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The signature of the Multilateral BEPS Convention

A first critical look and overview around the globe

1. Introduction

7 June 2017 witnessed an historical turning point in the area of international taxation with the signature of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI). The signing ceremony brought together 68 jurisdictions[1] (including Switzerland) which, to various degrees, agreed to introduce the tax treaty related measures of the OECD/G20 Base Erosion and Profit Shifting initiative (BEPS) into their international tax policy. Mauritius also joined on 5 July 2017. Notably, however, the United-States did not sign the MLI. This News Alert takes a critical look at the MLI, assesses its future impact on MNE Groups and, finally, offers a global overview of the positions taken by the signing jurisdictions (see the summary table complementing this News Alert).

The MLI operates to modify the application of existing DTCs, which are concluded between two or more parties to the MLI. It will not trigger a modification of existing DTCs but will need to be read alongside the latter. In line with the BEPS outcome, the MLI distinguishes on the one hand between tax treaty measures which represent **minimum standards** (i.e. Prevention of Treaty Abuse pursuant to BEPS Action item N 6 and commitment to apply the Mutual Agreement Procedure in line with BEPS Action item N 14) and which must be implemented in

[1] These jurisdictions are Andorra, Argentina, Armenia, Australia, Austria, Belgium, Bulgaria, Burkina Faso, Canada, Chile, China (People's Rep.), Colombia, Costa Rica, Croatia, Cyprus, the Czech Republic, Denmark, Egypt, Fiji, Finland, France, Gabon, Georgia, Germany, Greece, Guernsey, Hong Kong, Hungary, Iceland, India, Indonesia, Ireland, Isle of Man, Israel, Italy, Japan, Jersey, Korea (Rep.), Kuwait, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Mexico, Monaco, the Netherlands, New Zealand, Norway, Pakistan, Portugal, Romania, Russia, San Marino, Senegal, Serbia, Seychelles, Singapore, the Slovak Republic, Slovenia, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and Uruguay.

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some form or another and, on the other hand, measures which merely consist in **recommendations** which States may reserve not to apply.

2. Mechanism of the MLI and timing

The foregoing distinctions are put into effect by a flexible mechanism which, in very broad terms, may be summarized as follows:

First of all, the MLI only affects the application of DTCs that have been notified by countries to the Secretary-General of the OECD (covered DTCs). A specific DTC will be affected only if both contracting States notified (art. 2, para. 1(a)(ii) MLI).

The MLI then includes a **sophisticated reservation and option mechanism**:

- Concerning **the minimum standards**, this mechanism provides a certain level of flexibility on how it will be implemented by States. As discussed below, this flexibility materializes for instance as regards the implementation of the minimum standard on Treaty Abuse. In this area States are for instance free to adopt a general anti-abuse / "Principal Purpose Test (PPT)" rule or a "Limitation on Benefit (LOB)" clause. In this latter case, the LOB clause would however need to be supplemented by a PPT rule (Simplified LOB - SLOB) or a provision dealing with conduit structures (Detailed LOB). Further, a SLOB would apply to a particular treaty only if both States so decide (art. 7, para. 6 MLI), unless they agree otherwise (art. 7, para. 7, let. a MLI). In the field of dispute resolution, States also have the option to replace the adoption of certain provisions of the MLI by a commitment to apply corresponding administrative measures (see for ex. art. 16, para. 5, let. a MLI and 17, para. 3, let. b MLI). Furthermore, in case States chose different ways to achieve the minimum standard, the MLI give them the option in certain circumstances not to apply the entire provision provided that they endeavor to find a satisfactory solution bilaterally with the other contracting States of the covered DTCs (see for ex. art. 7, para. 16 MLI).

