BEPS and the Multilateral Instrument 2022

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INTRODUCTION

The Multilateral Instrument is the most tangible result of the OECD's action against base erosion and profit shifting in the tax field and may be seen as a tool of world tax governance. It fits therefore in the preoccupations which our colleague and friend Didier Willermain developed in his teaching and his writings encompassing various aspects of corporate governance.

As of 2022, there were 3,484 bilateral tax treaties in force. 100 States had signed the MLI, 79 had ratified it and the MLI had come into force in respect of 77 States. 1231 treaties qualify as covered tax agreements. The "multilateralization" of the process can be qualified as a success, although mostly located in developed countries. (1)

The MLI has been labelled an instrument designed to preserve bilateral treaties rather than a true multilateral treaty. (2)

The MLI is certainly not a perfect instrument. (3) It has been qualified as a product of the neoliberal institutionalist perspective, to be compared

[1] T.M. Vergouwen, D.M. Broekhuisen and J.J.H. Reijnen, "OECD/International – The Effectiveness of the Multilateral Instrument in Amending the Bilateral Treaty Network: (On) the Measure of Multilateral Success", *Bull. Int'l Taxation*, 2023, Vol. 77, nr 4.

[2] Y. Brauner, "McBEPS: The MLI – The first Multilateral Tax Traety that has Never Been", *Intertax*, 2018, p. 6.

[3] A.P. Dourado, "The MLI in Action", *Intertax*, Vol. 49, p. 753.

to the solution of the "prisoner's dilemma", leading to the adoption of the least damaging outcome.[4] The initial fears about its effectiveness[5] may now be dissipated in view of its relative achievements[6] justifying the optimistic forecasts, the absence of the United States notwithstanding.[7]

A. BEPS Action 15: A Multilateral Treaty

According to the Action Plan on Base Erosion and Profit Shifting, swift implementation of the various actions would be necessary if the anticipated results were to be achieved. Though some of the actions required domestic law provisions or changes merely to the Commentary of the OECD Model Tax Treaty or the OECD Transfer Pricing Guidelines, others would require changes to the OECD Model Tax Convention itself. These actions would be meaningless until such time as the bilateral treaties modelled on the OECD Convention or on the United Nations Model Tax Convention had been negotiated and approved by numerous countries. Instances cited include:

- introduction of an anti-treaty abuse provision;
- changes to the definition of "permanent establishments";
- changes to transfer pricing provisions; and
- provisions relating to hybrid mismatch arrangements.

In order to avoid protracted bilateral negotiations, OECD proposed, in Action 15 of the BEPS plan[8] the drafting and adoption of a multilateral

[4] D.M. Broekhuijsen, *A Multilateral Tax Treaty, Designing an Instrument to Modernize International Tax Law*, Thesis, University of Leiden, 2017, pp. 21, 69 and 231.

[5] M. Herzfeld, "US Perspectives on the Multilateral Instrument", *Intertax*, 2018, Vol. 46, p. 80.

[6] L. De Broe and S. Gommers, "Het Multilateral Instrument: een analyse van de formele bepalingen", *Algemeen Fiscaal Tijdschrift*, 2018/3, pp. 33-345; R. Avi-Yonah, *Advanced Introduction to International Tax Law*, Cheltenham, Edward Elgar, 2015, p. 147.

[7] C. Schelling, D. J. Salom and N. Burkhalter, "Overview of the Base Erosion and Profit Shifting Project", *in Base Erosion and Profit Shifting (BEPS). Impact for European and International tax policy*, Geneva/Zurich/Basel, Schulthess, 2016, p. 14; P. Pistone, "General Report", *in* M. Lang, J. Owens, P. Pistone *et al.* (eds), *Implementing Key BEPS Actions: Where do we stand?*, Amsterdam, IBFD, 2019, p. 20; P. Pistone and N. Cicin-Sain, *The Implementation and Lasting Effects of the Multilateral Instrument: General Report*, Amsterdam, IBFD, 2021, p. 85.

[8] OECD, "Developing a Multilateral Instrument to modify bilateral tax treaties Actions 15", Final Report, 2015 hereinafter cited as the "Multilateral Instrument Report"; M. Helminen, "The Problem of Double Non-Taxation in the European Union – To What Extent Could This Be Resolved Through a Multilateral EU Tax Treaty Based on the Nordic Convention?", *Eur. Tax.*, 2013, p. 306, P.D. Morrison, "BEPS (Part 2) – A Multilateral Tax Treaty", *Tax. Mgt. Int'l*, 2013, p. 306; G. Glou and F. Rodriguez, "Convention multilatérale de l'OCDE: comprendre sa prise d'effet et ses impacts pratiques sur les conventions fiscales françaises", *Rev. Dr. fisc.*, 2019, Étude 370, p. 7; A. Engels and Y. Van Brussel, "L'instrument multilatéral et nos conventions fiscales: c'est parti!", *Fiscologue International*, 2019, No 428, p. 1; C. Docclo, "L'instrument multilatéral ou la bouteille à l'encre",

instrument. The plan itself left the content open, calling for an analysis of the tax and public international law issues raised by the development of such an instrument. Elements of analysis were provided in a document published in September 2014.(9)

With very few exceptions, such as the Nordic treaty, this will be the first time that a multilateral instrument in the tax field has addressed not only procedural rules, such as exchange of information, but also substantive rules such as those mentioned above. In the field of international investment, efforts have been made to create multilateral agreements but they failed.(10) In the field of Trade Law, the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO) are examples of relative success, together with the various multilateral trade agreements supplementing them.

