International

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# OECD Multilateral Convention to Prevent BEPS: Implementation Guide and Initial Thoughts

**The final version of the OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) was published at the end of November 2016, and the signing ceremony took place in Paris on 7 June 2017, during which 67 countries covering 68 jurisdictions signed the instrument. Cameroon and Mauritius joined the initial signatories on early July 2017.**

**In this article, the authors provide a general description of the MLI, discuss the step plan to analyse whether a given tax treaty provision will be impacted by the instrument and offer some personal concluding remarks.**

## 1. Introduction

The Base Erosion and Profit Shifting (BEPS) Action Plan, which contained 15 actions to address BEPS issues in a coordinated and comprehensive manner, was developed by the OECD Committee on Fiscal Affairs (OECD CFA) and endorsed by the G20 leaders in September 2013.

Following to several years of work, the final OECD/G20 BEPS package consisting of a series of Final Reports on each of the 15 actions accompanied by an Explanatory Statement was published in October 2015 and endorsed by the OECD Council and the G20 leaders in November 2015.[1] It contains different types of measures which can be classified as follows:

(1) Recommendations for domestic law, taking the form of best practices and model domestic rules which relate notably to rules targeting hybrid mismatches developed under Action 2 of the BEPS Project ("Neutralising the Effects of Hybrid Mismatch Arrangements"), standards related to transfer pricing documentation including country-by-country reporting developed under Action 13 ("Guidance on Transfer Pricing Documentation and Country-by-Country Reporting"), rules targeting controlled foreign companies developed under Action 3 ("Designing Effective Controlled Foreign Company Rules"), and rules limiting interest deductibility developed under Action 4 ("Limiting Base Erosion Involving Interest Deductions and Other Financial Payments").

(2) Changes to the 2010 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines) developed under Actions 8 to 10 of the BEPS Project ("Aligning Transfer Pricing Outcomes with Value Creation") and under Action 13 ("Guidance on Transfer Pricing Documentation and Country-by-Country Reporting").

(3) Measures that modify the OECD Model Convention (OECD Model) and that are intended to be included in bilateral tax treaties, such as those developed under Action 2 of the BEPS Project ("Neutralising the Effects of Hybrid Mismatch Arrangements"), under Action 6 ("Preventing the Granting of Treaty Benefits in Inappropriate Circumstances"), under Action 7 ("Preventing the Artificial Avoidance of PE Status") and under Action 14 ("Making Dispute Resolution Mechanisms More Effective").

(4) Analytical reports with no specific recommendations, such as Action 1 of the BEPS Project ("Addressing the Tax Challenges of the Digital Economy") and Action 11 of the BEPS Project ("Measuring and Monitoring BEPS").

The publication and endorsement of the final OECD/G20 BEPS package were regarded as a great success given the time frame in which the package was elaborated. However, the OECD's ambition will only be achieved if these measures are widely and swiftly implemented in domestic and treaty laws.

In practice, several jurisdictions are already implementing BEPS recommendations in their domestic law. Notably, the country-by-country reporting obligations have been implemented in over 50 countries.[2] The new approach to transfer pricing documentation (containing a Master File, Local File and a country-by-country report) has been incorporated in numerous jurisdictions, including OECD members like the Netherlands, Australia, South Korea and Spain, as well as non-OECD members like China.[3] Also, the European Union has adopted several directives which contain BEPS recommendations, such as the exchange of tax rulings among Member States,[4] and the

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1. The final OECD/G20 BEPS package is available at: http://www.oecd.org/ctp/beps-2015-final-reports.htm.

2. For details, *see* http://www.oecd.org/tagx/automatic-exchange/country-specific-information-on-country-by-country-reporting-implementation.htm.

3. China decided, however, to go beyond the OECD standards on several items, notably with the inclusion of a value chain analysis as part of the local file requirements – *see* Bull. 42 published in July 2016.

4. Council Directive (EU) 2015/2376 of 8 December 2015 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, EU Law IBFD.

limitation of deductibility of excessive borrowing costs.[5] It is worth noting that several EU instruments contain direct references to the OECD/G20 BEPS works.

