Bloomberg Tax

Tax Planning International

European Tax Service

International Information for International Business

JULY 2018

bna.com

The Timing and Impact of the MLI—Countries' Perspective

Margriet Lukkien and Helen de Gier
Loyens & Loeff N.V., Amsterdam, the Netherlands

As one of the most revolutionary aspects of the BEPS project, the MLI will modify a large number of existing bilateral tax treaties with anti-tax avoidance measures developed in the BEPS project. What will this mean in practice for the jurisdictions that have signed up to it?

Margriet Lukkien is a Tax Partner and Helen de Gier is an Associate with Loyens & Loeff N.V., Amsterdam, the Netherlands

Entry into Force and Entry into Effect do not Happen on the Same Day

The MLI contains a myriad of intricate provisions on entry into force and entry into effect. First of all the MLI can only enter into force after at least five countries deposited their ratification instruments for the MLI with the OECD. This happened on March 22, 2018, with Slovenia being the fifth country. It was preceded by Austria (on September 22, 2017), the Isle of Man (on October 25, 2017), Jersey (on December 15, 2017) and Poland (on January 23, 2018) ("Five Frontrunners"). That resulted in the entry into force of the MLI on July 1, 2018, as the MLI provisions prescribe that entry into force takes place on the first day of the month following three calendar months beginning on the date that the fifth ratification instrument was deposited with the OECD. After the first five jurisdictions, the MLI will enter into force for any other jurisdiction on the first day of the month following three calendar months after such jurisdiction deposited the MLI ratification with the OECD.

However, different rules apply for entry into force and entry into effect of the MLI. Entry into effect of the MLI has not happened yet! Hence the MLI is not really a reality right now. That will be the case as of January 1, 2019, as explained below. For entry into effect a distinction applies between withholding taxes and any other taxes, such as corporate income taxes.

For withholding taxes the MLI will, in principle, have effect on 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 tax treaty partners. This means that for the Five Frontrunners the MLI provisions will have effect for withholding taxes as of January 1, 2019.

For all taxes other than withholding tax the MLI provisions will in principle have effect on taxable periods that begin on or after expiration of a period of six months counted from the latest of the two dates on which the MLI enters into force for each tax treaty partner. This timing means for the Five Frontrunners that for calendar year taxpayers the MLI provisions will have effect for other taxes as well as of January 1, 2019.

How Many Tax Treaties will be Impacted by the MLI as of January 1, 2019?

The MLI becoming a reality as of January 1, 2019 happens roughly two years after the so-called Ad Hoc Group, consisting of more than 100 jurisdictions, concluded negotiations on the MLI on November 24, 2016. It takes time for countries to go through their domestic MLI ratification procedures. Furthermore, not all countries signed the MLI. Out of the Ad Hoc Group, various members did not sign the MLI, although some of these countries expressed their intention to sign. The most prominent jurisdiction that did not sign the MLI and is not expected to do so, is the United States. One of the drivers behind this decision is that the U.S. takes the position that the MLI would not have an added value as the U.S. tax treaty policy is compliant with most of the MLI provisions. So it is expected that the tax treaties concluded with the U.S. will not be affected by the MLI. Also good to note is that various countries that were not part of the Ad Hoc Group nevertheless signed the MLI. These include Kuwait, Panama, Peru and the United Arab Emirates.

On January 1, 2019, the MLI will have effect on existing tax treaties that have been explicitly listed and which have been ratified in time by both contracting jurisdictions. How many tax treaties are we talking about?

First of all, as explained, the ratification of the MLI by the Five Frontrunners has been accomplished in time for having effect as of January 1, 2019. This resulted in a match for three bilateral tax treaties, i.e. the Austria–Poland, Austria–Slovenia and Poland–Slovenia treaties. For these three tax treaties, the MLI provisions will in principle enter into effect as of January 1, 2019. However, there is one important exception and that is the Austrian position that the MLI applies for taxes levied by Austria—apart from withholding taxes—one year later than prescribed by the general MLI rules. This specific timing for Austria results in the special situation of an asymmetrical entry into effect of the MLI for the bilateral tax treaty between Austria and Poland, respectively Austria and Slovenia; January 1, 2019 is the effective date for other taxes levied by Poland and Slovenia, while this is January 1, 2020 for other taxes levied by Austria. The asymmetrical entry into effect of the MLI is likely to happen on a large scale for bilateral tax treaties concluded with Austria.

The table shows how many tax treaties have been notified by the Five Frontrunners and that the MLI entered into force for three tax treaties as of July 1, 2018.

