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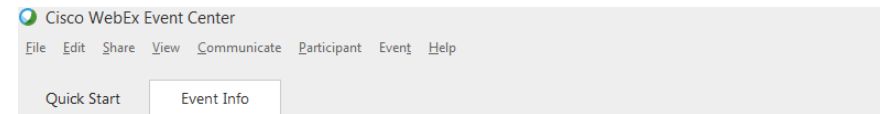
FUNDAMENTAL REFORM OF THE TAX TREATY NETWORK

11 July 2017

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AGENDA

1	Introduction
2	Overview of the MLI
3	Areas affected
4	A view from the US

INTRODUCTION

Malcolm Joy, BDO UK

THE MULTILATERAL INSTRUMENT (MLI)

John Wonfor, BDO Canada

THE MLI - WHAT IS IT?

- Action 15 of the OECD BEPS project called for the development of a Multilateral Instrument to implement treaty-related provisions of the BEPS action plan
- Approximately 100 jurisdictions participated in its development. Text was released in November 2016.
- Open for signing by countries since the end of 2016, with a signing ceremony on June 7, 2017
- 68 jurisdictions have now signed, impacting approximately 1,100 tax treaties when ratified (out of approximately 2,300 tax treaties globally). 9 additional jurisdictions have indicated an intent to sign, and the OECD expects close to 100 countries to sign by the end of 2017
- The US did not sign, but this is not considered significant as the US model tax treaty already meets the BEPS minimum standards on treaty-related provisions
- **One of the big successes of the BEPS project** - the first time, tax treaties can be modified without undergoing a bilateral treaty negotiation and ratification process. This will significantly speed up the implementation of these changes.



THE MLI - HOW DOES IT WORK?

- The MLI modifies tax treaties, it does not amend them. Essentially, it sits beside a tax treaty and modifies the text.
- Consolidated tax treaties may be prepared by countries, but this will not be the legal text.
- The MLI is written in the OECD's two official languages - English and French. Translations into other languages will likely be available, but the official version is only in these two languages.
- Countries that sign the MLI will choose which parts of their tax treaties they wish to modify, and with which countries. This information was released on June 7th for the 68 countries that signed.
- If there is a match with another country, the MLI will modify the text of the existing bilateral tax treaty, once the MLI has been ratified by both countries.
- The OECD will eventually release a database that will match particular tax treaties modified by the MLI.

OVERVIEW OF THE MLI

Part	Title	Articles	Type of rules
I	Scope and interpretation	1 - 2	
II	Hybrid mismatches	3. Transparent entities 4. Dual resident entities 5. Elimination of double taxation	<p>BEPS changes +</p> <p>Specific implementation rules to modify existing tax treaties</p>
III	Treaty abuse	6. Purpose of a covered tax agreement 7. Prevention of treaty abuse (PPT ¹ ; S-LOB ²) 8. Dividend transfer transactions 9. Capital gains immov property entities 10. Third country PEs ³ 11. Taxation of own residents	
IV	Avoidance of PE status	12. Commissionnaire arrangements 13. Specific activity exemptions 14. Splitting of contracts 15. Definition closely related to an enterprise	
V	Improving dispute resolution	16 MAP ⁴ 17 Corresponding adjustments	
VI	Arbitration	18 - 26	
VII	Final provision	27 - 36	General implementation rules

¹ PPT - Principal Purpose Test

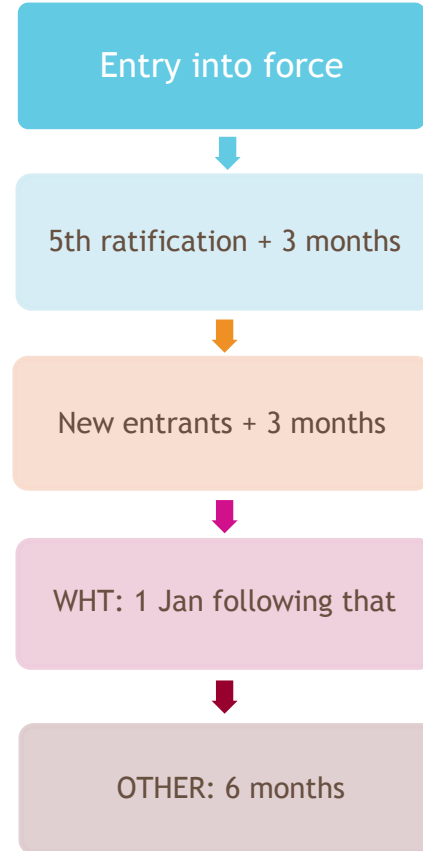
² S-LOB - Simplified Limitation on Benefits

