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Tax Treaty History – the Action 15 Multilateral Instrument

Tax treaty history was made (as the OECD Secretary-General enthusiastically announced) on 7 June 2017 as 76 countries and jurisdictions came together to sign, or formally express their intention to sign, the Multilateral Convention on Tax Treaty Related Measures to Prevent BEPS. Through signing this multilateral instrument (MLI), these countries started the process of amending 1100 tax treaties. The signatories included the UK and France; the US is not expected to become a signatory.

What is the MLI?

The MLI allows jurisdictions to transpose results from the BEPS Project into their existing networks of bilateral tax treaties. Each signatory is required to set out its 'MLI Position', a list of reservations and notifications that state which of the jurisdiction's tax treaties are covered by the MLI and which provisions apply to those covered tax agreements. From a UK perspective, HMRC has confirmed that it will produce a set of consolidated tax treaties showing how the MLI will apply to the UK's network of tax treaties.

What does the MLI cover?

The MLI contains provisions covering hybrid mismatch arrangements, treaty abuse, permanent establishment, and mutual agreement procedures, including an optional provision on mandatory binding arbitration. Under the treaty abuse provisions, of particular note is the principal purpose test, which many tax treaties will soon include:

"a benefit under the [treaty] *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* [treaty]*."*

Treaty benefits – principal purpose test

The commentary and examples provided by the OECD (in the BEPS Action 6 Final Report) give an indication of how the OECD expects the test to apply, although in each case it will come down to the views of the relevant local tax authority and, as discussed in 'Analysis – BEPS Action 6 and Private Equity Funds' there is still uncertainty about the rule's application in a fund context.

Entities seeking to benefit from a treaty will need to pay close attention to their reasons for choosing a particular jurisdiction. Taking into account a tax treaty network does not automatically mean that the test is failed but the entity must be able to show other substantive reasons for choosing that jurisdiction. These could include the availability of suitable human resources, a reliable legal system, a business friendly environment, political stability and a sophisticated banking industry. The final limb of the provision, which offers an exclusion from the test if it would be in accordance with the object and purpose of the tax treaty, should also not be overlooked: the examples note that tax treaties are intended to provide benefits to encourage cross-border investment.

The first modifications to bilateral tax treaties are expected to enter into effect in early 2018.

Please contact BEPS@Debevoise.com to discuss further.