Are We Compatible?: On Multilateral Tax Coordination

I BACKGROUND

Participation of jurisdictions in the drafting of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (the MLC) is considered to be a historical development in international tax law. It is indeed to celebrate the fact that over 100 jurisdictions – including OECD member countries, G20 countries and other developed and developing countries – participated in the drafting of the MLC, and on 7 June 2017, sixty-eight jurisdictions signed the MLC, and three other jurisdictions joined some weeks later.¹

The MLC addresses measures, such as the hybrid mismatch arrangements (Action 2), treaty abuse (Action 6), the artificial avoidance of the permanent establishment status (Action 7) and rules for improving dispute resolution mechanisms, including an optional mandatory binding arbitration (Action 14). Yet, only two Action points were considered minimum standards – namely the prevention of treaty abuse and dispute resolution.² Moreover, mandatory binding arbitration is applicable only between jurisdictions that expressly choose to apply it with respect to their tax treaties (Article 18 MLC).

The OECD expects at this moment that over 1,100 tax treaties will be modified based on matching the specific provisions that jurisdictions wish to add or change within the covered tax agreements (CTA) notified by the signatories.³ As the MLC is open for signature to any

interested jurisdictions, the subsequent joining by jurisdictions is to be expected.

However, the circumstances surrounding this massive participation and signing of the MLC are blurred and in most cases impossible to clarify. It is questionable and unknown whether all participating jurisdictions gave relevant input to the contents of the MLC; whether all interests and concerns were acknowledged in the MLC regime; whether they are aware of the likely consequences of signing the MLC in respect of inbound and outbound investment; whether they had substantial time to consider their state tax policy vis-à-vis reservations; whether they discussed and/or signed the MLC with the purpose of retaining to the greatest extent possible their current tax policy, moving further on in tax competition policies, or with the main purpose of entering into a new era of cooperation.

On the other hand, due to the intricacy of the MLC system of possible reservations, options, combination of rules, and subsequent modifications of CTA,⁴ it is also doubtful whether it is advantageous to be outside of the MLC and the circle of the major game players, and leaves outsiders with greater latitude to negotiate their tax policy (more time and information). This is questionable both for those that are allegedly ‘already compatible’, because they have unilaterally and bilaterally adopted the Base Erosion and Profit Shifting (BEPS) recommendations,⁵ as well as for those that are not (yet) compatible.

Notes

¹ <http://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm>; <http://www.oecd.org/tax/signing-ceremony-multilateral-convention-on-tax-treaty-related-measures-to-prevent-beps.htm> (accessed 10 Nov. 2017). Cameroon and Mauritius signed on 5 July, and Nigeria on 17 Aug.: <http://www.oecd.org/tax/treaties/beps-ml-signatories-and-parties.pdf>; See also e.g. R. J. Danon & H. Salomé, *The BEPS Multilateral Instrument, General Overview and Focus on Treaty Abuse*, IFF Forum für Steuerrecht 197, 199 (2017); A. Berbari, *The OECD/G20 Base Erosion and Profit Shifting (BEPS) Initiative and the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS*, Bull. Int'l Tax'n 538 (2017).

² In Oct. 2015, the OECD released the final reports on the fifteen action items of the BEPS Action Plan. The final reports contained recommendations that fall into different categories ranging from minimum standards, reinforced international standards and common approaches. The four minimum standards are: (1) Action 5: Counter Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance; (2) Action 6: Prevent Treaty Abuse; (3) Action 13: Re-examine Transfer Pricing Documentation; and (4) Action 14: Make Dispute Resolution Mechanisms More Effective: <http://www.oecd.org/tax/beps/beps-about.htm> (accessed 10 Nov. 2017); The MLC aimed at implementing the tax treaty-related BEPS minimum standards. On the topic, see e.g. Berbari, *supra* n. 1, at 539.

³ <http://www.oecd.org/tax/signing-ceremony-multilateral-convention-on-tax-treaty-related-measures-to-prevent-beps.htm> (accessed 10 Nov. 2017).

⁴ See Art. 30 of the MLC; on the topic, see e.g. See M. L. Gomes, *Implementation in Practice of the Principal Purpose Test in the Multilateral Convention*, published in this volume and issue at point 3.1; Y. Brauner, *McBEPS: The MLI – the First Multilateral Tax Treaty that Has Never Been*, published in this volume and issue at point 2.1.