Several solutions could have been envisaged to achieve swift implementation of BEPS(11). The first would have been a mere adjustment of the OECD Commentary. This would be effective only if the adjustment could be reconciled with the treaties already signed and the commentary in force at the time of signature, even if an ambulatory treaty interpretation were to be adopted. This was unlikely to be the case. The changes to Article 7 and its commentary relating to income attributable to a permanent establishment, insofar as the changes to the Commentary applied to previous treaties, have already been the subject of much controversy.

T.B.F.-R.F.P., 2020, p. 7. P.J. Hattingh, "The Impact of the BEPS Multilateral Instrument on International Tax Policies", *Bull. Int'l Taxation*, 2018, vol. 72, nr. 4-5; D.W. Blum, "The Relationship between the OECD Multilateral Instrument and Covered Tax Agreements, Multilateralism and the Interpretation of the MLI", *Bull. Int'l. Tax.*, 2018, vol. 72, nr. 3; M.L. Gomes, "International Taxation and the Challenges for Multilateralism in the Context of the OECD Multilateral Instrument", *Bull. Int'l Taxation*, 2018, vol. 72, nr. 2; M. Lang, P. Pistone, A. Rust *et al.* (eds), The OECD Multilateral Instrument for Tax Treaties: Analysis and Effect, Alphen aan den Rijn, Wolters Kluwer, 2018, p. 239; P. Valente, "BEPS Action 15: Release of Multilateral Instrument", *Intertax*, 2017, vol. 45, p. 219; P. Martin, M. Evers, L. Jaton, E. Marcus et C. Silberztein, *La convention multilatérale OCDE : quel impact sur la fiscalité internationale ?*, Actes de la soirée d'étude annuelle de l'FA, Droit fiscal, 2017, 587, p. 29; A. Bosman, "General Aspects of the Multilateral Instrument", *Intertax*, 2017, vol. 45, p. 642; 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. Taxation.*, 2017, vol. 71, nr. 10; C. Silberztein and J.B. Tristram, "OECD: Multilateral Instrument To Implement BEPS", *International Transfer Pricing Journal*, 2016, vol. 23, nr. 5; S. Austry, J.F. Avery Jones, P. Baker *et al.*, "The Proposed OESO Multilateral Instrument Amending Tax Treaties", *Bull. Int'l Taxation*, 2016, vol. 70, p. 683; CFE, "Opinion Statement FC 15/2014 on Developing a Multilateral Instrument to Modify Bilateral Tax Treaties (BEPS Action 15)", *Eur. Tax.*, 2015, vol. 55, nr. 4; A. Hernández González-Barreda, "A Historical Analysis of the BEPS Action Plan; Old Acquaintances, New Friends and the Need for a New Approach", *Intertax*, 2018, vol. 46, p. 278.

[9] G. Delfosse, "L'instrument multilatéral : Petit guide à destination de l'utilisateur", *RGCFP*, 2017/7, p. 15.

[10] G. Loibl, in M.D. Evans, *International Law*, 4th ed., Oxford, O.U.P., 2014, p. 710.

[11] J. Lutz, "Een multilateraal instrument – Denkpistes en verhouding tot de Belgische income rechtsorde", *Algemeen Fiscaal Tijdschrift*, 2014, p. 25; D.M. Broekhuijsen, "Naar een multilateraal fiscaal raamwerkverdrag", *Weekblad Fiscaal Recht*, 2013, p. 1143.

A second solution would have been to sign a general multilateral treaty replacing the network of bilateral treaties. This solution seems unrealistic in view of the number of treaties concerned (some 3,000) and their differing provisions.

A third solution would have been a framework multilateral treaty to which various States could adhere by declaration without modifying its terms.

A fourth solution, in the same vein, would have been a multilateral treaty amending bilateral treaties but on which Contracting States could formulate reservations.

In its report on the topic, OECD started out from the premise that the BEPS Action Plan would require changes to the current tax treaty system in order *inter alia*:

– to curb treaty abuse;
– to modify the definition of "permanent establishment";
– to improve dispute resolution procedures; and
– to introduce provisions targeting specific issues such as treaty abuse in hybrid mismatch arrangements and other anti-BEPS measures that may be incompatible with existing treaties.[12]

The prime benefits of the multilateral treaty route would be speed and unity of interpretation. It would also facilitate the inclusion in BEPS of developing countries, which often have difficulty in signing bilateral treaties.