As regards transfer pricing, on 23 May 2016, the OECD Council approved amendments to the OECD Guidelines, as set out in the 2015 BEPS Final Report on Actions 8 to 10 ("Aligning Transfer Pricing Outcomes with Value Creation") and the 2015 BEPS Final Report on Action 13 ("Transfer Pricing Documentation and Country-by-Country Reporting"). The OECD released on 10 July 2017 the 2017 edition of the OECD Guidelines including the revisions agreed as part of the BEPS project.[6]

As for the proposed tax treaty-related measures, their implementation could have required each jurisdiction to renegotiate all its existing bilateral tax treaties with its treaty partners. The number of existing bilateral treaties, estimated at over 3,000, would clearly make bilateral updates uncertain, burdensome and time-consuming, hence limiting the effective implementation of the tax treaty-related measures resulting from the final OECD/G20 BEPS package.

The OECD considered the possible multilateralism of the OECD Model when preparing its 1963 Draft Convention and 1977 Model Tax Convention. In 1991, R.J. Vann brought up the multilateral treaty as an alternative to the bilateral tax treaty network before concluding that "as the diversity of tax systems that is the cause of bilateralism has not been directly addressed by the OECD Model, it is not possible for the bilateral network simply to evolve into a multilateral treaty".[7] In the 2014 Model, the OECD CFA stated that "there [were] no reasons to believe that the conclusion of a multilateral tax convention involving all member countries could now be considered practicable".[8]

In the recent past, given the necessity to find an effective way to implement the tax treaty-related BEPS measures, the OECD revived the multilateral approach. In less than four years, thriving on a favourable political environment, a multilateral instrument was proposed, developed and agreed upon. The multilateral instrument is not a comprehensive multilateral tax convention and therefore differs from the multilateral treaty that was considered in earlier OECD works. Rather, it is a multilateral vehicle impacting existing bilateral tax treaties. The following describes the evolution of the instrument from the genesis of the multilateral approach to the conclusion of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI):

(1) Action 15 of the BEPS Action Plan called for the analysis of "the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties" (September 2013).

(2) The Action 15 interim report "Developing a Multilateral Instrument to Modify Bilateral Tax Treaties" approved by the OECD CFA in June 2014 and released in September 2014 (the "2014 Report") identified the issues arising from the development of such an instrument and provided an analysis of the international tax, public international law, and the political issues arising from such an approach. It finally concluded that a multilateral instrument is desirable and feasible, and that negotiations for such an instrument should be convened quickly.

(3) The Final Report on Action 15 reproduced the 2014 Report and developed a mandate to set up an ad hoc group responsible for developing the multilateral instrument. Such mandate was endorsed by the G20 finance ministers and Central Bank governors at their February 2015 meeting in Istanbul.[9] The mandate provided that the ad hoc group should develop a multilateral instrument to modify existing bilateral tax treaties in order to swiftly implement the tax treaty measures developed in the course of the OECD/G20 BEPS Project. It also provided that the ad hoc group should conclude its work and open the multilateral instrument for signature by 31 December 2016.

(4) The ad hoc group, made up of 99 countries,[10] was set up and met six times over the course of the negotiations. A subgroup dedicated to incorporating provisions related to mandatory binding arbitration of mutual agreement procedure cases was also set up (the "Arbitration subgroup"). It was composed of 27 countries and met five times over the course of the negotiations.

(5) On 24 November 2016, the ad hoc group and the Arbitration subgroup presented the MLI, along with an explanatory statement which aims at providing clarification of the approach taken in the MLI ("Explanatory Statement").

(6) On 7 June 2017, 67 countries covering 68 jurisdictions signed the MLI in Paris.[11] Angel Gurria, OECD Secretary General, declared at the signing ceremony: "The conclusion of this multilateral instrument marks a new turning point in tax treaty history. We are moving towards rapid implementation of the far reaching reforms agreed under the BEPS project in more than 1,100 tax treaties worldwide. In addition

5. Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, EU Law IBFD.
6. *See* press release at http://www.oecd.org/tax/transfer-pricing/oecd-releases-latest-updates-to-the-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations.htm.
7. R.J. Vann, *A Model Tax Treaty For the Asia-Pacific Region?*, Part I and II, 45 Bull. Intl. Fiscal Doc. 3, at 99-111,4, at 151-163 (1991).
8. *See OECD Model Tax Convention on Income and on Capital*, Introduction (26 July 2014), Models IBFD.
9. G20, Communiqué, G20 Finance Ministers and Central Bank Governors Meeting, 9-10 Feb. 2015, Istanbul, available at http://www.mofa.go.jp/mofaj/files/000111127.pdf.
10. Four jurisdictions and seven international organizations were also present as observers.
11. The list of signatories, as of 17 June 2017, is available at http://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf.