⁵ See however, the various arguments stating that the United States decision not to sign the MLC will leave it in a more competitive position: M. Herzfeld, *U.S. Perspectives on the Multilateral Instrument*, published in this volume and issue.

Independently of the aforementioned level of awareness and of the consequences for investment brought by the MLC to a jurisdiction, and independently of the acknowledgment of its interests by the same MLC, some trends illustrate that most adhering jurisdictions were (expectedly) inclined to defend their sovereign tax power, when they were granted that option.⁶

They did so by ignoring relevant potential negative consequences for taxpayers, such as the high risk of international juridical double taxation, as well as increased legal uncertainty, and by leaving a margin for tax competition when rejecting detailed rules. Examples of these include mandatory binding arbitration, adopted by only twenty-six out of the seventy-one jurisdictions that signed the MLC;⁷ and the fact that, according to the OECD, the principal-purpose-test⁸ will apply to all 1,100 treaties currently covered by the Multilateral Instrument (MLI), whereas only thirteen signatories have chosen to supplement the provisions of the principal-purpose-test with a simplified limitation-on-benefits test (including Argentina, Armenia, Bulgaria, Chile, Colombia, India,⁹ Indonesia, Mexico, Russia, Senegal, Slovak Republic, Uruguay and Mauritius^{10,11}).

2 MULTILATERAL TAX COORDINATION V. REINFORCED NETWORK OF BILATERAL TREATIES

At first sight, the signature of the MLC can be celebrated as a significant step towards multilateral tax coordination.¹² This move is not new, but parallel to the multilateral exchange of information, although it may seem more difficult to coordinate measures against BEPS practices than to adopt procedural rules, such as those under the various tools on exchange of information.

The set of rules in the MLC has implications for the allocation of taxing rights (especially the anti-hybrid rules and the rules on the permanent establishment status, but

also dispute resolution mechanisms, such as mandatory binding arbitration) whereas instruments to exchange information aim merely to ensure correct taxation under domestic law and tax treaty rules. There is stronger pressure to adhere to the OECD standards and there is increasing promotion of single standards. This pressure is illustrated by the 'inclusive framework' that allows interested countries and jurisdictions to work with OECD and G20 members, on developing standards, as well as reviewing and monitoring the implementation of the BEPS package.¹³

However, coordination in substance is hardly achievable by the MLC. It introduces a complex system of reservations, where contracting jurisdictions may opt out of a provision, if it does not reflect a minimum standard. The permitted reservations are listed in Article 28 (1), including with regard to hybrid mismatches rules; dual resident entities; the absence of restriction on a party's right to tax its own residents; transfer pricing adjustments; rules on the artificial avoidance of the permanent establishment status; and splitting up of contracts, among others.

Because each contracting party submits its reservations, the MLC works on the basis of asymmetrical application, leading to an extremely complex system of implementation.¹⁴ Besides, it will be difficult to ascertain what are the rules applicable, and one of the most notable examples is the interaction of the principal-purpose-test rule (a minimum anti-avoidance standard provision to counter treaty-shopping) and targeted anti-abuse provisions in force in the covered tax agreements.¹⁵ For example, interpretation of the principal-purpose-test rule itself and the application thereof as a general anti-avoidance rule to situations covered by other rules that serve an anti-avoidance function (such as the beneficial ownership clause) will raise many issues.¹⁶ The case of holdings and the substantive owners interpreted in light of the principal-purpose-test

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⁶ Also sceptical, see e.g. R. García Antón, *The 21st Century Multilateralism in International Taxation: The Emperor's New Clothes?* 8 World Tax J 148 (2016), Journals IBFD.

⁷ Mauritius signed on 5 July 2017, and pursuant to Art. 18 of the Convention, chose to apply Part VI.

⁸ See the argument in Brauner, *supra* n. 4, at point 2.7.

⁹ Eg. India decided to apply the limitation-on-benefits clause: 'Article 7 – Prevention of Treaty Abuse Notification of Choice of Optional Provisions Pursuant to Article 7(17)(c) of the Convention, India hereby chooses to apply Simplified LOB provision pursuant to Article 7(6)': <http://www.oecd.org/tax/treaties/beps-mli-position-india.pdf> (accessed 10 Nov. 2017).