To a certain extent, globalization makes the bilateral approach obsolete: the mobility of factors and the existence of global value chains are likely to generate multi-country disputes and require multilateral Mutual Agreement Procedures (MAPs), which could better be addressed in a multilateral treaty.[13]

The multilateral treaty would not supersede existing bilateral agreements but would complement them by addressing anti-BEPS measures and securing their compatibility with existing or future treaties. It would be negotiated at an International Conference,[14] as was the case, for instance, for several multilateral treaties in the field of Private International

[12] Multilateral Instrument Report, No 4, p. 15.

[13] Multilateral Instrument Report, No 14, p. 19.

[14] Multilateral Instrument Report, No 22, p. 21; D. Carreau, *Droit international*, Paris, Pedone, 2004, pp. 110-111; P. Dailliet, M. Forteau and A. Peel, *Droit international public*, 8th ed., Paris, L.G.D.J., 2009, p. 184.

Law, civil procedure, arbitration, and criminal extradition procedures and mutual assistance.

In OECD's view, the multilateral treaty would only apply to signatories that had signed a bilateral treaty among themselves, the only potential exception being a multilateral dispute resolution mechanism.(15)

Conflicts with existing provisions in bilateral treaties would be resolved by compatibility clauses in the multilateral instrument. Definitions in the multilateral text would also prevail over existing definitions in bilateral agreements.(16)

In the document supplementing the Report, drafted by international law experts and somewhat irreverently labelled "A Toolbox for a Multilateral Instrument", it is made clear that the instrument should include compatibility or conflict clauses defining its relationship with prior, or even future, bilateral treaties. The resolution of conflicts with existing treaties should not be left to the "*lex posterior derogat priori*" rule enshrined in Article 30/3 of the Vienna Convention on the Law of Treaties.(17)

The treaty-to-be was characterized as presenting "flexibility". In addition to core commitments, several opt-outs, opt-ins or alternatives could be provided(18) for. This would undoubtedly weaken the instrument and could make it as complex as a series of protocols amending bilateral treaties, an option that was pointedly ruled out by OECD. Reservations to a multilateral treaty raise practical difficulties because the treaty loses its uniformity between contracting parties. The treaty becomes "fractioned" or "divisible" and is hard to apply effectively(19) when it is the result of a compromise – and this could have been the case with the BEPS treaty – reservations are excluded. This was the case with the Montego Bay Treaty on the Law of the Sea.(20)

(15) Multilateral Instrument Report, No 13, p. 31.

(16) Multilateral Instrument Report, Annex 1, No 20, p. 32; N. Bravo, "The Multilateral Tax Instrument and its Relationship with Tax Treaties", *World Tax Journal*, 2016, p. 279.

(17) The VCLT.

(18) Multilateral Instrument Report, No 16, p. 19; N. Bravo, "Interpreting Tax Treaties in the Light of Reservations and Opt-Ins under the Multilateral Instrument", *Bull. Int'l Taxation*, 2020, Vol. 74, nrs. 4-5.

(19) D. Carreau, *Droit international*, Paris, Pedone, 2004, p. 134; P. Dailliet *et al.*, *Droit international public*, 8th ed., Paris, L.G.D.J., 2009, p. 197; M. Fitzmaurice, in M.D. Evans (ed.), *International Law*, Oxford, O.U.P., 2014, p. 191.

(20) D. Carreau, *Droit international*, Paris, Pedone, 2004, p. 135.

If a State's reservations are too significant, other Contracting States may refuse to allow the Treaty to enter into force vis-à-vis the States making those reservations.[21]

As the Report rightly points out, several measures contemplated in the BEPS Action Plan are multilateral in nature, such as multilateral MAPs or tackling dual-residence structures, transparent entities in hybrid arrangements, triangular PE cases and treaty abuse.[22]

Aside from the difficulties relating to drafting and signing such a treaty, consideration should be given to its future amendments. Amending a multilateral treaty is a slow process, to wit the changes made in 2011 to the 1988 multilateral treaty of the Council of Europe and the OECD on Exchange of Information. Traditionally, revising a treaty may require either unanimity or the consent of a majority of the Contracting parties. If the majority rule is adopted, revision may or may not be binding on the minority States. If they are binding, a minority State may or may not have the right to withdraw.[23]

In this respect, a procedure is conceivable that is already applied in international law and is provided for by Article 11 of the Vienna Convention on the Law of Treaties: a Member State's agreement may be expressed not only by its signature but also by all other means provided for by the treaty. In various fields, such as environment, transportation, health or labor law, States have submitted to the majority decision of a treaty-designated body or an international organization. Examples are agreements relating to the division of water resources among a number of States.

In international tax law, which body should have that power? In spite of its ground-breaking work, OECD does not seem to be ideal: it represents only the tax administrations of its Member States. The International Court of Tax Justice, which several writers dream of, seems far off. It would have been worthwhile creating an independent body under the treaty itself.

Another problem lies in the very ambit of the BEPS Action Plan, which contemplates changes in domestic provisions and in treaty provisions that might replace, supplement or amend domestic provisions. The United States favors the "first do no harm" rule: a bilateral treaty or multilateral agreement may not restrict the benefits granted by the law of the United

[21] D. Carreau, *Droit international*, Paris, Pedone, 2004, p. 138.

[22] Multilateral Instrument Report, No 14, p. 19.

