty but no CTA match	CTA Match	CTA Match	No DTA	Treaty but no CTA match
Japan	CTA Match	CTA Match	CTA Match	CTA Match	CTA Match	CTA Match		CTA Match	CTA Match	CTA Match	CTA Match	CTA Match	CTA Match	CTA Match	CTA Match	CTA Match	Treaty but no CTA match	CTA Match	CTA Match	Treaty but no CTA match	CTA Match
Korea	Treaty but no CTA match	CTA Match	No DTA	CTA Match	CTA Match	Treaty but no CTA match	CTA Match		CTA Match	CTA Match	Treaty but no CTA match	CTA Match	CTA Match	CTA Match	CTA Match	CTA Match	Treaty but no CTA match	CTA Match	CTA Match	CTA Match	CTA Match
New Zealand	CTA Match	CTA Match	Treaty but no CTA match	CTA Match	CTA Match	CTA Match	CTA Match	CTA Match		No DTA	CTA Match	CTA Match	CTA Match	CTA Match	No DTA	CTA Match	Treaty but no CTA match	CTA Match	CTA Match	CTA Match	CTA Match
Pakistan	No DTA	CTA Match	No DTA	CTA Match	No DTA	Treaty but no CTA match	CTA Match	CTA Match	No DTA		CTA Match	CTA Match	Treaty but no CTA match	CTA Match	No DTA	CTA Match	Treaty but no CTA match	CTA Match	CTA Match	No DTA	No DTA
Singapore	CTA Match	CTA Match	CTA Match	No DTA	CTA Match	CTA Match	CTA Match	Treaty but no CTA match	CTA Match	CTA Match		CTA Match	Treaty but no CTA match	CTA Match	CTA Match	CTA Match	Treaty but no CTA match	CTA Match	CTA Match	CTA Match	CTA Match

CTA Match | Treaty but no CTA match | No DTA

Table 3 shows all the matched CTAs for the Asia Pacific jurisdictions. The eleven countries had 658 treaties in total. Of these, 321 or 49 percent were matched CTAs.

Table 3: ASPAC – Matched CTAs

Country	Australia	China	Fiji	Hong Kong	India
Total matched CTAs	29	48	6	28	47
List of Matched CTAs	Argentina, Belgium, Canada, Chile, China, Czech Republic, Denmark, Fiji, Finland, France, Hungary, India, Indonesia, Ireland, Italy, Japan, Malta, Mexico, Netherlands, New Zealand, Poland, Romania, Russian Federation, Singapore, Slovak Republic, South Africa, Spain, Turkey, United Kingdom	Armenia, Australia, Austria, Belgium, Bulgaria, Canada, Croatia, Cyprus, Czech Republic, Denmark, Egypt, Finland, France, Georgia, Germany, Greece, Hungary, Iceland, Indonesia, Ireland, Israel, Italy, Japan, Korea, Kuwait, Latvia, Lithuania, Luxembourg, Malta, Mexico, Montenegro, Netherlands, New Zealand, Pakistan, Poland, Portugal, Romania, Russia, Serbia, Seychelles, Singapore, Slovakia, Slovenia, South Africa, Spain, Sweden, Turkey, UK	Australia, India, Japan, Korea, Singapore, United Kingdom	Austria, Belgium, Canada, Czech, France, Guernsey, Hungary, Indonesia, Ireland, Italy, Japan, Jersey, Korea, Kuwait, Latvia, Liechtenstein, Luxembourg, Malta, Mexico, Netherlands, New Zealand, Pakistan, Portugal, Romania, Russia, South Africa, Spain, UK	Armenia, Australia, Austria, Belgium, Bulgaria, Canada, Colombia, Croatia, Cyprus, Czech Republic, Denmark, Fiji, Finland, France, Georgia, Greece, Hungary,Iceland, Indonesia, Ireland, Israel, Italy, Japan, Korea, Kuwait, Latvia, Lithuania, Luxembourg, Malta, Mexico, Netherlands, New Zealand, Poland, Portugal, Romania, Russia, Serbia, Singapore, Slovak Republic, Slovenia, South Africa, Spain, Sweden, Switzerland, Turkey, United Kingdom, Uruguay
Total number of DTAs	44	105	11	37	92
Less: Not chosen as a CTAs by home country	1	5	0	1	0
Number of covered agreements selected by home country	43	100	11	36	92
Less: Chosen CTA, but other country did not sign MLI	9	50	4	7	41
Less: MLI signatory, but other country did not choose as CTA	4	1	1	1	3
Less: Norway (seeking direction from Parliament)	1	1	0	0	1
Matched CTAs	29	48	6	28	47
Percentage of treaties matched	66%	46%	55%	76%	51%

