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MULTILATERAL INSTRUMENT

View from (Dutch) tax practice

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Introduction

BEPS implementation phase has started

- Anti hybrid loan provision in EU PS Directive
- GAAR in EU PS Directive
- ATAD
- ATAD 2
- Unilateral measures since G20 in November 2012:
  - Deferred profit tax in UK
  - Kaaiman-tax in Belgium
  - Renegotiation offer to 23 developing countries by the Netherlands
  - German royalty deduction limitation
- MLI
- C(C)CTB?

MLI - general

- Purpose MLI: ***swiftly*** implement BEPS measures into the bilateral tax treaties of participating jurisdictions.
- ***Supplement existing tax treaties*** by adding new provisions or by modifying or replacing existing provisions.
- ***Not*** through an ***amendment*** of existing treaties.
- ***Instead***, the MLI provisions need to be read and applied ***alongside*** existing treaties.
- Countries have flexibility through ***opt-in and opt-out*** mechanisms (***except*** for certain mandatory ***minimum standards***), as well as ***alternative provisions***.
- Treaties that already contain provisions: "***compatibility clauses***" provide how an MLI provision will interact with related provisions of an existing tax treaty.
- The MLI will only apply to existing tax treaties that are ***explicitly listed*** by both contracting states.
- ***Optional*** MLI provisions: only if the two countries concerned indicate the ***same choice***.
- ***Reservations*** (resulting in opt-out): apply between that state and ***all other parties*** to the MLI.
- ***Notify*** the OECD (as depositary of the MLI):
  - (i) of the specific tax treaties they wish to bring within the scope of the MLI,
  - (ii) the options they have selected,
  - (iii) the reservations they have made and various provisions of the individual tax treaties that are affected by these various options and reservations.
- Typically subject to the same ***domestic ratification procedures*** as (tax) treaties.

Entry into effect

- Withholding taxes:

Taxable events occurring on or after the first day of the calendar year that begins on or after the latest of the two dates on which the MLI enters into force for each of the two Contracting States.

For example, if the MLI enters into force for Country A on 1 March 2018 and for Country B on 1 March 2019, the MLI will take effect with respect to withholding taxes relating to an event occurring from 1 January 2020 onwards.

- Other taxes (including CIT):

Taxes levied with respect to ***taxable periods*** beginning on or after expiration of a period of 6 calendar months (or a shorter period if Contracting States agree on this) from the latest of the two dates on which the MLI enters into force for each of the two Contracting States.

For example, if the MLI enters into force for Country A on 1 March 2018 and for Country B on 1 September 2018, the MLI provisions that will affect the A-B tax treaty will take effect with respect to taxable periods beginning on or after 1 March 2019 (and in case the taxable year coincides with the calendar year: as of 1 January 2020).

Position of the Netherlands

- MLI position paper sent to Dutch Parliament (Letter of 28 October 2016)
- Letter predates the publication of the MLI: so no reference to specific clauses in the MLI or options and alternatives offered in those clauses.
- Position Dutch government:
  - Bring as many tax treaties as possible within the scope of the MLI, but possibly exclude tax treaties on which negations are currently pending.
  - Support:
    - Treaty related measures proposed in the Final Report on BEPS Action 2.
    - Measured proposed in Final Report on BEPS Action 6, Action 7 and Action 14
    - Except savings clause (art 11. MLI) and and preference for sole application of PPT
- Question: does Netherlands really intend to implement all of art. 3-10 and 12-26 MLI?
- Approx. 150 questions in Dutch Parliament on letter 28 October 2016 – answers expected soon
- Ratification in Netherlands expected earliest in 2018: entry into effect 2019 for withholding taxes / 2020 for other taxes

Treaty network Netherlands – some figures

- Netherlands has concluded 88 DTA's per 1 July 2016
- 98 members in MLI Ad Hoc Group
- 68 members of Ad Hoc Group have DTA with Netherlands
- 26 in EU (no treaty with Cyprus) / 41 outside EU
- 15 DTA's have a PPT clause (5 within the EU)
- 3 DTA's with PPT signed but not yet ratified
- 8 DTA's have a LOB clause

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Impact on practice – brief analysis per MLI article

Transparent entities (art. 3 MLI)

Practical impact and attention points

- Art. 3 MLI denies treaty benefits on payments through reverse hybrids, e.g. in a CV/BV structure.