[23] D. Carreau, *Droit international*, Paris, Pedone, 2004, pp. 169-171.

States.[24] It is true that this rule does not appear in the OECD Model, although the model does contain in various provisions that “a contracting State may tax”, or “shall not tax”. The treaties signed by the United States include a saving clause, leaving unchallenged the right of the United States to tax its citizens as if the treaty did not exist, except in very restricted fields. As the BEPS Action Plan’s objectives include eliminating not only double taxation but also double non-taxation, the multilateral instrument would include several restrictions on the application of a treaty where an element of income or wealth is not taxed in another contracting State. For the United States, a treaty is no place for a provision, even an indirect one, that a State will tax such income or wealth.[25]

B. The Multilateral Agreement (2017)

BEPS is described as the “most significant re-write of international tax rules in a century.”[26] It culminates in the release, on 24 November 2016, of the Multilateral Instrument, a multinational convention providing for the simultaneous amendment of more than 3,000 existing bilateral double tax conventions, subsequently signed in 2017.

The financial crisis, maybe as a pretext, and various “leaks”, induced more than 100 countries to eliminate BEPS by making international tax rules coincide with modern business practices and securing that taxation takes place where economic value is created. The OECD Action Plan on Base Erosion and Profit Shifting was launched in 2013 and Final Reports on 15 Actions were issued in 2015. Action 15, the development of a multilateral instrument, arose from the acknowledgement that present DTC norms were old-fashioned, as were domestic international tax rules. Both sets of rules had to be modernized.

[24] P.D. Morrison, “BEPS (Part II – A Multilateral Tax Treaty?)”, *Tax Mgt. Intl J.*, 2013, p. 626.

[25] See Art. 1.2 of the 2006 US Model Treaty: “This convention shall not restrict in any manner any benefit now or hereafter accorded (1) by the laws of either Contracting State.”

[26] On the BEPS plan, see *e.g.,* A.P. Dourado, *Governação Fiscal Global*, Coimbra, Almedina, 2017, p. 43; R. Danon (ed.), *Base Erosion and Profit Shifting (BEPS). Impact for European and international tax policy*, Geneva/Zurich/Basel, Schulthess, 2016; J. Malherbe, C.P. Tello and M.A. Grau Ruiz, *La Revolución fiscal de 2014*, FATCA, BEPS, OVDP, Bogotá, Instituto Colombiano de Derecho Tributario, Legis, 2015.

The MLI is the instrument that aims to adapt DTC rules to fill gaps allowing “legal” tax avoidance. MLI provisions are divided into three categories:

1) The minimum standard provisions, which are necessary to achieve the goal of the exercise:
   1°. a preamble stating that treaties aim at avoiding double taxation without creating opportunities for non-taxation;

   2°. a principal purpose test (PPT), preventing the unjustified granting of treaty benefits;

   3°. the commitment of parties to apply a mutual agreement procedure (MAP) to solve problems in interpretation and application of treaties.

   The provision relating to corresponding adjustments in State B after a transfer pricing primary adjustment favorable to State A must also be considered as part of the minimum standard.(27)

2) A second category includes provisions relating to:
   – income derived through transparent entities;

   – granting DTC benefits to dual-resident legal entities;

   – the treatment of dividend payments;

   – the treatment of income attributable to permanent establishments (PEs);

   – artificial avoidance of PE status.

   Parties may reserve their rights in connection with those provisions, totally or partially.

3) A third category includes optional provisions which may be chosen by parties to a DTC:
   – the proper method to avoid double taxation;

   – the avoidance of PE status through the misuse of certain activity exemptions;

   – an additional preamble wording;

[27] A. Langer, “The Legal Relevance of the Minimum Standard in the OECD/BEPS Project”, in M. Lang, P. Pistone, A. Rust *et al.*, *The OECD Multilateral Instrument for Tax Treaties, Analysis and Effects*, Alphen aan den Rijn, Wolters Kluwer, 2018, p. 98.

– a simplified limitation on benefits (LOB) clause;

– an agreement to arbitrate tax disputes not resolved within the framework of a MAP.

The procedure of ratification and the effect of reservations on the introduction of provisions in existing treaty relationships is, therefore, extraordinarily complex. They may in addition be modified in the future. (28)

I. SCOPE AND INTERPRETATION OF TERMS (ARTICLES 1 AND 2)

The Multilateral Agreement modifies the Covered Agreements. This includes agreements for the avoidance of double taxation with respect to income taxes, capital taxes and taxes on capital gains. It does not apply to agreements applying solely to shipping and air transport or social security.

Those agreements must be in force between Parties. A Party is either a State, acting for itself or for a jurisdiction or territory for whose international relations the State is responsible, even if those jurisdictions have the ability to conclude tax agreements. Such jurisdictions may, therefore, become Parties to the Convention:

- by signing when being listed by name (29) in the Convention (Guernsey, Isle of Man, Jersey);
- by being authorized to sign and ratify the Convention by a decision by consensus of the Parties; (30)
- because a State Party includes the tax agreements of such jurisdiction in its list of Covered Tax Agreements.