 

to saving the signatories from the burden of bilaterally renegotiating these treaties, the Convention will result in more certainty and predictability for business, and a better functioning international tax system for the benefit of our citizens". This is the first wave of signatures and other countries are free to join at a later stage. Some jurisdictions[12] have already expressed their intention to sign the MLI.

(7) On 5 July 2017 and 11 July 2017, Mauritius and Cameroon respectively signed the MLI. [13]

In this article the authors provide a general description of the MLI (section 2.), discuss the practical step plan to analyse whether a given tax treaty provision will be impacted by the instrument (section 3.) and offer some personal concluding remarks (section 4.).

## 2. Presentation of the MLI: General Structure and Overview of the Content

The MLI consists of a preamble and seven parts that contain 39 articles:

- Part I (articles 1 to 2) provides guidance on the scope and interpretation of the terms.
- Parts II to VI (articles 3 to 26) deal with the modifications to be made to the covered tax treaties. Parts II to V cover tax treaty-related measures agreed upon as part of the Final BEPS Package. Part VI reflects the result of the work of the Arbitration subgroup to develop provisions for mandatory binding arbitration.
- Part VII (articles 27 to 39) contains the final provision of the instrument which notably lays out the implementation process, describes the signature and ratification procedure, lists the provisions that may be subject to reservation, and affirms the entry into force and into effect of the provisions of the MLI.

Some of the provisions constitute the minimum standard to which all countries and jurisdictions within the Inclusive Framework[14] have committed, while other provisions do not.

### 2.1. Minimum standard provisions

Actions 6 and 14 include minimum standard tax treaty-related measures which have been incorporated as such in the MLI in Parts III and V, and from which the signatories may opt out only in limited circumstances.

The Final Report on Action 6 "Preventing the Granting of Treaty Benefits in Inappropriate Circumstances" includes two minimum standards on preventing treaty abuse. They are included into the following MLI articles:

- Article 6(1) requires countries to 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.
- Article 7 requires the incorporation of a mechanism preventing treaty abuse satisfying the minimum standard with the implementation of either a principal purpose test (possibly completed with a simplified limitation-on-benefits (LOB) provision) or a detailed limitation-on-benefits provision supplemented by a mechanism that deals with conduit arrangements not already dealt with in tax treaties concerned.

The Final Report on Action 14 "Making Dispute Resolution Mechanisms More Effective" also contains a minimum standard which is included in article 16 of the MLI and requires signatories to include a mutual agreement procedure in their Covered Tax Agreements.

### 2.2. Non-minimum standard provisions

Other provisions contained in Parts II to VI do not constitute minimum standards. This means that signatories have more flexibility in their implementation, as they may discretionarily opt out of these provisions (i.e. not apply a provision if a reservation made) or opt into these provisions (i.e. apply a provision only if elected for it), following a mechanism as described in section 3.3. of this article.

These provisions are as follows:

- Articles 3 to 5 of Part II deal with hybrid mismatches resulting from the Final Report on Action 2.
- Articles 8 to 11 of Part III provide measures related to the prevention of treaty abuse which were not characterized as a minimum standard in the Final Report on Action 6.
- Articles 12 to 15 of Part IV deal with permanent establishment measures resulting from the Final Report on Action 7, which seeks to amend existing tax treaties to counter the artificial avoidance of permanent establishment status through: commissionaire arrangements and similar strategies (article 12 of the MLI), specific activity exemptions (article 13 of the MLI), and splitting-up of contracts (article 14 of the MLI). Article 15 provides a definition of the new notion of "Person Closely Related to an Enterprise".
- Article 17 of Part V provides a mechanism for signatories to implement a corresponding adjustments mechanism in the mutual agreement procedure article of their Covered Tax Agreements.
- Articles 18 to 26 of Part VI provide for mandatory binding arbitration of mutual agreement procedure cases in which the competent authorities are unable to reach agreement within a fixed period of time. This development was announced in the Final Report on Action 14 which, however, did not contain any lan-

12. Côte d'Ivoire, Estonia, Jamaica, Lebanon, Nigeria, Panama and Tunisia.
13. The press release related to the signature of the MLI by Mauritius is available at http://mof.govmu.org/English/DOCUMENTS/COMMUNIQUE%20-MULTILATERAL%20CONVENTION%2005%2007%202017%20REVISED.PDF.
14. Information related to the Inclusive Framework is available at http://www.oecd.org/tax/beps/beps-about.htm.

guage. The relevant articles were developed by the Arbitration subgroup.

