TaxNewsFlash

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KPMG analysis: Multilateral instrument implementing the treaty-related BEPS provisions

The Organisation for Economic Cooperation and Development (OECD) on 7 June 2017 hosted a signing ceremony for the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (BEPS) under BEPS Action 15 (the Multilateral Instrument or MLI). The ceremony was widely attended by ministers and dignitaries representing members of the OECD BEPS inclusive framework. During the 7 June ceremony held in Paris, 67 countries, covering 68 total jurisdictions, signed the MLI and an additional eight countries expressed a commitment to sign at a future date. Based on the current signatories, and subject to ratification, the MLI will result in changes to over 1,100 treaties. The OECD announced at the signing ceremony that an additional 20 to 25 jurisdictions are expected to sign the MLI later in the year.

Background

The MLI was developed to provide a vehicle for the swift implementation of the tax treaty-related measures produced under Actions 2 (hybrid mismatches), 6 (treaty abuse), 7 (permanent establishments), and 14 (mutual agreement procedures) of the BEPS project. To maximize participation, the MLI provides potential signatories with significant flexibility to decide which portions of the MLI to adopt, modify, or reject. Specifically, the MLI grants jurisdictions:

- Choice with respect to which tax treaties the MLI modifies (referred to as Covered Tax Agreements or CTAs)

- Alternative ways to meet the minimum standards under Actions 6 (treaty abuse) and 14 (mutual agreement procedures) agreed as part of the BEPS project

- Ability to opt out completely or partially of certain provisions with respect to all or with respect to certain CTAs, and

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- Ability to apply optional or alternative provisions

Read **text of the MLI** [PDF 276 KB]

Information provided upon signing

In connection with the signing, each signatory has deposited a document with the OECD (MLI Position) that lists their CTAs as well as their preliminary positions and reservations with respect to each provision of the MLI. Read a **list of signatories** [PDF 127 KB], with links to each of their MLI Positions.

Each signatory will finalize its positions on the MLI after the normal ratification process in each jurisdiction is completed (subject to any modification that may occur during that process).

Note that some countries previously indicated that they intended to include only a small number of treaties as CTAs at signature, but will add treaties to their list of CTAs as they complete bilaterally agreed implementation with respect to those treaties. In addition, some countries previously indicated they intended to take a conservative approach at signature, but were considering a more expansive approach at ratification, so important changes to the provisions ultimately adopted by particular countries may occur during ratification. Nonetheless, in the MLI Positions already filed with the OECD, the signatories have already covered 85% of the treaties that they have concluded among themselves.

In a **press release**, the OECD Secretariat indicated its intent to develop tools to allow taxpayers to reconcile changes and options agreed between jurisdictions. The OECD also recently provided the following helpful documents on its website:

- **Information brochure** [PDF 1.46 MB]

- **List of "frequently asked questions" (FAQs)** [PDF 1.95 KB]

- **MLI application toolkit**

Noteworthy outcomes

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

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2. Address treaty shopping by, at a minimum, implementing (i) a Principal purpose test (PPT) alone, (ii) a PPT **and** a simplified or detailed limitation on benefits provision (LOB), or (iii) a detailed LOB, supplemented by a mechanism (treaty-based or otherwise) that would deal with conduit arrangements not already dealt with in the tax treaty.

Article 6 of the MLI provides 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.

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. With respect to the second leg, option 1—the PPT alone—is the default unless the signatory elects one of the other options. Signatories may elect to opt out of the PPT with respect to CTAs that already contain a PPT, or across the board if they elect to satisfy the minimum standard by adopting a detailed LOB (to be negotiated) and domestic anti-conduit rules.

A preliminary review reveals that all countries opted for the PPT to address treaty abuse either by accepting the default rule, or opting out on the basis of an existing PPT. Just 12 countries, many from Latin America—including Argentina, Chile, Colombia, Mexico, and Uruguay—but also India and Indonesia, opted for both the PPT and the simplified LOB outlined in Article 7 of the MLI. In addition, three other countries agreed to permit application of the simplified LOB where the other country also signed up for it, and seven countries indicated that they would pursue bilateral negotiation of a detailed LOB.

Changes to the permanent establishment article

Articles 12 to 14 of the MLI incorporate the provisions implementing the recommendations outlined in the final report for Action 7 (Artificial Avoidance of PEs) of the BEPS project. Action 7 is not a minimum standard. Accordingly, signatories to the MLI are free to opt out or selectively adopt the provisions relating to PEs in Articles 12 to 14 of the MLI.

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." 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. Adoption of this change would create PEs for principals that distribute products and services through commissionaires and other dependent agent arrangements. In addition, 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. It was not clear how

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many jurisdictions would agree to this expansion of the definition of the dependent agent PE standards.