The State may make reservations and notifications which are different in respect of such jurisdiction from its own. (31)

States and Jurisdictions are referred to as Parties. (32) Contracting Jurisdictions are parties to a Covered Tax Agreement. (33) Signatories are States

[28] E. Schoueri and G. Galdino, “Action 2 and the Multilateral Instrument: Is the Reservation Power Putting Coordination at Stake?”, *Intertax*, 2018, Vol. 46, p. 104.

[29] Art. 27.1.b).

[30] Art. 27.1.c).

[31] Explanatory Memorandum, hereafter EM, 30.

[32] EM, 34.

[33] EM, 35.

and Jurisdictions which have signed the Convention but for which the Convention is not yet in force.(34)

Terms which are not defined in the Convention shall, unless the context otherwise requires, have the meaning which they have under the relevant Tax Agreement at the time the Convention is applied (ambulatory interpretation). If a term is not defined in the Convention or in the Covered Tax Agreement, it will generally have the meaning which it has in the Domestic Law of the Contracting Jurisdiction applying the Covered Tax Agreement, the tax law meaning prevailing over the meaning in other laws.

The context will include:

- the purpose of the Convention, *i.e.* the application of various BEPS measures;
- the purpose of the Covered Tax Agreements.

Those include:

- the preamble, stating that the purpose of the Convention is to implement tax-treaty related BEPS measures;
- its reference to Article 6, being the elimination of double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance including treaty shopping.(35)

II. HYBRID MISMATCHES

A. Article 3: Transparent Entities

The Action 2 Report “Neutralizing the Effects of Hybrid Mismatch Arrangements” includes a Chapter 14 “Treaty provision on transparent entities”. It extends the contents of the OECD Partnership Report of 1989 to cover not only partnerships but, *e.g.*, trusts.

Article 1 of the Model Convention “Persons Covered” is, therefore, supplemented by paragraphs 2 and 3. The Convention applies to persons who are residents of one or both of the States (§ 1) but income derived by or through an entity or arrangement treated as wholly or partly transparent under the tax law of either Contracting State shall be considered as income

[34] EM, 36.
[35] Art. 2; E.M., 37-38.

of a resident of a Contracting State only to the extent that the income is treated as income of such resident for purposes of taxation by that State (§ 2). Absent such provision, income derived by a transparent entity would not be income of a resident under the treaty as the transparent entity would not be subject to tax and therefore would not be a resident.(36)

Example

An entity formed by two partners in State B has loaned money to a debtor residing in State A. State A considers the entity of State B as a company. State B considers it fiscally transparent as a partnership and taxes each of its two partners on half of the interest. One of the partners resides in State B and the other one is resident in a State with which States A and B have no treaty.

The withholding on interest in State A is 30% but is reduced by treaty to 10%. The partner residing in State B is taxable on the interest. State A will reduce its withholding to 10% but only in favor of the partner residing in State B. The reduction will apply even if State B does not consider the entity as a company and the income is, for State A, paid to a company and for State B paid to an individual partner.

Meaning of fiscally transparent.(37)

An entity is fiscally transparent when:

- the tax is determined according to the personal characteristics of that person;
- the character and source and the timing of realization of the income are not affected by the fact that it has been earned through the entity or arrangement.

It is indifferent, however, that the income is computed at the level of the entity or arrangement (French *société civile immobilière* – SCI).(38)

[36] OECD, Comm. Art. 1, 5; A. Nikolakis *et al.*, "Some Reflections on the Proposed Revisions to the OECD Model and Commentaries, and on the Multilateral Instrument, with Respect to Fiscally Transparent Entities", *Bulletin for International Taxation*, 2017, Vol. 71, Nos 9 and 10.

[37] 2015 Action 2 Final Report, 26.10.

[38] OECD, "The Application of the OECD Model Tax Convention to Partnerships, Neutralizing the Effects of Hybrid Mismatch Arrangements", 1999, pp. 37-40; French doctrine considers the company in that case as "translucid".

1) Partial Transparence

The entity or arrangement may be partially transparent.(39)

Examples

In a Trust, the distributed portion is taxable to the beneficiaries and the accumulated portion is taxable to the trustees. In a limited partnership, the portion of the general partner is taxable to him but the portion of the limited partners is taxable to the partnership.

2) Relation with saving clause

The Action 6 Report on "Preventing of the Granting of Treaty Benefits in Inappropriate Circumstances" has added to Article 1 of the Model Convention a paragraph 3 reproducing the saving clause applied by the United States. Under this clause, a Convention limits only the right of a Contracting State to tax non-residents but not its right to tax its own residents.(40)

There are some exceptions to that rule, including, *e.g.*, Article 23 on the avoidance of double taxation. Article 23, when applying the exemption method (Article 23A) or the credit method (Article 23B), grants the benefit of those methods to residents of the States who derive income or own capital which may be taxed in the other State. If this were applied to income of transparent entities, Contracting State A taxing the income of a partnership resident in that State whereas Contracting State B taxing the partners resident in its territory, Article 23 could be interpreted as precluding State B from taxing its residents on their share of the partnership's income or capital.