	Indonesia	Japan	Korea	New Zealand	Pakistan	Singapore	Total
	22	32	45	27	27	47	**358**
	Australia, Belgium, Canada, China, Croatia, Finland, France, Hong Kong, India, Italy, Japan, Luxembourg, Netherlands, New Zealand, Poland, Seychelles, Singapore, Slovakia, South Africa, South Korea, Turkey, UK	Australia, Bulgaria, Canada, China, Czech Republic, Fiji, Finland, France, Germany, Hong Kong, Hungary, India, Indonesia, Ireland, Israel, Italy, Korea, Kuwait, Luxembourg, Mexico, Netherlands, New Zealand, Pakistan, Poland, Portugal, Romania, Singapore, Slovak Republic South Africa, Sweden, Turkey, United Kingdom	Belgium, Bulgaria, Canada, Chile, China, Columbia, Croatia, Denmark, Egypt, Fiji, Finland, France, Georgia, Germany, Greece, Hong Kong, Hungary, Iceland, India, Indonesia, Ireland, Israel, Italy, Japan, Kuwait, Latvia, Lithuania, Luxembourg, Malta, Mexico, Netherlands, New Zealand, Pakistan, Poland, Portugal, Romania, Russia, Serbia, Slovakia, Slovenia, South Africa, Spain, Sweden, UK, Uruguay	Australia, Belgium, Canada, Chile, Czech Republic, Denmark, Finland, France, Germany, Hong Kong, India, Indonesia, Ireland, Italy, Japan, Mexico, Netherlands, Poland, Russian Federation, Singapore, South Africa, Spain, Sweden, Turkey, United Kingdom, China, Korea	Ireland, Poland, Malta, Canada, Belgium, Netherlands, Italy, Turkey, Sweden, UK, Korea, Denmark, China, Hungary, Singapore, France, Finland, Egypt, South Africa, Kuwait, Romania, Portugal, Austria, Japan, Spain, Serbia, Czech Republic	Australia, Austria, Belgium, Bulgaria, Canada, China, Cyprus, Czech Republic, Denmark, Egypt, Fiji, Finland, France, Georgia, Guernsey, Hungary, India, Indonesia, Ireland, Isle of Man, Israel, Italy, Japan, Jersey, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Mexico, Netherlands, New Zealand, Pakistan, Poland, Portugal, Romania, Russian Federation, San Marino, Seychelles, Slovak Republic, Slovenia, South Africa, Turkey, United Kingdom, Uruguay, Seychelles, Kuwait	
	71	66	91	40	63	82	**702**
	38	31	28	4	0	14	**122**
	33	35	63	36	63	68	**580**
	9	2	15	6	32	17	**192**
	1	0	2	2	3	3	**21**
	1	1	1	1	1	1	**9**
	22	32	45	27	27	47	**358**
	31%	48%	49%	68%	43%	57%	**51%**

Selecting options

The MLI provides potential signatories with significant flexibility to decide which portions of the MLI to adopt, modify, or reject. This is designed to give rise to maximum participation.

Indeed, the MLI provides various choices for both meeting the minimum standards which concern treaty abuse and dispute resolution and for other articles which all countries elect to opt out of completely or partially.

Table 4 provides an outline of each of the options adopted by the eleven Asia-Pacific countries. These are discussed below.