- Measures consisting on the other hand **in recommendations** generally apply unless States reserve their right to apply them only partially or not at all. Other provisions apply only if States expressly so decide (for example elimination of double taxation, see art. 5, para. 1 MLI, specific activity exemptions for permanent establishments, see art. 13, para. 1 MLI, mandatory arbitration, see art. 18 MLI and agreement on a different resolution, see art. 24 MLI). As shown below, the approach taken by the signing jurisdictions in this area varies. While some States, such as Switzerland for instance, have reserved their right not to apply most of these recommendations, other jurisdictions, on the other hand, have chosen to favor several of them.

- As a rule, a reservation shall modify the provisions of the MLI for the reserving party as well as, to the same extent, for all other parties to the MLI. In other words, the provision on which a reservation is made will not affect or affect to a limited extent (as foreseen by the reservation) any of the covered DTCs of the reserving party. Conversely, the option to apply a specific provision normally affects DTCs only if both States decide to apply the provision. This is for example the case of the provisions dealing with specific activity exemptions for permanent establishments (art. 13, para. 7 MLI) as well as mandatory arbitration (art. 18 MLI). Also, States may in general reserve their right not to apply a provision of the MLI to a subset of DTCs that contain a clause having a similar content or go beyond it.

Therefore, to what extent DTCs will be affected by the MLI will depend first of all on the wording of existing provisions. DTCs that are more in line with the latest version of the OECD Model Tax Convention may indeed be less impacted than others. Furthermore, it will also largely depend on the choices and reservations made by each State.

States having signed the MLI are now required to submit ratification, acceptance or approval instruments. The MLI will enter into force on the first day of the month following the end of a three calendar months period from the date on which the fifth ratification or acceptance will be deposited. With regard to other Signatories, the MLI will enter into force after the lapse of the same period of time, starting from the submission of ratification, acceptance or approval.

Subject to diverging election by States, the MLI comes into effect as follows:

- **Withholding taxes**: for taxes levied where the event giving rise to such tax occurs on or after 1st January of the next calendar year that begins on or after the latest of the date on which the MLI enters into force for each contracting State of a covered DTT (art. 35, para. 1, let. a MLI).

- **Other taxes**: for taxes levied with respect to tax years starting at least 6 calendar months from the latest of the dates on which the MLI enters into force for each contracting State of a covered DTT (art. 35, para. 1, let. b MLI).

- **Mutual agreement procedure and mandatory arbitration**: for cases submitted from the latest of the dates on which the MLI enters into force for each contracting State of a covered DTT (art. 35, para. 4 and 36, para. 1, let. a MLI).

3. Content of the MLI

With a distinction between minimum standards and recommendations, **the substantive content of the MLI** may be illustrated as follows:

Treaty Abuse **(minimum standard)**	• Amendment to preamble of DTCs (no "*opportunities for the non-taxation or reduced taxation through tax evasion or avoidance"*) • Principal Purpose Test (PPT rule)
Improving Dispute Resolution **(minimum standard)**	• Commitment to apply Mutual Agreement (MAP) Procedure to resolve disputes
Hybrid Mismatches **(recommendations)**	• Transparent entities (codification of OECD Partnership Recommendation) • Dual resident entities • Application of methods for elimination of double taxation
Treaty Abuse **(recommendations)**	• Dividend transfer transactions • Capital gains in real estate companies • Anti-abuse rule for PEs in third jurisdictions • Savings clause • Artificial avoidance of PE status through commissionaire arrangements and similar strategies • Artificial avoidance of PE status through the specific activity exemptions • Splitting of contracts
Improving Dispute Resolution **(recommendations)**	• Corresponding adjustments
Arbitration **(recommendation)**	• Mandatory arbitration upon request of the taxpayer in case States fail to agree in a mutual agreement procedure

As can be seen from the foregoing summary table, the largest set of recommendations, which will also be of great practical relevance for MNE Groups, relate to **Treaty Abuse.** In line with

BEPS Action item N 6, States are required to implement, **at a minimum**, (i) **a PPT rule alone**; (ii) **a PPT rule and either a simplified (SLOB) or detailed LOB**; or (iii) a **detailed LOB provision**, complemented by a **mechanism relating to conduit arrangements** not already dealt with in DTCs. The MLI, however, does not include a detailed LOB. As a result, States wishing to address treaty abuse through a detailed LOB may opt out of the PPT but must then agree to endeavor to reach a bilateral agreement that satisfies the minimum standard. In this latter case, the relevant States may however choose to accept the PPT as an interim measure (art. 17(a) MLI).