The text of Article 3 has been, therefore, amended to read "When a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State under the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also derived by a resident of that State) […]", the exemption or credit will apply. In other words, double taxation relief applies in State B only when State A is a State of source or a State where a permanent establishment is located(41).

[39] 2015 Action 2 Final Report, 26.11, *ibid*.

[40] "Preventing the Granting of Treaty Benefits in Inappropriate Circumstances", Final Report, 2015, Action 6, pp. 62-63.

[41] Final Report, 2015, Action 6, p. 64. OECD Comm., new § 11.1.

Relief must not be granted for taxation levied on the basis of residence of the taxpayer.

Belgium has made no reservation to this provision.

B. Article 4: Dual Resident Entities

If a person other than an individual is a resident of both Contracting States, the competent authorities of both States shall try to determine by mutual agreement the State in which the person shall be deemed to be a resident, having regard to its place of effective management, its place of incorporation or constitution and other relevant factors. Failing such agreement, such person shall not be entitled to relief provided by the Covered Tax Agreement except if the competent authorities agree on such relief.[42]

This provision replaces provisions of the Covered Tax Agreements enacting other tie-breaker rules (place of effective management, place of organization) or calling on mutual agreement but failing to exclude relief in the absence of an agreement.[43]

Many countries resented the replacement of the traditional criterion of place of effective management and feared that the mutual agreement procedure would lead to an excessive burden on their tax administrations.

Belgium has reserved the right not to apply this provision.

Dual-listed companies are excluded from the application of the provision. These apply to arrangements between two parent companies, each listed, creating special voting shares giving to shareholders the same position as if they were direct shareholders of the common subsidiary.[44]

C. Article 5: Application of Methods for Elimination of Double Taxation

The BEPS Actions aim at eliminating double non-taxation, a.o., Deduction/Non Inclusion (D/NI).

[42] Art. 4.1.

[43] Art. 4.2.

[44] EM, 53.

The Action 2 Report makes two recommendations:

a) A dividend exemption should not be granted if the dividend payment is deductible by the payer;

b) The jurisdiction of the payer, if the credit method is applied in the jurisdiction of the payee, should restrict its relief in proportion to the net taxable income of the taxpayer (45).

An example is the arrangement providing for the borrowing of securities, the borrower in country B paying a manufactured interest to the lender in country A equal to the interest received during the period of the loan.

The arrangement is a hybrid because A Co is the owner of the bond under the law of country A whereas B Co is the owner of the bond under the law of country B.

If a withholding tax of 10% is levied in the source country of the interest, A Co and B Co will both be entitled to a credit of 10. The taxable income of A is:

Manufactured interest	90	
Withholding	10	
	100	
Tax rate 30%	30	
Tax credit	10	
Tax payable		20
After tax return		70

The taxable income of B is:

Interest	90	
Withholding	– 10	
Manufactured interest	– 90	
	10	
Tax rate 30%	3	
Tax credit (46)	10	
Tax payable		7
After tax return		7

[45] Final Report, 2015, Action 2, 112, p. 47.

[46] The excess credit is used against other income or carried forward.

If the relief is restricted in proposition to the net taxable income of Co B, its taxable income is:

	10
Tax 30%	3
Tax credit	3
Tax to pay	0
After tax return	0 [47]

The Multilateral Instrument applies these recommendations to treaties by granting Contracting States three options in the event of application of the exemption method, following the suggestions of the Action 2 Report. [48]

Option A

The Covered Tax Agreement providing that Resident State A shall exempt income derived or capital owned by a resident of A from tax shall not apply when Source State B exempts the income from source taxation or levies tax at a reduced rate. If the income or capital is taxed at a reduced rate, Residence State A will switch to the credit method and grant to its resident a credit for the tax levied in State B without exceeding the tax levied in the Residence State. This would apply to dividends, interest and royalties, but primarily to "mismatched" dividends.

Option B

A Covered Tax Agreement exempting income treated as dividends in Residence State A shall not apply if the income gives rise to a deduction in Source State B. Residence State A shall only grant a credit equal to the amount of the tax eventually imposed on the payment in the Source State.

This is a partial solution as it applies only to dividends. [49]

Option C

Option C eliminates the problem by substituting the exemption method by the credit method. Residence State A grants to its residents a credit for the tax paid in Source State B which may also tax it, except – as we have seen – if State B is allowed to tax because the income is income of one of its residents. The credit may not exceed the tax levied in Residence State A.

[47] Final Report, 2015, Action 2, example 2.2, p. 281.
[48] *Ibid*., 444, p. 146.
[49] *Ibid*., 444, p. 147.

If such exemption applies to any type of income or capital in Residence State A, State A may take the income or capital into account to calculate the tax due on other income or capital (exemption with progression).

Asymmetrical application

If two Parties choose different options, each option chosen will apply to the residents of the electing Party.

As reservations are allowed, a Party may then elect not to apply Article 5 in its entirety.[50]

Belgium did not elect any of these options.

III. TREATY ABUSE

A. Article 6: Purpose of a Covered Tax Agreement

A preamble should be introduced in Covered Tax Agreements stating that Parties intend to eliminate double taxation in respect of taxes covered by the agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance[51] including treaty-shopping arrangements aiming at obtaining treaty relief for the indirect benefit of residents of third jurisdictions.