Table 4: ASPAC Country Selections in MLI

Country	Australia	China	Fiji	Hong Kong	India
Preventing treaty abuse					
Adopt new preamble language	Yes, including additional preamble text	Yes, including additional preamble text	Yes, including additional preamble text	Yes, including additional preamble text	Yes
Adopt Principal Purpose Test for Treaty Abuse	Yes	Yes	Yes	Yes	Yes
Adopt Simplified Limitations of Benefits test	No	No	No	No	Yes additional S-LOB Art 7 (17)(c)
Detailed Limitations of Benefits test	No	No	No	No	No
Permanent Establishment rules					
Adopt new dependent permanent establishment rule	No	No	No	No	Yes
Choice on specific activity exemption	Option A, with 13(6)(b) (not for treaties that already explicitly require that each specific activity exemption is 'preparatory or auxiliary')	No	A	No	A
Adopt anti-fragmentation rule	Yes	No	No	No	Yes
Adopt contract-splitting rule	Yes with 14(3)(b) reservation relating to the exploration for or exploitation of natural resources.	No	No	No	Yes
Adopt Mandatory Binding Arbitration	Yes	No	Yes	No	No
Other rules					
Article 3: Transparent Entities	Yes, but France & Japan Art 3(5)(d)	No (Art. 3(5)(a) reservation)	Yes, no reservation	No (Art. 3(5)(a) reservation)	No (Art. 3(5)(a) reservation)
Article 4: Dual Resident Entities	Yes, but Art. 4(3)(e) reservation replace sentence 2 of para 1	Yes, no reservation	Yes, but Art. 4(3)(e) reservation	No (Art. 4(3)(a) reservation)	Yes, no reservation
Article 5: Elimination of Double Taxation	No option – counter-party could choose	No option – counter-party could choose	No option – counter-party could choose	No: Art. 5(8) reservation	No: Art. 5(8) reservation
Article 8: Dividend Transfer Transactions	Yes, no reservation	Yes, no reservation	Yes, no reservation	No: (Art. 8(3)(a) reservation)	Yes, except Portugal with >365 days
Article 9: Capital Gains	Yes, except those covered Art 9(6)(e)	No (Art. 9(6)(b) reservation)	Yes, no reservation	No: (Art. 9(6)(a) reservation)	Yes: Art 9(4) chosen by Article 9(8)
Article 10: PEs in Third Jurisdictions	No (Art. 10(5)(a) reservation)	No (Art. 10(5)(a) reservation)	Yes, no reservation	No (Art. 10(5)(a) reservation)	Yes, no reservation
Article 11: Prevent treaties restricting right to tax its own residents	Yes, no reservation	Yes, no reservation	Yes, no reservation	No (Art. 11(3)(a) reservation)	Yes, no reservation
Article 15: Definition of a person closely related	Yes, no reservation	No (Art. 15(2) reservation)	Yes, no reservation	No (Art. 15(2) reservation)	Yes, no reservation
Art 16: Mutual Agreed Procedures	Yes	Yes, Art 16(5)(a)	Yes	Yes	Yes, Art 16(5)(a)
Art: 17 Corresponding adjustments	Yes	Yes	Yes	Yes (Art 17(3)(a) reservation)	Yes (Art 17(3)(a) reservation)

Indonesia	Japan	Korea	New Zealand	Pakistan	Singapore
Yes	Yes, including additional preamble text; Germany already applies	Yes	Yes, but not additional preamble text (as all 36 considered to contain equivalent language)	Yes, including additional preamble text	Yes, including additional preamble text
Yes	Yes	Yes	Yes	Yes	Yes
Yes additional S-LOB Art 7 (17)(c)	No	No	No	No	No
No	No	No	No	No	No
Yes	Yes	No	Yes	No	No
A	A	No	Option A	No	Option B
Yes	Yes	No	Yes	No	No
Yes	No	No	Yes	No	No
No	Yes	No	Yes	No	Yes
No (Art. 3(5)(a) reservation)	Yes, but Art. 3(5)(f), Art. 3(2) not apply	No (Art. 3(5)(a) reservation)	Yes, no reservation	No (Art. 3(5)(a) reservation)	No (Art. 3(5)(a) reservation)
Yes, Art. 4(3)(c) for TUR & USA & Art 4(3)(e) replace sentence 2 para 1	Yes, but Art. 4(3)(e) reservation replace sentence 2 of para 1	No (Art. 4(3)(a) reservation)	Yes, no reservation	No (Art. 4(3)(a) reservation)	No (Art. 4(3)(a) reservation)
No option – counter-party could choose	No option – counter-party could choose	No: Art. 5(8) reservation	No option – counter-party could choose	No: Art. 5(8) reservation	No: Art. 5(8) reservation
Yes, no reservation	No: (Art. 8(3)(a) reservation)	No: (Art. 8(3)(a) reservation)	Yes, no reservation	No: (Art. 8(3)(a) reservation)	No: (Art. 8(3)(a) reservation)
Yes: Art 9(4) chosen by Article 9(8)	Yes: Art 9(4) chosen by Article 9(8)	No: (Art. 9(6)(a) reservation)	Yes: Art 9(4) chosen by Article 9(8)	No: (Art. 9(6)(a) reservation)	No: (Art. 9(6)(a) reservation)
No (Art. 10(5)(a) reservation)	Yes, no reservation	No (Art. 10(5)(a) reservation)	Yes, no reservation	No (Art. 10(5)(a) reservation)	No (Art. 10(5)(a) reservation)
Yes, no reservation	No (Art. 11(3)(a) reservation)	No (Art. 11(3)(a) reservation)	Yes, no reservation	No (Art. 11(3)(a) reservation)	No (Art. 11(3)(a) reservation)
Yes, no reservation	Yes, no reservation	No (Art. 15(2) reservation)	Yes, no reservation	No (Art. 15(2) reservation)	No (Art. 15(2) reservation)
Yes, Art 16(5)(a)	Yes	Yes	Yes	Yes	Yes, Article 16(5)(a)
Yes (Art 17(3)(b) reservation)	Yes	Yes (Art 17(3)(a) reservation)	Yes	Yes	Yes

Minimum standard to prevent treaty abuse (including PPT and LOB)

The MLI provides options for implementing the minimum standard to combat treaty abuse outlined in the final report for Action 6 of the BEPS Action Plan. The minimum standard requires that countries:

1. include in their tax treaties an express statement that their common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance including through treaty-shopping arrangements; and
2. address treaty shopping by, at a minimum, implementing (i)a Principal Purpose Test (PPT), (ii) a PPT *and* a simplified or detailed limitation on benefits provision (LOB), or (iii) a detailed LOB, supplemented by a domestic law mechanism that would deal with conduit arrangements not already dealt with in the tax treaty.