³ PE - Permanent Establishment

⁴ MAP - Mutual Agreement Procedure

TIMELINE FOR MLI

Covers BEPS 2, 6, 7 and 14



AREAS AFFECTED

Hans Noordermeer, BDO Netherlands

ART. 3 MLI - TRANSPARENT ENTITIES

BEPS Action 2 - Hybrid Mismatches

- Not a minimum standard
- Some countries will already have domestic anti-hybrid provision
- EU ATAD-2 also addresses this point (2020)

Article 3(1) MLI

- DTA¹ only applies to PERSONS that are RESIDENTS
- Treaty benefits only available to transparent entities to the extent the income is taxed on the state of residence
- Aimed at preventing double non-taxation

Article 3(2) MLI

- Aimed at preventing excessive double tax relief in case the same income is taxed in the hands of different tax payers

Some MLI position examples

No application of entire art. 3:

- Canada
- Germany

No application of art. 3(2):

- Japan
- Luxembourg
- United Kingdom

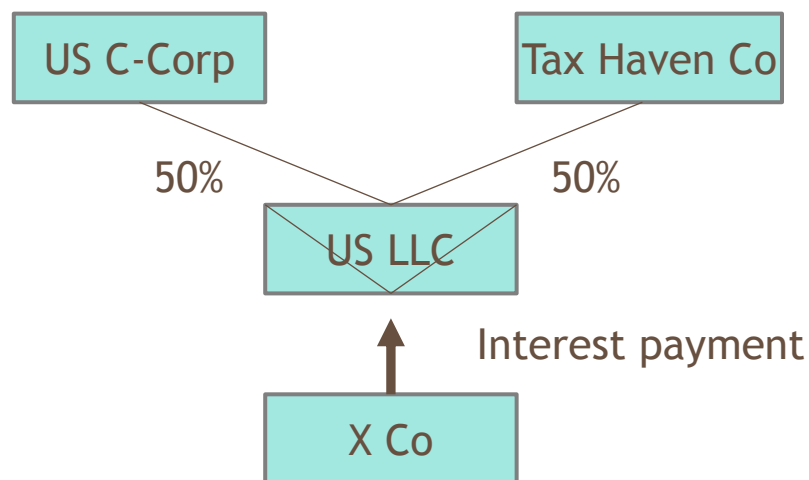
¹ DTA - Double Tax Agreement

ART. 3 MLI - TRANSPARENT ENTITIES

BEPS Action 2 - Hybrid Mismatches

Simplified example

- X Co, resident in country X, pays interest to US LLC
- US LLC is treated as transparent for US purposes
- US LLC is not resident in country X
- Say Country X has a treaty with US
- Country X should apply:
 - Treaty WHT on interest in relation to the 50% referable to US C-Corp
 - Full WHT on interest in relation to the 50% referable to Tax Haven Co



ART. 4 MLI - DUAL RESIDENT ENTITIES

BEPS Action 2 - Hybrid Mismatches

- Not a minimum standard
- Aimed at countering arbitrage by dual resident entities
- Tie-breaker becomes Competent Authority Agreement (CAA) rather than place of effective management
- No / Limited access to treaty benefits if there is no such agreement

Some MLI position examples

No application of entire art. 4:

- Canada
- Germany
- Luxembourg

Countries that deny treaty benefits in absence of CAA:

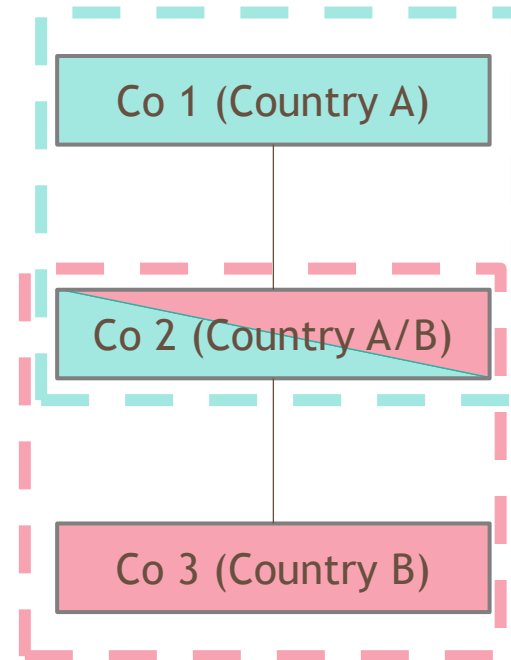
- Australia
- Japan

ART. 4 MLI - DUAL RESIDENT ENTITIES

BEPS Action 2 - Hybrid Mismatches

Example

- Company 2 is resident in two countries
- Losses of Company 2 are deducted in two countries via tax consolidation



ART. 7 MLI - PREVENTION OF TREATY ABUSE

BEPS Action 6

- Minimum standard
- Article 7 MLI gives three options:
 1. Principal Purpose Test (PPT)
 2. PPT + Simplified Limitation on Benefits (LOB) clause
 3. Detailed LOB + PPT or anti-conduit rules (not in MLI)
- Option 1 is the default choice
- A country can make a reservation for the PPT not to apply only:
 - for Covered Tax Agreements that already have a comprehensive PPT
 - if the intention is to meet minimum standard via option 3
- So in essence signing up to the MLI implies that the country adopts measures to prevent treaty abuse

MLI: PPT IS KEY ELEMENT

Article 7(1)

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.

- Low threshold to apply: ... one of the principal purposes ...
- Paragraph 12 ES¹: BEPS Commentary is relevant for interpretation of articles 3 - 17 MLI
- From BEPS 6 it follows:
 - object and purpose = economic substance in the treaty country

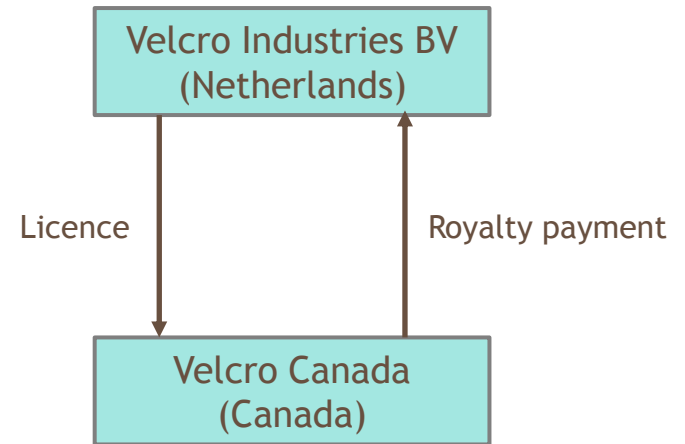
¹ES - Explanatory Statement to MLI

ART. 7 MLI - PREVENTION OF TREATY ABUSE

BEPS Action 6

Example - Velcro

- Velcro Industries BV granted a licence to Velcro Canada
- Velcro Industries BV is resident in the Netherlands
- Velcro Canada pays royalties to Velcro Industries BV