The inclusion of this minimum standard is compulsory, except if the language or a broader formulation is already included in the Covered Tax Agreements. The standard will serve to interpret the treaty provisions.

[50] Art. 5.8.

[51] "*Évitement fiscal*" in French; K. Taramountas, "The PPT: The Introduction of a Uniform Standard with an Uncertain Application", *Intertax*, 2019, vol. 47, p. 922; C. Elliffe, "The Meaning of the Principal Purpose Test: One Ring to Bind Them All?", *World Tax Journal*, 2019, vol. 11, nr. 12; V. Chand, "The Principal Purpose Text in the Multilateral Convention: An in-depth Analysis", *Intertax*, 2018, vol. 46, p. 18; C. Bergedahl, "Anti-Abuse Measures in Tax Treaties Following the OECD Multilateral Instrument", *Bull. Int'l Taxation*, 2018, vol. 72, nr. 1 and nr. 2; B. Kuzniacki, "The Principal Purpose Test (PPT) in BEPS Action 6 and the MLI: Exploring Challenges Arising from Its Legal Implementation and Practical Application", *World Tax Journal*, 2018, vol. 10, nr. 2; E. 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", *Intertax*, 2018, vol. 46, p. 68; R. Danon, "Treaty Abuse in the Post-BEPS World: Analysis of the Policy Shift and Impact of the Principal Purpose Test for MNE Groups", *Bull. Int'l Taxation*, 2018, vol. 72, nr. 1; V. Chand, "The Interaction of the Principal Purpose Test (and the Guiding Principle) with Treaty and Domestic Anti-Avoidance Rules", *Intertax*, 2018, vol. 46, p. 115.

Parties may add: “Desiring to further develop their economic relationship and to enhance co-operation in tax matters.” Belgium has chosen that language.

Article 7: Prevention of Treaty Abuse

1) Each Covered Tax Agreement must, in principle, contain a Principal Purpose Test (PPT) stating that treaty benefits shall not be granted in respect of an item of income or capital if it is reasonable to conclude, with regard to all relevant facts and circumstances, that obtaining the benefit was one of the principal purposes of the arrangement or transaction which resulted in that benefit, unless it is established that granting the benefit in these circumstances would be in accordance with the object and purpose of the Covered Tax Agreement.
   The PPT will be included in place or in the absence of similar provisions.
   An exception may be provided, stating that the competent authority of the Contracting State that would have granted the benefit may find that the benefit would have been granted in the absence of the transaction or arrangement and therefore grants the benefit or different benefits. Before rejecting a request, such competent authority shall consult with the competent authority of the other State.
2) Parties may choose to apply a Simplified Limitation of Benefits (LOB) provisions as a supplement to the PPT[52].
3) A Party may reserve the right not to apply the PPT by adopting a combination of a detailed LOB provision and either rules addressing conduit financing structures or a principal purpose test meeting the minimum standard for preventing treaty abuse under the BEPS package.[53] It should be a comprehensive PPT, not a PPT limited to certain benefits. The detailed provision on limitation of benefits is the type now described in Article 29 Entitlement to benefits sub 1 to 7 and in the Commentary thereof.[54]

[52] Art. 7.6 ; B. Kuzniacki, “The Limitation on Benefits (LOB) Provision in BEPS Action 6/MLI: Ineffective Overreaction of Mind-Numbing Complexity – Part I”, *Intertax*, 2018, Vol. 46, pp. 68 and 124.

[53] Art. 7.15, a).

[54] EM, 110.

Simplified Limitation on Benefits Provision

The simplified LOB Provision denies to persons other than qualified persons the benefits of a Covered Tax Agreement other than:

- the provision determining the residence of a person who is a dual resident;
- the provision granting a corresponding adjustment following a transfer pricing adjustment by the other Contracting Jurisdiction;
- the access to the MAP procedure.

The following residents are qualified persons:

a) An individual;

b) A State, its political subdivisions, local authorities or agencies or instrumentalities thereof;

c) A quoted company: the principal class of shares whereof is quoted on a recognized stock exchange, being a class of shares representing the majority of the vote and value of the company; [55]
   i) Non-profit organization agreed upon by diplomatic notes;

   ii) Entities which are:

      A) regulated pensions funds,

      B) investment funds for the benefit of pension funds;

d) An entity 50% owned during half of a 12-month period including the time of granting of the benefit by qualified persons.

Treaty benefits will be granted to all persons engaged in the active conduct of a business if the income emanates from the business or is incidental to the business.

The active conduct of a business does not include:

(i) Operations as a holding company;

(ii) Supervision or administration of a group of companies;

(iii) Group financing including cash pooling;

(iv) Making or managing investments except for banks, insurance companies and registered securities dealers operating in the ordinary course of business.

[55] Art. 7.13, b).