Example: State A taxes Entity X, incorporated under the laws of State A, on worldwide income on the basis of its residence in State A. The participants in X are residents of State B. State B treats Entity X as transparent and taxes the participants in X on the basis of their residence in State B. Neither State A nor State B is obliged to provide relief for the other state's taxes.

- Similar provisions are already found in the US Model Treaty, art. 24(4) US-Netherlands treaty, art. 22(4) UK-Netherlands treaty and art. 4(1)(b) US-Luxembourg treaty.

- Will the Netherlands be able to maintain the Decree of the Under Minister of Finance of 6 July 2005, No. IFZ2005/546M, which unilaterally disables art. 24(4) US-Netherlands treaty in certain instances?

- CV/BV structure already targeted by ATAD 2.

Compatibility clause

Art. 3(1) MLI applies in place of or in the absence of general or specific Tax Treaty provisions that deal with income of fiscally transparent entities.

Permitted reservations

This MLI provision does not reflect a minimum standard. Consequently, Parties may opt out of art. 3(1) or (2) MLI entirely or choose to keep existing provisions.

Dual resident entities (art. 4 MLI)

Practical impact and attention points

- The country of residence of a dual resident entity for purposes of a Tax Treaty will be determined in a mutual agreement procedure between the Contracting States.
- No Tax Treaty benefits are available until the residence is settled in a mutual agreement procedure.
- Migration of the place of effective management of an entity to a treaty jurisdiction in relation to which art. 4 MLI applies will no longer limit the taxation rights of the jurisdiction of origin.
- For Dutch tax purposes: effectively overrules the Dutch Supreme Court ruling of 28 February 2001, *BNB* 2001/295 (‘*Drielandenpunt-arrest*’).
- Dutch government promised not to agree to such clause anymore after discussions about UK-Netherlands tax treaty.
- Practice has strong preference for existing tie breaker approach.

Compatibility clause

- Art. 4(1) MLI applies in place of or in the absence of any existing tie-breaker provisions in Tax Treaties.
- However, it does not apply to specific rules on residence of dual-listed companies.

Permitted reservations

This MLI provision does not reflect a minimum standard. Consequently, Parties may opt out of art. 4 MLI entirely, or only with regard to Tax Treaties already containing certain specific provisions.

Prevention of treaty abuse (art. 7 MLI)

System of art. 7 MLI

- PPT is the default option (since it satisfies the minimum standard on its own).
- Parties may *supplement* the PPT by opting for a *simplified* LOB.
- Parties may opt out of the PPT and choose a detailed LOB. However, a detailed LOB should be negotiated bilaterally and is not included in the MLI provision.
- Parties that choose to bilaterally negotiate a detailed LOB may apply the PPT as an interim measure.

BEPS measure: PPT

A treaty benefit is denied if it is reasonable to conclude 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 the treaty benefit is in accordance with object and purpose of a Tax Treaty.

Compatibility clause

Art. 7(1) MLI is a minimum standard and therefore applies in place of or in absence of any existing principal/main/primary purpose rules in a Tax Treaty. It is not intended to restrict the scope of other types of existing anti-abuse rules in a Tax Treaty.

Prevention of treaty abuse (art. 7 MLI)

Practical impact and attention points

- Expected to have a substantial impact on treaty eligibility in new and existing holding, financing and royalty structures.
- Most Parties are expected to apply the PPT only, in particular within the EU (given the EU compatibility concerns regarding the LOB).
- Limited guidance
  - The accompanying OECD Commentary on the PPT offers only clear-cut examples that offer little guidance on the structures that will be affected by the PPT (e.g. holding structures).
  - Discussion Draft non-CIV funds January 6, 2017 contains some guidance, but only for non-collective investment vehicle funds?
- Increase substance and functionality of holding, financing and royalty companies should strengthen the PPT position of such companies. For instance, by centralizing holding functions into a regional or divisional headquarter or investment platform.
- PPT in Dutch tax treaties with EU member states: influence on Dutch non-resident tax / dividend tax (EU withholding exemption)?
- Example: LOB in treaty with Japan: is ‘floor’ (if LOB does not apply) compatible with minimum standard?