ART. 7 MLI - PREVENTION OF TREATY ABUSE

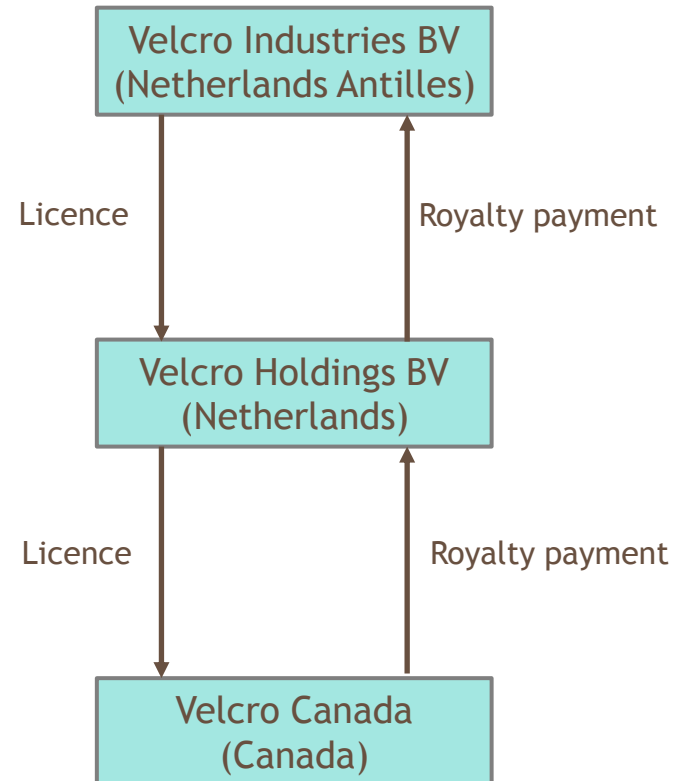
BEPS Action 6

Example - Velcro

- Velcro Industries BV granted a licence to Velcro Canada
- Velcro Industries BV is resident in the Netherlands
- Velcro Canada pays royalties to Velcro Industries BV
- Velcro Industries BV moves its tax residence to the Netherlands Antilles and assigns the licence to another Dutch company Velcro Holdings BV

Impact of MLI

- In court case beneficial ownership was central point of discussion
- Under MLI: what is the principal purpose, what is the economic reason for having this intermediate company

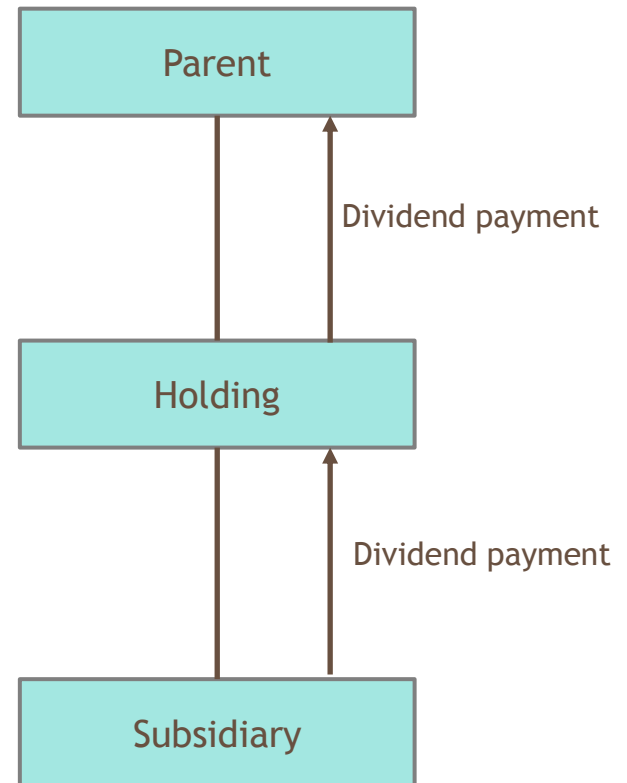


ART. 7 MLI - PREVENTION OF TREATY ABUSE

BEPS Action 6

Example - Intermediate Holding company

- Dividends from subsidiary to Holding to Parent
- Currently: beneficial ownership test
- MLI: PPT
 - Substance
 - Economic reason for the holding company
 - Tax is always a consideration



ART. 12-14 MLI: AVOIDANCE OF PE

BEPS Action 7

- MLI has several articles aimed at avoidance of having a taxable presence through a permanent establishment or permanent representative
- No minimum standard
- Art. 12: commissionaire
- Art. 13: auxiliary activities
- Art. 14: splitting up of contracts

- Practical problems: what is the profit that needs to be allocated

Some MLI position examples

No application of art. 12 MLI:

- Australia
- Canada
- Germany
- Luxembourg
- United Kingdom

No application of art. 14 MLI

- Australia (except for natural resources exploration)
- Canada
- Germany
- Japan
- Luxembourg
- Netherlands (except for natural resources exploration)
- United Kingdom

ART. 13 MLI: AVOIDANCE OF PERMANENT ESTABLISHMENT (PE)

BEPS Action 7

- Treaties list certain auxiliary activities not to be a taxable presence, eg:
 - storage of goods
 - keeping stock for delivery
 - purchasing goods
 - collecting information
- MLI adds the following requirement:
 - PROVIDED that such activity or,, the overall activity of the fixed place of business, is of a preparatory or auxiliary character
- MLI adds an anti-fragmentation rule