	Austria	**Isle of Man**	**Jersey**	**Poland**	**Slovenia**	
Total comprehensive bilateral tax treaties (Treaties)	93	11	13	89	59	
Notified Treaties	38	8	10	78	57	
Treaties for which the MLI entered into force as of July 1, 2018	2	0	0	2	2	Hence, in total 3 affected Treaties

Secondly, the MLI can still have effect on other tax treaties than described above as of January 1, 2019. This depends on when countries—other than the Five Frontrunners—will have completed their domestic ratification procedures and the depositing with the OECD. Counting backwards from the above explained timing of three months after depositing for entry into force and accompanying rules for entry into effect of the MLI, it appears that the key deadline is September 30, 2018: in order for MLI provisions to have effect for withholding taxes as of January 1, 2019, jurisdictions need to deposit their instrument of ratification at the latest by September 30, 2018. For other taxes than withholding taxes it is already too late; due to the three months for entry into force and the subsequent six months for entry into effect, ratification should have been finalized and deposited by March 31, 2018 to achieve that the MLI can have effect for other taxes as of January 1, 2019.

In the meantime four more countries followed the Five Frontrunners. Before the end of June 2018, Serbia (June 5, 2018), Sweden (June 22, 2018), New Zealand (June 27, 2018) and the United Kingdom (June 29, 2018) have deposited their MLI ratification with the OECD. As a consequence thereof, the MLI will enter into force for another 11 bilateral tax treaties as of October 1, 2018. For those treaties the MLI will in principle have effect for withholding taxes as of January 1, 2019. For other taxes, the MLI can have effect for those treaties as of April 1, 2019, depending on the start of the taxable period at stake.

The question is how many more jurisdictions will deposit their MLI ratification with the OECD before September 30, 2018? It is likely that entry into effect of the MLI will happen on a large scale as of 2020. Speaking for our home jurisdiction, i.e. the Netherlands, it is likely that the MLI will be ratified after September 30, 2018. This was also acknowledged by the State Secretary of Finance recently. In order for the MLI to be ratified by the Netherlands, the Lower House and Upper House of Parliament need to approve the MLI and before doing so they typically ask all kinds of questions to the government. Therefore, for the tax treaties concluded by the Netherlands it is expected that the MLI will not have effect as of 2019 already but as of January 1, 2020.

Main MLI Provisions Relevant for Businesses—How do These Apply for the Affected Tax Treaties of the Five Frontrunners?

The tax treaties which have been explicitly listed and which have been ratified by both contracting jurisdictions will be affected by the MLI, but for the optional MLI provisions in principle only if the contracting jurisdictions made matching choices. So not all MLI provisions crafted by the OECD will apply to all tax treaties covered by the MLI. Complicated compatibility clauses exist to determine whether there are matching choices and whether MLI provisions supersede or supplement similar rules in existing tax treaties. It will be quite a puzzle to find out what MLI provisions will exactly apply for each tax treaty.

In our experience the top three MLI provisions for businesses to look into timely, for identifying risks plus tax exposures and assessing the consequent MLI impact on business models and corporate structures, are:

- preventing treaty abuse in the form of the PPT;
- expanding the scope of the permanent establishment ("PE") definition, in particular for dependent agents; and
- dual resident entities for which the country of tax residency is to be determined via a mutual agreement procedure ("MAP").

The PPT is part of the BEPS minimum standard and can be seen as the backbone of the MLI. In summary, under the PPT no tax treaty benefits are granted if it is reasonable to conclude that one of the principal purposes of a transaction or arrangement is obtaining that tax treaty benefit. This applies to a wide range of treaty benefits including reduced taxes on dividends, interest, royalties and capital gains. All 82 jurisdictions covered by the MLI opted at least for the PPT. So in the three bilateral tax treaties of the Five Frontrunners, for which the MLI will have effect as of January 1, 2019, the PPT will apply; i.e. for the tax treaties between Austria–Poland, Austria–Slovenia and Poland–Slovenia. However, Poland expressed that the PPT is seen as an interim measure as Poland ultimately intends to adopt an LOB provision through bilateral negotiations. Other countries that have opted for such approach include Canada, Chili, Colombia, Kuwait, Norway and Peru.

In none of the three affected tax treaties of the Five Frontrunners, the MLI provision will apply for expanding the scope of the definition of dependent agent PEs. This targets among other things the artificial avoidance of PE status for commissionaire arrangements. Quite a considerable number of countries have not opted in for this MLI provision, including countries like Germany, Italy and the United Kingdom.