In essence, therefore, because the PPT rule is the only measure which satisfies the minimum standard on its own, it applies by default. Where it applies, the PPT rule also replaces existing (and notably those narrower) provisions of DTCs covered by the MLI.

As shown in the summary table attached to this News Alert, most European jurisdictions (including Switzerland as discussed below) have, as expected, opted for the PPT rule which provides that: *"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 ».*

This being said, the adoption of the **PPT rule remains controversial** for a number of reasons which are well known. First of all, while the PPT rule is inspired from the so-called "*Guiding Principle"* found in the OECD Commentary, the PPT has a lowered threshold when it comes to the existence of an abuse and also reverses the burden of proof to the detriment of the taxpayer. Finally, the concrete application of the objective and subjective elements of the PPT rule may prove to be delicate in practice.

It should also be borne in mind that the PPT rule is far reaching in scope and thus does not only cover so-called **classical treaty shopping ownership structures**, for example channeling of dividends through a corresponding immediate dividend distribution (so-called direct conduit case) or deductible expenses (so-called stepping stone case) but also **abusive restructuring.** For example, the PPT rule could typically apply where a shareholding is transferred to a corporation prior to a dividend distribution in order to take advantage of a more favorable tax treaty rate (see BEPS Action item N 6 final report pp. 64-65).

Where the PPT rule is found to be applicable, another practical issue arising is the question of whether treaty benefits that would otherwise have been applicable in the absence of the problematic transaction or arrangement (for example a 15% residual tax treaty rate) could automatically be claimed. Unfortunately, the question is to be answered in the negative. Where the PPT rule is applicable, **the MLI does not provide for an automatic return to *status quo***. Rather, the MLI only includes **an optional clause** (art. 7 para. 3 and 4 MLI) which States may choose to include in their covered tax agreements and which allows the State denying treaty benefits to treat the taxpayer as *"as being entitled to this benefit, or to different benefits with* *respect to a specific item of income or capital, if such competent authority, upon request from that person and after consideration of the relevant facts and circumstances, determines that such benefits would have been granted to that person in the absence of the transaction or arrangement* ». In our opinion, on this point, the solution provided by the MLI is not satisfactory. An automatic return to status quo would indeed have been preferable. Further, it should be observed that some States (such as Switzerland for example) have not opted for this possibility.

The PPT rule applies "*Notwithstanding any provisions of a Covered Tax Agreement*". This implies, in particular, that the PPT rule **will apply in addition to the so-called beneficial ownership requirement** commonly found in DTCs.

Let us also observe that the OECD is currently undertaking work which will need to be taken into consideration in order to assess the future concrete impact of some other treaty recommendations. For example, while the MLI, in accordance with BEPS Action item N 7, contains **measures designed to lower the permanent establishment threshold** (with a view *inter alia* to catch commissionaire arrangements and similar strategies), **new guidance relating to the attribution of profits** to permanent establishments in these instances **is expected in the coming weeks.** These developments will thus need to be monitored.