Article 6 of the MLI offers options for treaty preamble language that would address the first leg of the minimum standard and *Article 7* of the MLI offers options for addressing the second leg of the minimum standard.

Article 6 – Preamble to treaties

With respect to the first leg, signatories to the MLI are only permitted to opt out to the extent a CTA already contains language satisfying the minimum standard. Japan has selected this option in relation to its treaty with Germany. For other Asia Pacific treaties the new wording will apply. This will mean matched CTAs will contain the following wording:

"Intending to eliminate double taxation with respect to taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third party jurisdictions)."

In addition the MLI provides countries with an option to include additional preamble text. This preamble is

"Desiring to further develop their economic relationship and to enhance their co-operation in tax matters."

Australia, China, Fiji, Hong Kong, Japan, Pakistan and Singapore have opted to include this additional text. India, Indonesia and Korea have chosen not to do so. New Zealand has also chosen not to do so on the basis that additional preamble is already covered in their treaties.

Article 7 –Anti-treaty shopping rule

Action 6 provided for three different forms of anti-treaty shopping. The first and default rule is the PPT. It is a general anti-avoidance rule for treaties which applies to deny treaty benefits where obtaining a treaty benefit was one of the principal purposes of the arrangement.

Specifically it states:

"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."

All parties to the MLI have signed up to the PPT. There is, however, an additional optional PPT rule which requires relevant Competent Authorities to consult before rejecting a taxpayer's request for benefits. Australia, Fiji, New Zealand, Pakistan and Singapore have chosen this additional option.

Hong Kong has chosen to exclude its treaties with Belarus and Pakistan from *Article 7* on the basis that those treaties already contain a PPT rule.

The second rule is a *Simplified Limitations of Benefits* article referred to by the acronym S-LOB. This is a supplementary and optional rule which grants treaty benefits only to particular 'qualified persons'. These comprise individuals, government entities, certain listed companies, non-profit organisations, pension funds, entities that are engaged in active businesses or entities that meet specified ownership requirements.

There are twelve countries that have chosen to supplement the PPT with an S-LOB: India and Indonesia in the Asia-Pacific, Argentina, Chile, Columbia, Mexico and Uruguay in Latin America and Armenia, Bulgaria, Russia and the Slovak Republic.

The third rule is a detailed limitation of benefits rule or D-LOB which would need to be separately negotiated outside the MLI.

"Intending to eliminate double taxation with respect to taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third party jurisdictions)."

Changes to the Permanent Establishment Article

Articles 12 to 14 of the MLI deal with Action 7 which concerns when a permanent establishment (PE) is created. This is the dividing line between when a company is considered to be selling to a country and thus not taxable and when it is selling within a country and taxable.

Action 7 is not a minimum standard. Thus, countries are free to opt out or selectively adopt the provisions relating to PEs.

Article 12 – Expansion of the Dependent Agent Standard for creating a PE

Article 12 of the MLI expands the standard for when a dependent agent creates a PE of the principal to include situations in which the dependent agent *"habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise."*

This is wider than most current treaties in three respects. Firstly, it lowers the bar of behavior that will give rise to a PE by a dependent agent. Generally, this bar is currently met if the dependent agent has an authority to conclude contracts on behalf of the non-resident. For those adopting the new standard the dependent agent need only *"habitually play the principal role leading to the conclusion of contracts".*

Secondly, while existing dependent agent PE provisions typically cover only the conclusion of contracts that are 'in the name of' or binding on the principal, *Article 12* also covers contracts for the transfer or use of property of the principal, or for the provision of services by the principal. This will impact many civil law countries, such as France and Germany, where the adoption of this change would cause commissionaires and other dependent agent arrangements to be treated as PEs.

Thirdly, *Article 12* provides that an agent is not independent if that agent works exclusively or almost exclusively on behalf of one or more closely related enterprises.

Article 12 has caused significant concern on the basis that companies may become taxable in a jurisdiction where that was not previously the case. This, it is feared, will lead to greater disputation. The second concern is that the new rules will lead to a proliferation of permanent establishments throughout the world.