In the Poland–Slovenia tax treaty the MLI will replace the article regarding dual resident entities, as a consequence of which the country of residence of a dual resident entity needs to be determined in a MAP. The place of effective management is no longer decisive. No grandfathering rules apply. The taxpayer will not obtain any treaty benefits until treaty residency is settled via the MAP or in another manner. For the other two affected tax treaties, i.e. Austria–Poland and Austria–Slovenia, the place of effective management remains decisive for dual resident entities. Worldwide this MLI provision was opted in by about 30 out of the 82 jurisdictions currently participating (these jurisdictions include Australia, China, Japan, the Netherlands and the United Kingdom).

Challenges for Tax Authorities and Taxpayers

Once it has been figured out what MLI provisions apply for a specific tax treaty, interpretation of the MLI provisions can be a considerably big challenge for local tax authorities and taxpayers as well. This is caused by various ambiguous terms and many grey areas in the MLI provisions, while the available guidance is limited. For example, how do jurisdictions assess whether one of the principal purposes of a transaction or arrangement is obtaining that tax treaty benefit and that consequently the PPT applies? And to what extent will business reasons and genuine economic activity result in non-application of the PPT? Or what amount of profits are to be allocated to a dependent agency PE? It is expected that the MLI provisions will not be interpreted in the same way by different jurisdictions within the near future, which is likely to lead to more domestic and tax treaty disputes.

First of all, it is likely that the state applying the treaty will look at its domestic law for guidance on interpretation of an ambiguous MLI term. This also follows from the MLI, in which is stated in Article 2(2) that a term that is not defined in the MLI has the meaning that it has under the applicable tax treaty. In that respect Article 3(2) of the OECD model tax convention (which wording is part of nearly all bilateral tax treaties) provides that in the absence of relevant context requiring otherwise, such term has the meaning that it has under the domestic tax laws of the state applying the treaty.

Secondly, language inconsistencies can be expected for the MLI provisions. The MLI is available in two equally authentic languages: English and French. This can result in language discrepancies between the deposited ratification instruments, in English and French, but also with the unofficial MLI translations jurisdictions are making into their own official language. This will be even more felt for tax treaties not concluded in English or French, but only in other languages. This is for example the case for the tax treaty between the Netherlands and Mexico which has not been concluded in English, but only in Dutch and Spanish.

Thirdly, for application of the MLI there will be two interacting layers of treaty law; the MLI does not amend tax treaties (like a protocol) but the tax treaty and the MLI must be read and applied side-by-side. This layering of treaties instead of amending the bilateral tax treaties as such results in extra complexity in interpreting the MLI provisions.

Taking into account the above, the MLI is likely to result in varying interpretations of the same rule, most notably for the PPT. Hence it is to be assessed on a country by country basis whether the PPT or other MLI provisions will be a problem for a structure and what restructuring solutions would be available.

As taxpayers will be struggling with the same challenges as tax authorities in applying and interpreting the MLI provisions, it can be expected that tax authorities will receive requests for confirmations and rulings on the impact of the MLI on the spe-

   ISSN 1754-1646

cific situation of a taxpayer. Not only will there be more communication in advance, but it is to be expected that the MLI will also result in more dispute resolution via MAPs and arbitration later on. Overall this will lead to an increase of the workload for tax authorities and competent authorities at higher levels, which will probably result in a lack of capacity for authorities, also taking into account other BEPS measures (other than the MLI) to be dealt with by authorities.

Planning Points

As the MLI ratification, entry into force and entry into effect is a dynamic process, it is key for taxpayers to keep on monitoring what tax treaties are relevant for their structures and what tax treaty texts—including the MLI—are exactly applicable to them at a given point in time. It is obviously key to monitor which countries sign and ratify the MLI, but it is also crucial to monitor the countries that already ratified the MLI. The reason is that when treaty partners of the ratified countries will ratify the MLI in due course, such tax treaties would be affected in due course. Another point of attention is that it is possible that the countries that already ratified the MLI, will opt-in for certain additional MLI provisions in the future, meaning that the applicable tax treaty text—including the MLI—will change in the future.

Once it is clear what MLI provisions apply for a specific tax treaty, interpretation of the MLI provisions can be a considerably big challenge for tax authorities and taxpayers as well. Given the lack of clear guidance by the OECD or other relevant sources, we expect diverging interpretations of the MLI provisions. It is to be assessed on a country-by-country basis whether the MLI provisions will be a problem for a structure and what restructuring solutions would be available.

Margriet Lukkien is a Tax Partner and Helen de Gier is an Associate with Loyens & Loeff N.V., Amsterdam, the Netherlands.