As a result of the implementation of BEPS measures and of more stringent rules being applied, it is expected that the **need for MAP will increase** in the near future. The OECD is hence keen on enabling a large access to MAP (including on transfer pricing cases) by ensuring that updated provisions apply in place or in the absence of existing DTC provisions. The purpose of these updated provisions is that MAP be based on provisions that are in line with the latest standard of the OECD MC as well as with a few amendments proposed in the Final Report on BEPS Action item 14. As a result, taxpayers will be entitled to **submit their case to the tax authorities of both contracting States** rather than, as provided by the current version art. 25(1) OECD MC, only to the tax authorities of the contracting State of residence (in general) or nationality (discrimination issues). They will furthermore have the right to do so **within three years** from the first notification of the action resulting in taxation not in accordance with the DTC, despite the fact that existing DTCs may provide for shorter deadlines. In principle, States will also be **compelled to implement** an agreement resulting from a MAP notwithstanding any time limits in their domestic law as well as, in the field of transfer pricing, to grant correlative adjustments. Parties to the MLI will however have the option to replace the adoption of certain MAP provisions of the MLI by corresponding administrative measures. With regard to the implementation of MAP agreements as well as to correlative adjustments, States may also replace the adoption of the corresponding MLI provision by a commitment to accept, in the course of the future negotiation of DTCs, to refrain from proceeding with a primary adjustment (art. 7 (1) and 9 (1) OECD MC) after a certain deadline has lapsed, which should be agreed upon with the other contracting State.

4. Position taken by the signing jurisdictions and Switzerland

4.1 In general

As shown in the summary table attached to this News Alert, the positions taken by the signing jurisdictions are not uniform. While some States have, to various degrees, adopted several recommendations of the MLI, other countries, by contrast, have chosen to limit their commitment to the minimum standards.

4.2 Switzerland

Switzerland falls into this latter category. In accordance with its policy, Switzerland has indeed chosen to primarily focus **on the implementation of the minimum standards (Treaty Abuse and Dispute Resolution)**. In an initial phase, the signature of the MLI by Switzerland will however impact its DTCs with Argentina, Chile, India, Iceland, Italy, Liechtenstein, Lithuania, Luxembourg, Austria, Poland, Portugal, South Africa, the Czech Republic and Turkey. Switzerland will thus implement the BEPS minimum standards into its tax treaties either within the framework of the MLI or by means of the bilateral negotiation of its DTCs

In the area of **Treaty Abuse**, Switzerland has opted for **the PPT rule.** However, Switzerland has also chosen to favor the **mandatory and binding arbitration provision** which is a very positive development for business.

Switzerland's primary focus on the minimum standards implies inter alia that i**t has reserved the right not to apply the MLI provisions on:**

- Dual resident entities
- Dividend transfer transactions
- Anti-Abuse rule for permanent establishments Situated in third Jurisdictions
- The Saving clause
- Artificial avoidance of PE Status through commissionaire arrangements, the specific activity exemptions, splitting of Contracts

It is certainly arguable that the **introduction of a PPT rule into Swiss tax treaty policy** will not substantially affect the practice of Swiss tax authorities when it comes to treaty income sourced in Switzerland (typically dividends) and paid to entities (typically holding companies) resident in other contracting States. Yet, one question which will need to be settled in the future is the interaction between the PPT rule and the beneficial ownership requirement to which the Swiss Supreme Court's recent case law has given an extensive meaning. Because the PPT rule will apply in addition to the beneficial ownership requirement, it may in our opinion be desirable for the Supreme Court to revisit its interpretation of beneficial ownership and to realign it with the meaning of the term under the 2014 OECD Commentary.

In terms of timing, the Federal Council shall submit the MLI for public consultation towards the end of 2017. The MLI will then undergo the usual parliamentary approval process before entering into force.

5. Impact for MNE Groups

The MLI may in the future have a significant impact on the content of DTCs concluded by jurisdictions in which a MNE Group operates. MNE Groups are thus well advised to review their business models in light of the implementation of the BEPS tax treaty measures of the MLI. Possible areas of focus would typically include the impact of these measures on source taxation and, more generally, in States in which activities are conducted. Holding structures should also be assessed in light of the new provisions on Treaty Abuse. Finally, possible benefits entailed by the MLI should also be examined.

The Firm analyzes the substantive impact of these changes and, where required, closely collaborates with the best firms in the relevant jurisdictions in order to provide a genuine multijurisdictional advice.

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