In the Asia-Pacific, Australia, China, Hong Kong, Korea, Pakistan and Singapore have chosen not to adopt the new PE definition. By way of contrast, New Zealand, Fiji, India, Indonesia and Japan, have elected to include this provision in their CTAs.

In the EU most have chosen not to adopt the new dependent agent PE article. France, Netherlands and Spain are exceptions. By way of contrast all the Latin American signatories have chosen the new article. Middle Eastern and African signatories are split on the issue.

Article 13 – Changes to the application of the Specific Activity Exemptions

Most treaties currently identify specific activities, such as warehousing or purchasing goods, that may be carried on at a location without creating a PE. BEPS Action 7 raised concerns that these exceptions to the definition of a PE were being used to artificially avoid a PE.

Option A would limit the availability of all specific activity exemptions to circumstances where the activity is of a 'preparatory or auxiliary' character based on an evaluation of the facts and circumstances. A number of Asia-Pacific jurisdictions elected option A including: Australia, New Zealand, Fiji, India, Indonesia, and Japan.

Only one jurisdiction in the Asia-Pacific, Singapore, elected option B. Option B has a lesser impact and, in effect, inserts a requirement that some but not all the specific activity exemptions must be of a preparatory or auxiliary character.

The remaining ASPAC jurisdictions – China, Hong Kong, Korea and Pakistan – opted out of *Article 13* entirely.

Article 13 –Anti-fragmentation rule

Article 13 also provides an anti-fragmentation provision. The provision operates to cause the specific activity exemptions not to apply when an enterprise or a closely related enterprise carries on business activities in one or more places in the same State, and either (1) the place constitutes a PE for one of the related enterprises, or (2) the overall activity resulting from the combination of the activities is not of a preparatory or auxiliary character.

Of those ASPAC jurisdictions that adopted *Article 13*, a majority elected to adopt the anti-fragmentation rule including: Australia, New Zealand, Fiji, India, Indonesia, and Japan. One jurisdiction, Singapore, opted out of this specific provision.

Article 14 – Contract splitting rule

Article 14 of the MLI aims to prevent artificial avoidance of a PE through splitting up contracts. Generally, *Article 14* requires aggregation of time spent (in excess of 30 days in the aggregate) at a building site or construction or installation project by the enterprise and connected activities carried out (during periods that exceed 30 days) by closely related enterprises at the same building site or construction or installation project during different periods of time.

A minority of ASPAC jurisdictions elected to adopt the anti-contract splitting rule including: Australia, New Zealand, Fiji, and Indonesia. Most jurisdictions opted out of this specific provision including: Singapore, China, Hong Kong, India, Japan, Korea and Pakistan.

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Arbitration

Article 18 – Mandatory Binding Arbitration

The Mutual Agreement Procedures in tax treaties generally provide taxpayers with a mechanism to seek assistance from Competent Authorities from the two jurisdictions to resolve a dispute under the treaty. These disputes usually arise when both jurisdictions are seeking to tax the same economic gain. These rules, however, do not require the Competent Authorities to resolve the dispute and sometimes they remain unresolved indefinitely.

The MLI includes optional provisions for mandatory binding arbitration in what is known as Part VI. *Articles 18 to 26* of the MLI provides flexibility for countries to bilaterally agree on the mode of application of the MBA, including the form of arbitration.

The MLI provides for 'final offer' arbitration as the default type of arbitration process. This is also known as 'baseball arbitration' or 'either/or' arbitration. Here the arbitrator can choose either one or the other of the two parties' positions but cannot choose an intermediate position. This form of arbitration is intended to create an incentive of the parties to adopt reasonable positions rather than make 'ambit claims'.

However, countries may make a reservation on the 'final offer' type of arbitration proceedings and apply the 'independent opinion' type of proceedings instead. Five ASPAC jurisdictions opted to include arbitration in their CTAs, including: Australia, New Zealand, Singapore, Fiji, and Japan. Of these, only Japan made a reservation to apply the 'independent opinion' type of proceedings.

Other articles

There are 10 other articles in the MLI which will have a narrower impact.

Article 3 – Transparent entities

This article seeks to deal with double non-taxation or excessive double tax relief where a fiscally transparent vehicle such as a partnership or trust is treated in one manner in one jurisdiction (e.g. transparent) and in another manner in another jurisdiction (e.g. opaque).

Australia has adopted this provision, but not for its treaties with France and Japan which already have similar provisions. Japan has adopted the rule in relation to double non-taxation, but not in relation to double tax relief. Fiji and New Zealand have adopted the rules without reservation.

China, Hong Kong, India, Indonesia, Korea, Pakistan and Singapore have elected not to apply the rules.