## 3. Practical Approach to the MLI: How to Assess Whether a Provision in an Existing Bilateral Treaty Is Impacted by the MLI?

The OECD offers a five-step approach to taxpayers, tax authorities and tax courts to assess whether a given provision in a given existing tax treaty may be impacted by the MLI.[15] Once it is determined that a given tax treaty provision is impacted by the MLI, a further step will consist of interpreting the so impacted provision.

### 3.1. Has the MLI entered into force?

The entry into force of MLI should be considered at (1) the level of the MLI itself and (2) the level of the parties to a given tax treaty.

(1) Article 34 of the MLI states that the MLI's provisions will enter into force only upon the ratification under domestic law of the MLI by at least five signatories. Once the fifth signatory has ratified the MLI and deposited its instrument of ratification with the OECD, the MLI will enter into force on the first day of the month following the expiry of three calendar months beginning on the date of depositing the ratification (i.e. if the fifth signatory deposits its instrument of ratification of the MLI on 15 February 2018, the MLI will enter into force as from 1 June 2018).

(2) The entry into force of the MLI for a given tax treaty (assuming it is a Covered Tax Agreement as explained hereafter) is subject to the signing of the MLI by both contracting countries to this tax treaty. There are therefore two situations:

- If both parties to a tax treaty sign the MLI, and the MLI is itself already in force (as explained in (1)), it shall enter into force with respect to a particular signatory on the first day of the month following the expiry of three calendar months beginning on the date such signatory deposits its instrument of ratification, acceptance or approval.
- If one or both parties have not signed the MLI, the latter will not enter into force and will not affect the provisions of a given tax treaty. For instance, out of the G20 members, Brazil, Saudi Arabia and the United States did not sign the MLI.

### 3.2. Is a given tax treaty a Covered Tax Agreement within the meaning of the MLI?

Signing countries have flexibility as regards the tax treaties they wish to modify with the MLI. Articles 1 and 2 of the MLI state that the instrument shall modify only the "Covered Tax Agreements", meaning those in force between two signatories[16] and listed by both as a treaty they wish to be covered by the MLI.

Thus, the MLI will only modify a tax treaty if it has been specifically identified by both parties in a notification to the OECD.

For a given bilateral tax treaty in force, there are therefore three situations:

(1) Both contracting countries have signed the MLI and listed the bilateral tax treaty as a Covered Tax Agreement. Consequently, the tax treaty may be modified by the provisions of the MLI subject to the mechanisms described hereafter in section 3.3. of this article.

(2) Both contracting countries have signed the MLI, but only one has listed the tax treaty as a Covered Tax Agreement. Consequently, the tax treaty will not be modified by the provisions of the MLI.

For instance, while France listed the France-Switzerland tax treaty as a Covered Tax Agreement, the latter will not be impacted by the MLI since Switzerland did not list it.

Based on the number of signatories, 2,365 tax treaties could be expected to be amended by the MLI. However, the number of matching tax treaties reached only 1,105. This difference is explained by the fact that some treaty partners decided to leave a given tax treaty out of the MLI's reach, or by the fact that some treaty partners decided to include tax treaties concluded with countries which have not yet signed the MLI.

(3) Both contracting countries have signed the MLI and neither of them has listed it as a Covered Tax Agreement. Consequently, such a tax treaty will not be modified by the provisions of the MLI.

### 3.3. Identifying which MLI provisions may apply to a Covered Tax Agreement through reservations and choices of optional provisions

The OECD announced that one of the MLI's key features is its flexibility aiming at accommodating a variety of tax policies while ensuring that the tax treaty-related BEPS measures are effectively implemented. To this end, in addition to the distinction between minimum standard and non-minimum standard provisions, the MLI provides several mechanisms as follows:

- *Reservations.* Signatories may choose to reserve the right not to apply (i.e. to opt out through a reservation before the OECD) an MLI provision which otherwise applies by default. Items on which a reservation is allowed are listed in article 28 of the MLI. *See* section 3.3.1.