Capital gains on shareholdings in real estate entities (art. 9 MLI)

BEPS measure

Counter possibility to contribute assets to an entity shortly before a sale of the shares in that entity to dilute the proportion of value that is derived from real estate.

Alternative 1

- Amend definition 'real estate entity' by including a 365 days testing period.
- Include ownership interests that are comparable to shares

Alternative 2

Replace existing Tax Treaty provisions entirely with the new art. 13(4) OECD Model as per the Final Report on BEPS Action 6 or add the provision if it is currently lacking (art. 9(3)-(5) MLI).

Permitted reservations

This MLI provision does not reflect a minimum standard. Consequently, Parties may opt out of art. 9(1) or (2) MLI entirely or opt our of specific clauses separately. Parties may also opt out of art 9(4) MLI (introduction real estate entity provision, if not yet included).

Practical impact and attention points

- Treaty policy Netherlands: not include a real estate shares clause, so Alternative 2 not likely. If elected, serious impact on Dutch real estate investments abroad expected.
- Netherlands likely to choose alternative 1.
- Consider exit strategies as early as possible, preferably already at the moment the investment is made.
- Follow asset mix subsidiary during testing period.

Anti-abuse rule for third country PEs (art. 10 MLI)

BEPS measure

- No treaty benefits if income allocated to low taxed passive PE.
- Abti-abuse rule not applicable if:
  - PE taxed at 60% of 'hypothetical tax' on income item in head office state
  - PE carries on an active trade or business;
  - the Contracting State of source concludes that it is justified in a particular case to apply an exemption or reduced rate nonetheless.

Practical impact and attention points

- Information deficiency: how can payor be aware that that payment is attributed by that payee to a low-taxed third country PE. Request the payee to certify that art. 10 MLI does not apply to a particular item of income?
- Compare tax rates and explore third countries that would meet the tax threshold.

Compatibility clause

Art. 10 MLI applies in place of or in the absence of existing provisions in Tax Treaties that deny treaty benefits on income that is attributed to a third jurisdiction PE.

Permitted reservations

This MLI provision does not reflect a minimum standard. Consequently, Parties may opt out of art. 10 MLI entirely, or apply the provision not or only to Tax Treaties already containing certain specific provisions.

Artificial avoidance of PE through commissionaire arrangements (art. 12 MLI)

New 'agent PE' definition

- A person that acts on behalf of a foreign enterprise and that habitually plays the principal role in the conclusion of contracts that are routinely concluded without material modification by the foreign enterprise constitutes a PE for that foreign enterprise, if the contracts are:
  - in the name of the foreign enterprise;
  - for the transfer of property owned by the foreign enterprise; or
  - for the provision of services by the foreign enterprise.
- Independent agent acting on behalf of a foreign enterprise in the ordinary course of its business does not constitute a PE for the foreign enterprise.
- A person that acts (almost) exclusively on behalf of one or more 'closely related' enterprises is not an independent agent.

Practical impact and attention points

- Art. 12 MLI significantly lowers the threshold for a dependent agent PE
- New definition requires a material analysis of functions and powers of a potential agent and its principal
- No longer relevant whether the agent has the formal authority to sign contracts.
- Art. 12 MLI is not intended to address low-risk distributor arrangements.

Permitted reservations

This MLI provision does not reflect a minimum standard. Consequently, Parties may opt out of art. 12 entirely.

Artificial avoidance of PE through specific activity exemptions (art. 13 MLI)

Anti-fragmentation rule (several options)

- Option A: restrict existing specific activities exemption to those activities that are preparatory or auxiliary in nature
- Option B: preserve specific activity exemptions irrespective of whether the activities are preparatory or auxiliary in nature
- Additional options: activities carried out by several 'closely related' enterprises if taken as a whole are not of a preparatory or auxiliary character and constitute complementary functions that are part of a cohesive business operation.