Article 4 – Dual resident entities

Where a person is a resident of two jurisdictions under respective domestic laws, treaties generally provide a tie-breaker rule to determine residence. That is commonly the Place of Effective Management. It was perceived that this could be open to abuse and that an expanded set of criteria should apply. *Article 4* seeks to include other factors and provide for Competent Authorities to endeavor to agree on a single jurisdiction as the tax resident. However, there is also a power for the Competent Authority to provide relief from tax as they feel appropriate if they cannot agree on a single jurisdiction.

China, India and New Zealand have agreed to this position. Australia, Fiji, Indonesia and Japan have provided that if the Competent Authorities cannot agree on a single jurisdiction then all relief is denied. Hong Kong, Korea, Pakistan and Singapore have opted not to apply this provision.

Article 5 – Application of methods for elimination of double taxation

This article seeks to address a situation where a treaty provides an exemption method for relieving double taxation, but there is no taxation in the foreign jurisdiction. This article substitutes a tax credit method in circumstances based on one of three options: Option A – income that the treaty allows the other party to exempt or tax at a reduced rate: Option B – dividends that are tax deductible in the other country or Option C – all types of income that the treaty allows the other country to tax.

No Asia-Pacific country has adopted *Article 5*. Australia, China, Fiji, India, Japan and New Zealand will allow a counter-party to make a choice based on any option.

Article 8 – Dividend transfer transactions

Many treaties provided for a concessional tax treatment for dividends paid to non-resident shareholders based on their level of ownership. This rule requires that shares be held for a minimum holding period of 365 days before the reduced tax rate will apply.

Australia, China, Fiji, Indonesia and New Zealand have adopted this rule. So has India but with the exception of its treaty with Portugal which has a longer withholding period in any event. Hong Kong, Japan, Korea, Pakistan and Singapore have rejected this rule.

Article 9 – Capital gains from the alienation of shares in land rich vehicles

This is similar to *Article 8*. *Article 9* will introduce a 365 day period for testing whether a relevant entity is land-rich for the purpose of determining whether a jurisdiction has a right to tax real property gains where there has been an indirect disposal. There are two clauses that could apply.

The main clause simply provides a timing rule. There is an extended clause which provides a reference to the relevant interests that need to be evaluated.

India, Indonesia, Japan and New Zealand have adopted the extended clause. Australia has adopted the main clause, but with the preservation of the wording of existing agreements where such clauses exist. Hong Kong, Korea, Pakistan and Singapore have not adopted this clause.

Article 10 – Anti-abuse rule for Permanent Establishments situated in Third Jurisdictions

Tax treaties often protect a taxpayer from being taxed in another jurisdiction where they are resident in another jurisdiction. A resident of a treaty jurisdiction may, however, establish a branch in a third jurisdiction. Their home jurisdiction may provide for an exemption from taxation for the branch income located in the third jurisdiction. This may result in low or no taxation.

Article 10 seeks to deal with this by allowing a domestic rate of tax, rather than a treaty concessional rate of tax where profits of the branch are exempt in the other tax jurisdiction and taxed below 60 percent of the tax that would have been payable if the income was not exempt but taxed in the other jurisdiction.

Of the ASPAC Countries, Australia, China, Hong Kong, Indonesia, Korea, Pakistan and Singapore have chosen not to apply the provision. Fiji, India, Japan and New Zealand have accepted *Article 10*.

Article 11 – Preventing treaties restricting rights for a country to tax its own residents

Generally treaties are used to restrict a country's right to tax non-residents. It has been argued that treaties can be used to restrict a country's right to tax its own residents. This article seeks to ensure that this is not the case except in certain specific circumstances which are outlined in the article. An example of an exception is where a treaty has a provision that restricts a country's ability to tax one of its own resident individuals if that individual derives personal services income in another country. Some treaties restrict taxation for their own residents where the person is a teacher, professor or student who meets specific conditions outlined in the treaty.

Australia, China, Fiji, India, Indonesia and New Zealand have accepted this provision. Hong Kong, Japan, Korea, Pakistan and Singapore have rejected it.

Article 15 – Definition of person closely related for the purposes of Articles 12, 13 and 14

This is a minor definitional clause which is designed to apply where changes have been made to the Permanent Establishment article. Broadly it is a control or 50 percent direct or indirect beneficial ownership test.

The countries in the Asia-Pacific who have adopted one or more of Articles *12, 13 or 14* have also agreed to *Article 15*. They are Australia, Fiji, India, Indonesia, Japan and New Zealand. The remaining countries – China, Hong Kong, Korea, Pakistan and Singapore – have rejected all of the Permanent Establishment changes and thus have also rejected *Article 15*.