15. The OECD five-step approach is available at http://www.oecd.org/tax/treaties/step-by-step-tool-on-the-application-of-the-MLI.pdf.

16. Agreements signed but not yet in force which have been listed will be modified by the MLI upon its entry into force and further to the notification of this date to the OECD. *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (7 June 2017), Treaties IBFD.

 

- *Optional provisions.* Signatories can choose to apply (i.e. to opt into) optional provisions which otherwise do not apply. *See* section 3.3.2.
- *Alternative provisions.* Several provisions contain alternative wording from which signatories can choose. *See* section 3.3.3.

Reservations and optional provisions are, in principle, restricted to non-minimum standard provisions, while alternative provisions may exist for both minimum standard (e.g. article 7) and non-minimum standard provisions (e.g. article 13).

### *3.3.1. Reservations of MLI provisions*

For non-minimum standard provisions, a signatory may elect to opt out of a provision which otherwise applies by default. The reservation may relate to an entire article, a paragraph contained in an article or part of a paragraph. Thus for instance:

- Ireland reserved the right for the entirety of article 12 (Artificial Avoidance of Permanent Establishment Status through Commissionnaire Arrangements and Similar Strategies) not to apply to its Covered Tax Agreements.
- The United Kingdom reserved the right for article 3(2) (Transparent Entities) not to apply to its Covered Tax Agreements.
- Switzerland reserved the right to replace the references in (1) paragraphs 1 and 4[17] and (2) paragraph 5[18] of article 35 with reference to "30 days after the date of receipt by the Depositary of the latest notification by each Contracting Jurisdiction making the reservation described in paragraph 7 of article 35 (Entry into Effect) that it has completed its internal procedures for the entry into effect of the provisions of this Convention with respect to that specific Covered Tax Agreement".

In principle, the reservation applies to any of the Covered Tax Agreements of the reserving signatory. As an exception, a signatory may, for policy reasons, opt out of applying a provision to a subset of Covered Tax Agreements that "contain provisions that have specific, objectively defined characteristics".

Opting out of minimum standard provisions is, in principle, not possible. There is an exception where a signatory Covered Tax Agreement already meets that minimum standard. For instance, a signatory may reserve the right for the minimum standard contained in article 6(1) not to apply to a given Covered Tax Agreement that already contains preamble language describing the intention of the parties to the Covered Tax Agreement to eliminate double taxation without creating opportunities for non-taxation or reduced taxation.

17. "[T]he latest of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the Covered Tax Agreement".
18. "[T]he date of the communication by the Depositary of the notification of the extension of the list of agreements".

### *3.3.2. Optional provisions*

Signatories can choose to apply (i.e. to opt into) optional provisions which otherwise do not apply. Optional provisions have no impact on a Covered Tax Agreement unless both parties opt in. For instance, Part VI on Arbitration will only apply if both parties to a Covered Tax Agreement have opted in. Other optional provisions are found in article 6(3), article 7(4), article 7(6) and article 9(4).

As an exception, within the optional provisions contained in Part VI, article 23(5) relating to the confidentiality of the arbitration procedure will apply to a party to a Covered Tax Agreement as soon as such party opts in (irrespective of whether the other party to the Covered Tax Agreement has also opted in).

### *3.3.3. Alternative provisions*

In some cases, following the recommendations of the Final Reports, alternative provisions are proposed to address a specific issue. In particular:

- Following the Final Report on Action 6, article 7 of the MLI contains three alternative solutions to address treaty abuse: (1) a Principal Purpose Test (PPT); (2) a PPT and a simplified LOB provision; or (3) a detailed LOB provision supplemented by a mechanism that deals with conduit arrangements not already dealt with in tax treaties.

  Given this provision is a minimum standard, signatories are required to select one of the three solutions. Solution (1) is the default option under article 7(1). Signatories that wish to opt for solution (3) shall agree to endeavour to reach a bilateral agreement that satisfies the minimum standard (article 7(15) of the MLI).