¹⁰ See e.g. the declaration by Mauritius: 'Article 7 – Prevention of Treaty Abuse Statement of Acceptance of the PPT as an Interim Measure Pursuant to Article 7(17)(a) of the Convention, Mauritius hereby expresses a statement that while Mauritius accepts the application of Article 7(1) alone as an interim measure, it intends where possible to adopt a limitation on benefits provision, in replacement of Article 7(1), through bilateral negotiation'. <http://www.oecd.org/tax/treaties/beps-mli-position-mauritius.pdf> (accessed 10 Nov. 2017).

¹¹ On the limitation on benefits clauses in the MLC, and the reasons on its limited adoption by the signatory States, see B. Kuzniacki, *The Limitation on Benefits (LOB) Provision in BEPS Action 6/MLI: Ineffective Overreaction of Mind-Numbing Complexity (Part I)*, published in this volume and issue.

¹² On a nuanced purpose, Brauner, *supra* n. 4, at point 2.1: 'In conclusion, the scope of the MLI conservatively supports the bilateral architecture of the international tax regime, yet its message is nuanced, opening a door toward increased multilateralization of the regime'.

¹³ <http://www.oecd.org/tax/beps/beps-about.htm> (accessed 10 Nov. 2017).

¹⁴ See Gomes, *supra* n. 4, at points 3.1. and 4.

¹⁵ See again Gomes, *supra* n. 4, at 4. And also, E. A. Palmitessa, *Interplay Between the Principal Purpose Test in the Multilateral BEPS Convention and the Beneficial Ownership Clause as Treaty Anti-Avoidance Tool Targeting Holding Structures*, published in this volume and issue; Danon & Salomé, *supra* n. 1, at 199, 237 et seq.

¹⁶ Danon & Salomé, *supra* n. 1.

rule is one example where it is uncertain whether case law will achieve the same results as under the interpretation of beneficial ownership.¹⁷

Article 7 (2) of the MLC, which states that the principal-purpose-test rule is to apply in place or in the absence of principal-purpose-test provisions of a covered tax agreement, denying benefits that would otherwise be provided under the CTA, will not prevent doubts on the application of the new principal-purpose-test rule.¹⁸

Because of the complexity the MLC raises, a 'Tool Kit for Application of the Multilateral instrument for BEPS Tax Treaty Related Measures' will be issued by the OECD.¹⁹ However this will only clarify the intricate regimes deriving from the interaction between the MLC and the covered tax agreements. It will not resolve interpretation issues that will arise before the national courts.

The fact that the MLC is based on a minimum standard (as opposed to reinforced international standards and common approaches), that reservations may be introduced, and that it is based on asymmetric implementation makes it difficult to

claim that the MLC leads to multilateral coordination, and even less to a new era of cooperation.

Rather than contributing to a new era of multilateral tax cooperation or governance, the signing of the MLC reinforces the network of bilateral treaties negotiated and concluded based on the OECD Model Convention. The legal relationship between the MLC and the covered agreements acknowledges the standardized character of the bilateral tax treaties,²⁰ and provides some tools to strengthen the sovereign tax jurisdiction. It is still the tax competition model among States that is in force, more complex, likely to divert cross-border investment flows, and increase litigation.

The articles and country-note published in this issue are dedicated to a critical analysis of the MLC. They cover some of the policy and interpretation problems resulting from the MLC provisions. In subsequent issues this year, the reader will continue to find sections or articles and country-notes dedicated to the MLC.

Ana Paula Dourado
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¹⁷ Palmitessa, *supra* n. 15.

¹⁸ See Gomes, *supra* n. 4, at point 4.1.; On the interpretation of the principal-purpose-test rule in the MLI, see V. Chand, *The Principal Purpose Test in the Multilateral Convention: Detailed Analysis*, published in this volume and issue.

¹⁹ <http://www.oecd.org/tax/treaties/application-toolkit-multilateral-instrument-for-beps-tax-treaty-measures.htm> (accessed 10 Nov. 2017).

²⁰ Brauner, *supra* n. 4, at point 2.1.