Practical impact and attention points

- Although apparently only effective if both Contracting States choose the same option, art. 13 MLI may result in diverging positions of Parties on specific activity exemptions.
- All structures currently relying on a specific activity exemption under affected Tax Treaties should be reviewed.

Permitted reservations

This MLI provision does not reflect a minimum standard. Consequently, Parties may opt out of art. 13 entirely, or out of art. 13(2) or (4) MLI separately.

Splitting-up of contracts (art. 14 MLI)

BEPS measure

- Counter perceived abuse consisting of enterprises dividing their contracts into several parts, each covering a shorter period that 12 months, or dividing contracts over separate entities.
  - Activities at a place that constitutes a building site or construction or installation project or other activities specified in the relevant Tax Treaty provision or supervisory or consultancy activities in connection with such a place, that are carried on during on or more periods of time that, in the aggregate, exceed 30 days; and
  - connected activities at the same building site or construction or installation project by one or more 'closely related' enterprises during different periods of time.

Practical impact and attention points

- The perceived abuse in splitting up of contracts is not only targeted by art. 14 MLI, but may also be countered by the PPT of art. 7 MLI.
- The effect of art. 14 MLI has to be closely monitored if a group has several companies engaged in activities at the same building site or construction or installation project, if those various activities may not seem to be 'connected' within the meaning of art. 14 MLI at first sight.

Compatibility clause

- Art. 14 MLI applies in place of or in the absence of existing provisions in Tax Treaties that address the division of contracts into multiple parts to avoid the application of a time period in relation to the existence of a PE for specific projects or activities.
- Art. 14 MLI is, however, intended to leave in place those existing provisions to the extent they apply to activities other than a building site or construction or installation project or other activities that are not within the scope of art. 14 MLI.

Permitted reservations

This MLI provision does not reflect a minimum standard. Consequently, Parties may opt out of art. 14 entirely, only with respect to existing Tax Treaty provisions regarding the exploration for or exploitation of natural resources.

Mutual agreement procedure

- Countries commit to implement a minimum standard to ensure an effective and timely resolution of treaty-related disputes (Final Report on BEPS Action 14)

- This minimum standard, complemented by best practices:
  - implementation of the mutual agreement procedure (**MAP**) of art. 25(1)-(3) OECD Model, with certain amendments (art. 16 MLI);
  - providing access to MAP in transfer pricing cases and implement the resulting agreement (art. 17 MLI); and
  - a commitment to seek to resolve MAP cases within an average timeframe of 24 months (not reflected in MLI).

- Art. 16 MLI reflects a minimum standard. Consequently, Parties cannot opt out entirely. However, the minimum standard offers some alternatives and parties may partly opt out of art. 16 MLI under certain conditions. Parties may opt out of art. 17(1) MLI under certain conditions.

Practical impact and attention points

- Tax payers are not formally part of the discussions

Arbitration

- A number of countries have committed to adopt and implement mandatory binding arbitration as a way to resolve disputes that otherwise prevent the resolution of cases through MAP.

- Countries that have expressed an interest in doing so include:

Australia	*Austria*	*Belgium*
Canada	*France*	*Germany*
Ireland	*Italy*	*Japan*
Luxembourg	*the Netherlands*	*New Zealand*
Norway	*Poland*	*Slovenia*
Spain	*Sweden*	*Switzerland*
United Kingdom	*United States*	

- The MLI provisions on arbitration are entirely optional and apply only if both Contracting States to a Tax Treaty have notified the Depositary of their choice to apply arbitration.

Conclusions

Conclusions

- Implementation phase of BEPS has really started
- Considerable impact on the tax practice
- Only few years still to prepare for entry into effect
- Period of significant uncertainty expected
- How to advise if things are not so clear?
- International business/investments will always remain.
- Chaos creates work: never a dull moment for a tax advisor!

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