  So far all signatories have opted for a PPT, whether alone (solution (1) retained by 56 signatories) or complemented with a simplified LOB (solution (2) retained by 12 signatories). No signatory opted for solution (3).
- Consistently with the Final Report on Action 2, article 5 of the MLI includes three alternative solutions for signatories to address problems arising from the inclusion of the exemption method in treaties with respect to items of income that are not taxed in the state of source. Given this provision is not a minimum standard, signatories also have the possibility not to opt in.
- Consistently with the Final Report on Action 7, article 13 of the MLI relating to permanent establishment-specific activity exemptions allows signatories to either: (1) explicitly state that each of the permanent establishment exemptions included in article 5(4) of the OECD Model is restricted to activities that are otherwise of a "preparatory or auxiliary" character (Option A); or (2) retain the existing wording of article 5(4) considering that the activities referred to in paragraph 4 are intrinsically preparatory or auxiliary (Option B). Given this provision is not a

minimum standard, signatories also have the possibility not to opt in.

Under this mechanism, where alternative solutions are proposed, the general principle is that a given solution will apply to a Covered Tax Agreement only if both parties affirmatively choose to apply the same solution. As an example, for the permanent establishment exemptions provision, Italy opted for Option A while France opted for Option B. Accordingly, the wording of article 5(3) of the France-Italy tax treaty will not be impacted by the MLI.

However, asymmetrical positions may also exist. As an example,[19] for the PPT/LOB minimum standard, in cases where one of the parties to a Covered Tax Agreement chooses to apply solution (1) (PPT only) while the other party decides to apply solution (2) (PPT supplemented with a simplified LOB provision), solution (2) may nevertheless apply to the Covered Tax Agreement:

(1) with respect to both parties, if the party that originally chose to apply solution (1) agrees to apply solution (2) by exception to this specific Covered Tax Agreement; or
(2) with respect only to the party that chose to apply solution (2), if both parties agree to such an asymmetrical situation.

### 3.4. How is a Covered Tax Agreement modified?

The MLI modifies Covered Tax Agreements in different ways. For each MLI provision, the method of modification is defined by means of a compatibility clause which sets out the relationship between that provision on the one hand and the Covered Tax Agreements on the other. The different types of compatibility clauses contained in the MLI are:

(1) "in place of": in this situation, the MLI provision replaces existing Covered Tax Agreements provisions, if any;
(2) "applies to" or "modifies": in this situation, the MLI provision is intended to change the application of an existing Covered Tax Agreement provision without replacing it;
(3) "in the absence of": in this situation, the MLI provision is intended to apply only if the corresponding Covered Tax Agreement's provision does not exist; and
(4) "in place of or in the absence of": in this situation, the MLI provision is intended to replace an existing Covered Tax Agreement provision or to be added to the Covered Tax Agreement if there is no existing Covered Tax Agreement provision.

Signatories are required to use their best efforts to identify all provisions that are within the scope of the compatibility clause. In effect:

– provisions falling in items (1) and (2) will apply only in cases where all parties to a bilateral tax treaty notify the existing provision of the Covered Tax Agreement to be replaced with or modified by the MLI provision;
– provisions falling in item (3) will apply only in cases where all parties to a bilateral tax treaty notify the absence of an existing provision in the Covered Tax Agreement; and
– provisions falling in item (4) will apply to a Covered Tax Agreement in any case, regardless of the existence of a provision and of the notification by the parties.

Thus, the notification process is an essential part of the implementation of the MLI and country notifications should systematically be checked when determining whether a specific article of a given bilateral treaty is impacted by the MLI.

### 3.5. Has the MLI entered into effect?

From a general standpoint,[20] the entry into effect of the provisions of the MLI depends on the nature of taxes at stake. The chart in Figure 1 provided by the OECD in a presentation published in June 2017 and referred to as the "Step-by-Step Overview of on the Application of the MLI" clearly summarizes the two situations.

**Figure 1**

With respect to taxes withheld at source:


With respect to all other taxes levied by the Contracting Jurisdiction:


### 3.6. Interpretation of MLI provisions

During the public consultation held on 7 July 2016, the OECD indicated that it may develop tools such as an explanatory statement, commentary or consolidated versions to assist with a consistent application of the MLI provisions. In practice, the MLI was adopted along with an Explanatory Statement. Paragraph 12 of the Explanatory Statement, however, specifically indicates that the latter intends to clarify the operation of the MLI to modify Covered Tax Agreements and that "it is not intended to address the interpretation of the underlying BEPS measures".[21]

The Explanatory Statement adds that "the provisions contained in Articles 3 through 17 [Part II to Part V] should

19. *See also* article 5 which allows for asymmetrical positions. The Explanatory Statement indicates that: "Where each Contracting Jurisdiction to a Covered Tax Agreement chooses a different Option (or where one Contracting Jurisdiction chooses to apply an Option and the other chooses to apply none of the Options), the Option chosen by each Contracting Jurisdiction shall apply with respect to its own residents."