Article 16 – Mutual Agreement Procedures

Mutual Agreement Procedures or MAPs are designed to provide taxpayers with a mechanism for resolution of tax disputes under a treaty. *Article 16* seeks to improve the efficiency of these rules by allowing taxpayers to present a case to either Competent Authority of either treaty jurisdiction, requiring taxpayers with a 3 year time limit to request MAP assistance, and requiring the respective Competent Authorities to endeavor to resolve the case by mutual agreement and any difficulties arising from the interpretation of the treaty.

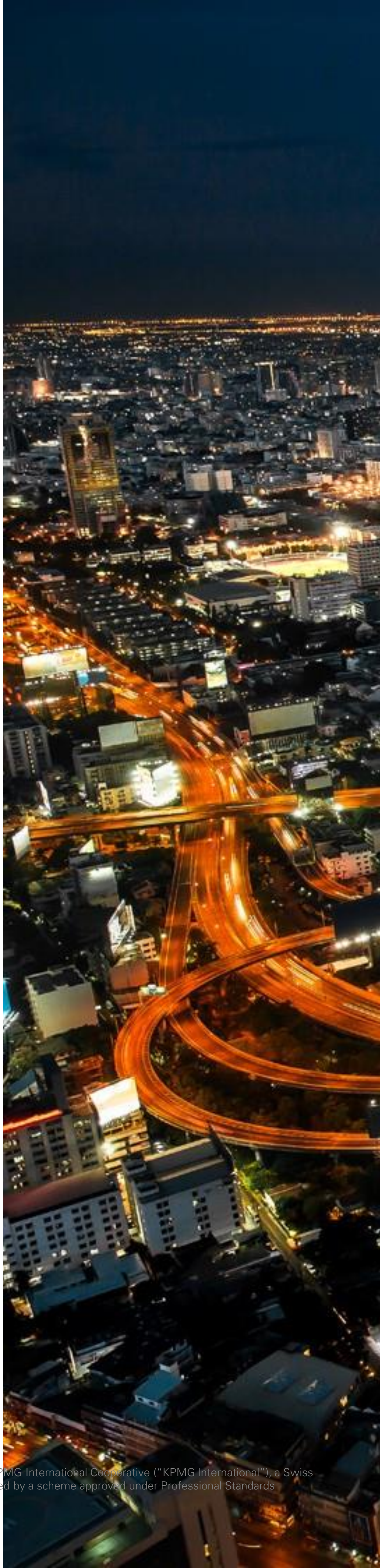
Countries can adopt the article but reserve in relation to each of the three components. All the Asia-Pacific signatories have adopted the MAP procedures, except that China, India, Indonesia and Singapore have not agreed that a taxpayer can seek resolution of the dispute from either Competent Authority.

Article 17 – Corresponding adjustments

Adjustments arising from disputes in one jurisdiction, particularly involving transfer pricing, can lead to double taxation unless a corresponding adjustment is made in another jurisdiction. This Article requires a tax authority to make a downward adjustment in one jurisdiction where an upward adjustment has been made in the other treaty jurisdiction which reflects the true allocation of profits in accordance with arm's length principles.

Apart from Indonesia, which has made a reservation to the effect that all corresponding adjustments must be dealt with under the MAP procedures, the Asia-Pacific Countries have accepted this rule. Hong Kong, India and Korea have made a reservation to preserve the existing corresponding adjustment rules in their treaties where they exist.