Examples of new PE's:

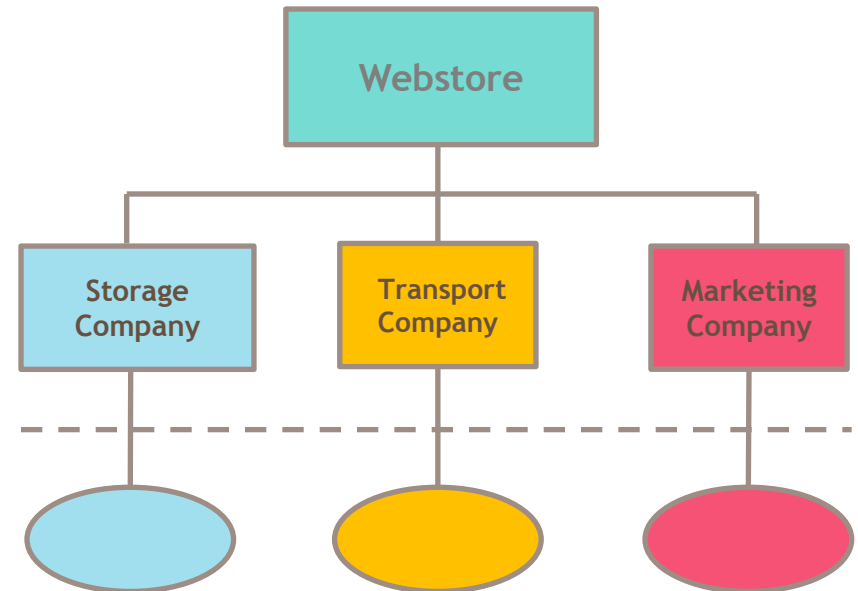
- warehouse that performs a vital function in the supply chain of the company (eg online webstore brings goods close to the client)
- purchasing office that performs an essential and significant part of the company's overall activity (eg if the company's own activity is the purchasing and selling of particular goods)

ART. 13 MLI: AVOIDANCE OF PE

BEPS Action 7

Anti-fragmentation rule

- Taken separately each entity claims that activity is auxiliary
- Currently: no taxable presence
- MLI: add activities of related parties together to assess auxiliary nature



ART. 16 - 26 MLI - DISPUTES / ARBITRATION

BEPS Action 14

- MLI contains several articles that deal with mechanisms for resolution of disputes
 - Art. 16: mutual agreement procedures
 - Art. 17: corresponding adjustments
 - Art. 18 - 26: Part VI - arbitration (optional)
- Since MLI contains a number of concepts open to different interpretation, it is expected that these clauses are very relevant

Some MLI position examples

Countries opting for Part VI - arbitration

- Australia
- Canada
- Germany
- Japan
- Luxembourg
- Netherlands
- United Kingdom

MLI: WHAT DOES IT MEAN IN PRACTICE

- Once MLI enters into force, tax treaties can change
- From current country positions already some 1,100 treaties are potentially affected
- The **challenge** is keeping track of
 - At what moment does the MLI have impact on a particular tax treaty
 - What changes in the treaty
 - Where can new treaty texts be found

Suggested approach to keep the task manageable:

- Identify what treaty benefits are most important for your group
- Keep track of the developments of those treaties
- As a follow-up do a more thorough impact review

A VIEW FROM THE US

Sean Dokko, BDO USA

MLI: UNITED STATES UPDATE

- US did not sign the multilateral instrument
- US tax treaty network has a low degree of exposure to base erosion and profit shifting issues
- US has significant safeguards as it relates to tax treaties -
 - Most treaties contain comprehensive LOB articles designed to prevent treaty shopping and limit benefits to the intended beneficiaries of treaties
 - There are rules that prevent third-country investors from routing their investment through the treaty partner to get the benefits
 - Many treaties contain arbitration provisions (including many treaties with binding mandatory arbitration)
 - Most treaties contain rules relating to transparent entities (many treaties have rules relating to hybrid entities/also rules under domestic law designed to address with hybrid entities)
 - Saving clause included in treaties
- Procedural issues in US relating to multilateral instrument (State Department and US Senate)
- The signing of the multilateral instrument by other nations can have a significant impact on US based multinationals

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