20. Article 35(2) allows signatories to deviate from the general rules and article 36 provides for specific entry into force rules for Part VI related to mandatory binding mutual agreement procedure arbitration.

21. Except with respect to the mandatory binding arbitration provision contained in articles 18 through 26.

 

be interpreted in accordance with the ordinary principle of treaty interpretation, which is that a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose", and adds that "the object and purpose of the Convention is to implement the tax treaty-related BEPS measures. The commentary that was developed during the course of the BEPS Project and reflected in the Final BEPS Package has particular relevance in this regard."

By contrast, the Explanatory Statement on Part VI related to arbitration addresses both the substance and its technical application to Covered Tax Agreements.

## 4. Some Concluding Remarks

The signature of the MLI by 69 countries covering 70 jurisdictions on June and July 2017 is a major achievement for the OECD and the culmination of the BEPS journey which started in 2013 with an extraordinarily ambitious program and time frame. However, implementation inevitably had to cope with a range of legal, policy, political and administrative constraints.

In particular, the absence of the United States from the first list of signatories cannot go unseen. At a Bloomberg BNA and Baker McKenzie transfer pricing conference held on 8 June 2017 in Washington, D.C., the Deputy International Tax Counsel at US Treasury brought forward several explanations, including the fact that the United States' tax treaty network has a low degree of exposure to BEPS and that any modifications of tax treaties which deviate from the US model tax treaty provisions are subject to a heavy approval procedure.

The success of the MLI shall not be measured today, but down the road when experience is gained from interpreting and applying the new treaty provisions, and when additional countries join the first batch and initial choices made by signatories evolve and are revised. To date, the MLI raises interesting questions in relation to its flexibility and interpretation.

### 4.1. Flexibility

The preamble of the MLI states: "The Parties to this Convention […] [r]ecognising the *need for an effective mechanism to implement agreed changes in a synchronised and efficient manner* across the network of existing agreements for the avoidance of double taxation on income *without the need to bilaterally renegotiate* each such agreement; have agreed as follows: […]". Additionally, the Explanatory Statement explicitly recognizes that the purpose of the MLI is to "swiftly implement the tax treaty-related BEPS measures" (*see* paragraph 14).

To meet these objectives, the OECD had to provide flexibility to countries in a number of respects.

First, concerning the list of the Covered Tax Agreements, the Explanatory Statement indicates that the possibility to leave a given tax treaty out was necessary to cover specific situations such as where the treaty has been recently renegotiated to implement the outcomes of the BEPS Project, or is currently under renegotiation with the intention of implementing those outcomes in the renegotiated agreement. As a result, not all the treaties in force among signatories are impacted. 1,105 treaties are matched between the signatories, while the number of treaties listed by the signatories as Covered Tax Agreements is 2,365 (and there may be an even greater number of treaties existing among those countries). As an example, Switzerland which has an extensive bilateral tax treaty network (over 100), decided to initially cover only 14 tax treaties under the MLI. Switzerland indicated that these 14 treaty partners are "prepared to agree with Switzerland the precise wording on how the provisions of the existing DTAs will be amended through the BEPS Convention. If agreements on the technical implementation of the BEPS Convention can be obtained with further partner states, the corresponding DTAs will equally be amended by the BEPS Convention at a later stage. Alternatively, the BEPS minimum standards can also be agreed by means of a bilateral DTA amendment."[22]

The MLI also provides flexibility as regards the scope of implemented non-minimum standard provisions and, for provisions which contain alternative solutions, the content of the provision that will be implemented.