Future process and effective dates

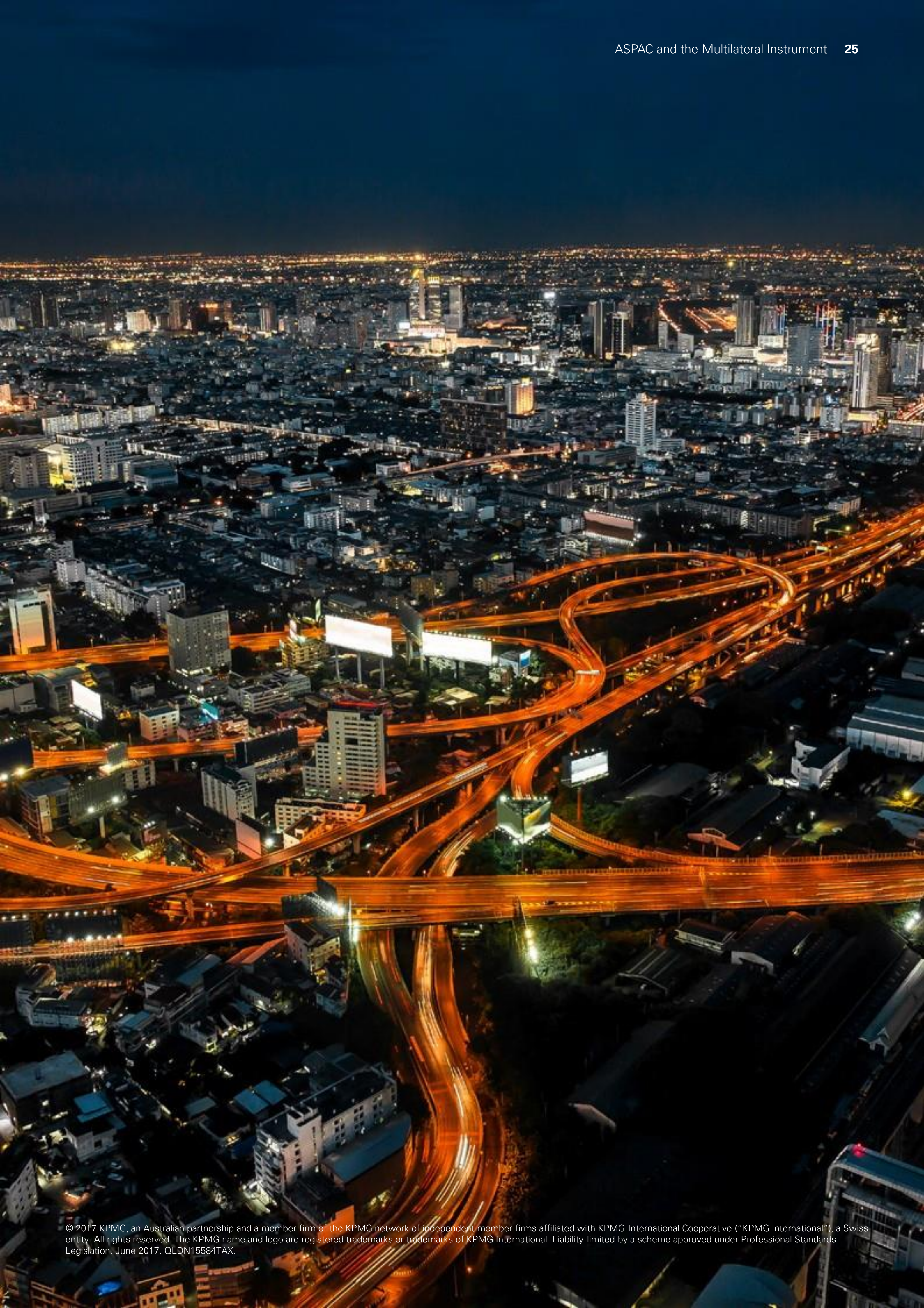


The MLI is subject to a ratification process which will vary from country to country. Each country must deposit a notice with the OECD once that local ratification procedure has taken place.

Technically, the MLI will not enter into force until three months after at least five jurisdictions have deposited such ratification notices. It is expected that this will occur this calendar year.

Thereafter, the MLI generally enters into force with respect to a jurisdiction on the first day of the month following a period of three months after it deposits its ratification notice with the OECD.

Then the MLI enters into effect with respect to a particular treaty depending on the nature of the tax concerned. For withholding taxes, the new treaty rules would apply from the first day of the calendar year that begins after the latest of the dates on which the MLI enters into force for each of the parties. For all other taxes, the new treaty rules would apply for taxable periods beginning after the expiration of a period of six months from the latest of the dates on which the MLI enters into force for each of the parties.



What is to be done?

Changes to treaties brought about by the MLI requires a revaluation of multinational supply chains and the use of regional holding companies, particularly in light of the new PPT. In the Asia-Pacific use of holding companies in Singapore and Hong Kong in particular will need to be considered in the context of the substance and commercial purpose of the particular structure.

For many this will require an evaluation both up and down the chain of companies within a structure. It may also impact all forms of profits and capital gains and not simply dividend, interest and royalty flows. The need for evaluation extends beyond multinationals to collective investment vehicles, pension funds and sovereign wealth funds.

In short, Chief Financial Officers and Chief Tax Officers will need to do the following:

1. identify any structures which rely on treaty outcomes which rely on the interposition of one or more holding companies
2. identify the treaties involved and how they may be impacted by the MLI
3. identify the treaty benefits that could be subject to change
4. consider whether reorganization is required based on the PPT or other provisions such as the PE article changes or the third party branch rules
5. if a restructure is required, propose a solution that would meet the new standards and document why the new structure would meet those standards
6. if a restructure is not required, document the commercial purposes and analysis of the substance of the arrangement to defend any potential future review by taxation authorities
7. consider whether it would be appropriate to obtain 'sign-off' from various revenue authorities to provide certainty in relation to the arrangements; and
8. consider whether revenue authority 'sign-off' should also be undertaken in the context of other rule changes or potential issues including transfer pricing analysis, Diverted Profits Tax (Australia & the UK) and other anti-avoidance provisions if potentially applicable.

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