Notably, the UK previously announced its intent to opt out of this provision. A number of jurisdictions joined the UK in opting out of this provision including Australia, Belgium, Canada, China, Germany, Hong Kong, Ireland, Italy, Korea, Luxembourg, Singapore, South Africa and Switzerland. Indeed, less than half of all signatories elected to include this provision in their CTAs.

Nonetheless, several jurisdictions, including again several in Latin America such as Argentina, Chile, Colombia, Costa Rica, Mexico, and Uruguay, but also France, India, Indonesia, Japan, the Netherlands, New Zealand and Spain, elected to include this provision.

Changes to the application of the specific activity exemptions. The current OECD model treaty specifically identifies certain activities that may be carried on at a location without creating a PE. To address concerns about the use of these exemptions to "artificially" avoid a PE, pursuant to the recommendations in the Final Report on Action 7, Article 13 of the MLI provides several options for modifications to the availability of these exemptions. Option A would limit the availability of the specific activity exemption to circumstances where the activity is of a "preparatory or auxiliary" character. In other words, this modification would condition the availability of the specific activity exemptions on a subjective analysis based on all the facts and circumstances. Around one-third of the signatories elected option A including Argentina, Australia, Austria, Germany, India, Indonesia, Italy, Japan, Mexico, the Netherlands, New Zealand, South Africa and Spain.

Option B, which was included as an alternative to Option A for countries that preferred to ensure greater certainty about the application of the specific activity exceptions, would make explicit that the specific activity exceptions are per se exceptions and are not subject to an overall condition of "preparatory or auxiliary" character. A number of jurisdictions elected option B, including Belgium, France, Ireland, Luxembourg and Singapore.

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) one or more such places constitute a PE for one of the related enterprises, or (2) the overall activity resulting from the combination of the activities in such places is not of a preparatory or auxiliary character. A majority of signatories elected to apply the anti-fragmentation rule to their CTAs. Of the jurisdictions listed in the previous two paragraphs, a few opted out of the anti-fragmentation rule, including Germany, Luxembourg and Singapore. In addition, some jurisdictions opted out of the specific activity exemption rule changes altogether, including Canada, China, Hong Kong, Korea, and Switzerland. Article 14 of the MLI aims to prevent artificial avoidance of a PE through splitting up contracts.

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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. Many jurisdictions opted out of the rule relating to splitting up contracts, but some elected to adopt the rule (although some only with respect to activities other than natural resource exploration and exploitation), including Argentina, Australia, France, India, Indonesia, Ireland, the Netherlands, and New Zealand.

Arbitration

The MLI includes optional provisions for mandatory binding arbitration (MBA). Articles 18 to 26 of the MLI provide 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 (also known as "baseball arbitration") as the default type of arbitration process. However, countries may make a reservation on the "final offer" type of arbitration proceedings and opt for the "independent opinion" process instead.

Twenty-five of the 7 June signatories signed up for the arbitration provisions in the MLI: 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. This will lead to the introduction of arbitration to over 150 existing treaties. Most of the countries opting in for arbitration have opted for the default option of final offer arbitration. Note that while arbitration was fairly widely adopted, the carve-outs are in many cases quite broad and not always very clearly drafted, with the result that it's not clear how many disputes will be in scope.

Additional information

Reports prepared by KPMG member firms across the globe provide additional information about the options, reservations and CTAs selected by the various signatories to the MLI. Read ***TaxNewsFlash-BEPS***

Future process and effective dates

The MLI will be subject to each jurisdiction's treaty procedures for ratification, acceptance, or approval (collectively, ratification).

Pursuant to its terms, the MLI will not enter into force until three months after at least five jurisdictions have deposited instruments of ratification with the OECD. 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 instrument of ratification with the OECD.

The MLI enters into effect with respect to a particular CTA as follows:

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- With respect to withholding taxes—on or after the first day of the next calendar year that begins on or after the latest of the dates on which the MLI enters into force for each of the parties to the CTA

- With respect to all other taxes—for tax periods beginning on or after the expiration of a period of six calendar months (or a shorter period, if all parties to the CTA notify the OECD depositary that they intend to apply such shorter period) from the latest of the dates on which the MLI enters into force for each of the parties to the CTA

KPMG observation

Taxpayers will need to pay close attention to the choices of options and opt-outs that each country made under the MLI, evaluate how and when the MLI will have an impact on their operations, and develop plans to address that impact.

Tax professionals believe the universal adoption of a PPT will have a significant, if yet indeterminate, impact on the interpretation and application of treaties. Moreover, while the PE changes were not universally adopted, those changes will have significant impacts on taxpayers where they apply. In addition, although a significant number of countries have initially chosen only to adopt the minimum standards under Actions 6 (treaty abuse) and 14 (mutual agreement procedures), it is not yet clear whether that will be their final position, and it will be important to monitor that, as positions can change any time until ratification.

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