As an example, more than half of the signatories, including Belgium, Canada, Germany, Hong Kong, Ireland, Luxembourg, Malta, Singapore, Switzerland and the United Kingdom, have not opted to apply article 12 which lowers the threshold for recognition of a dependent agent. The position taken by these jurisdictions may be explained by the fact that:

- the consequences of this article are still being developed (the OECD recently published another discussion draft on attributing profits to permanent establishments for comments);
- some jurisdictions have implemented other measures into domestic law, such as a diverted profits tax.[23] A member of the UK HMRC corporate tax team notably indicated that the diverted profits tax implemented "to fight tax avoidance by internet companies is already effective, well-targeted and proportionate".

As another example, Part VI on Arbitration received a cold welcome as less than half of the signatories opted in for the mandatory arbitration provision. Among them, a majority are EU countries which are already parties to the EU Arbitration Convention and are currently discussing a new EU directive on mutual agreement procedures and arbitration. Australia, Canada, Singapore and Switzerland are among the significant non-EU countries which elected for arbitration. Given the uncertainty created by the fast adoption of an impressive volume of new treaty and transfer pricing guidance at OECD and country level, the authors find it regrettable that arbitration was not set

22. *See* press release dated 7 June 2017, available at https://www.sif.admin.ch/sif/en/home/dokumentation/medienmitteilungen/medienmitteilungen.msg-id-66981.html.
23. The United Kingdom and Australia notably.

as a minimum standard and that important countries such as China, India, Korea, Mexico, Russia and South Africa did not opt for it.

Additionally, the implementation of a provision in a given bilateral tax treaty depends on both contracting countries or jurisdictions including the treaty in the list of their Covered Tax Agreements, taking the same position (or in certain cases differing but compatible positions) on that particular provision, and consistently making the required notifications to the OECD.

These layers of flexibility create a tough environment for taxpayers, tax administrations and tax courts to determine whether a tax treaty is affected by the MLI and if so, in what way. For this purpose, the OECD recently published a tool facilitating the identification of matches between co-contracting parties to a bilateral tax treaty. While this tool is still in its beta form, it should help the stakeholders to apply the new modified rules. [24]

To conclude, although the MLI's flexibility has allowed 69 countries representing 70 jurisdictions to sign the instrument within a very short time frame, this was at the cost of less harmonization of treaty provisions than initially contemplated.[25]

### 4.2. Interpretation

It is to be expected that the interpretation of specific provisions in a given Covered Tax Agreement will raise difficulties. The flexibility given to countries will result in some treaty provisions being only partly impacted by the MLI, hence the need to refer to both the relevant commentary in the OECD Model for the part of the provision that is not impacted, as well as the commentary included in the Final BEPS Package for the part of the provision that is impacted.

Further questions may arise as to whether parts of the commentary included in the Final BEPS Package may or may not be used to interpret provisions that are not impacted by the MLI following a dynamic interpretation of tax treaties.

Questions arise as to the legal weight that will be given by domestic courts to the commentary included in the Final BEPS Package, in the absence of any express endorsement of said commentary by MLI signatories. This is especially true for countries that did not take part in the negotiation of the Final BEPS Package but have signed the MLI.

24. The OECD MLI Matching Database (beta) is available at http://www.oecd.org/ctp/treaties/mli-matching-database.htm.

25. The BEPS Monitoring Group during a presentation to the Inclusive Framework of the G20/OECD BEPS Project on 22 June 2017 made the following comments: "We would have expected OECD/G20 countries, which negotiated these provisions, to adopt them with few reservations, to enable those developing countries which wish to do so to benefit from the changes. Unfortunately, the initial lists submitted by the 68 first signatories show that many have made numerous reservations. Only the general provisions on preventing treaty abuse in articles 6 and 7, which are a minimum commitment under the BEPS project, have not been subject to any reservation. This is disappointing, especially in view of the support for the BEPS project voiced by the G20 leaders. It may be simply out of caution, and these reservations may still be withdrawn. Failure to do so would undermine the BEPS project, perhaps fatally. The Multilateral Convention on BEPS should establish a common floor of basic provisions. Obviously improvements are possible, and could be added over time, either by the parties acting jointly or in bilateral treaties. However, this convention should not be treated as a model from which countries can pick and choose elements to be negotiated bilaterally. We urge OECD countries to publish clear policy statements explaining any reservations they have made, by specifying how they deal with the issue. Reservations which cannot be justified in this way should be withdrawn." *See* complete statement on https://bepsmonitoringgroup.files.wordpress.com/2017/06/if-presentation-1706.pdf.

 