The business activity has to be substantial in relation to items of income in relation with the activity or a connected activity. Activities of connected persons are included. (56) A connected person is a person who owns at least 50% of the vote and value of the company or entity or has control thereof. (57)

A competent authority may grant the benefit if the resident who is not a qualified person demonstrates that its principal purposes was not the obtention of the treaty benefit. The competent authority will consult with the other competent authority before granting or denying the request. (58)

A resident of a Contracting Jurisdiction who is not a qualified person will be entitled to the treaty benefits granted if "equivalent beneficiaries" own during one half of a 12-month period including the granting of benefit 75% of the beneficial interests of the resident. (59)

Equivalent beneficiaries are persons which would be entitled to equivalent or more favorable benefits in respect of an item of income under domestic law, the Covered Tax Agreement or any other international instrument. (60)

The Simplified Limitation of Benefits shall apply in lieu of or in the absence of provisions in the Covered Tax Agreement that would limit treaty benefits other than those which must be maintained in any event. (61)

If such a provision exists, parties are free not to apply the Simplified Limitation of Benefits provision (62).

Belgium has adopted the general rule of Article 7 including the faculties given to competent authorities, but without the addition of a Simplified LOB rule.

Parties which are EU Member States may, therefore, keep treaty provisions providing that the Directive shall prevail over existing dividend provisions. (63)

(56) Art. 7.10.
(57) Art. 7.13, e).
(58) Art. 7.12.
(59) Art. 7.11.
(60) Art. 7.13, c).
(61) Art. 7.14.
(62) Art. 7.15, c).
(63) EM, 123.

Opting out of the provision entirely is possible. It is also possible if the Covered Tax Agreement already includes a minimum holding period, eventually shorter or longer than 365 days.(64) If the Covered Tax Agreement provides for two split rates (*e.g.*, 5 and 15%) and for a holding period only in respect of one of them, Article 8 will then apply to the other one.(65)

B. Article 8: Dividend Transfer Transactions

The withholding or other tax on dividends levied by a Source State may be waived or lowered when the recipient is a company of the other Contracting Jurisdiction owning, holding or controlling more than a certain amount of the capital, stock, voting power, voting rights or similar interests of the payer company. No minimum holding period was required under Article 10 of the OECD Model Convention in order to have a broadly applicable provision and to avoid the conduct of inquiries to ascertain the situation.

The MLI adds to the conditions a minimum holding period of 365 days including the day of payment. The computation of the period takes no account of changes of ownership resulting from a corporate reorganization involving the payee or the payee company. Such a provision is now included in the OECD Model Treaty.(66)

Other conditions that apply to the benefit are not modified, such as:

– an investment of more than a certain monetary value;
– subjection to tax of the distributed profits in the residence jurisdiction;
– composition of profits, including no more than a certain amount of interest or dividends.(67)

Opting out and compatibility with the EU Parent-Subsidiary Directive

Under the Parent-Subsidiary Directive, Member States have the option not to apply the Directive to companies which do not maintain their holding of the shares of their subsidiary for an uninterrupted period of two years. This holding period may refer to the past or the future, *i.e.* to the period preceding or following the payment of the dividends.

[64] Art. 8.3.
[65] EM, 126.
[66] EM, 111.
[67] EM, 122.

The holding period imposed by the MLI does not specify whether the condition must be fulfilled in the past or may be fulfilled in the future.[68] It is, therefore, compatible with the Directive.

Countries often provide for a holding period in order to grant the withholding exemption but not for the granting of the deduction for dividends received.

C. Article 9: Capital gains from Alienation of Shares or Interests in Entities Deriving their Value Principally from Immovable Property

Article 13.4 of the OECD Model Convention provides that gains from the alienation of shares deriving more than 50% of their value directly or indirectly from immovable property situated in a Contracting State may be taxed in that State.

1) The MLI modifies this provision in two respects.
   It introduces a testing period of 365 days preceding the alienation: taxation in the Source State will be allowed if the criterion has been met at any time during that period.

   This will prevent the contribution of other than immovable assets shortly prior to a sale in order to dilute the percentage of immovable property held by the company and avoid the source taxation.[69]

   It expands the scope of the provision by applying it not only to shares of companies but also to comparable interests, such as interests in partnerships or trusts.

   Exceptions provided in Covered Tax Agreements, such as an exclusion of listed shares, may continue to apply.[70]

2) Parties may prefer to apply the wording provided in the OECD Model Treaty[71] allowing taxation in the source Jurisdiction if more than 50% of the value of the shares or of comparable interests is derived directly or indirectly from real property situated in the source

[68] C. Gradl and M. Kiesewetter, "Das Mehrseitige Übereinkommen (Multilateral Instrument)", *IStR*, 1/18, p. 5.

[69] EM, 128; Final Report, 2015, Action 6, 44, p. 72.

[70] EM, 131.

[71] OECD Model Treaty, Art. 13.4.

Jurisdiction and if such situation exists at any time during the 365 days preceding the alienation. (72)
This provision will then apply in the absence of a similar provision or to substitute a rule applying when a certain part of the value of the shares or rights is derived from real property or consists of real property. (73)

3) Parties may opt out of the provision entirely only for the application of the holding period or the extension to interests other than shares, for the application of the holding period when a holding period is already provided in the Covered Tax Agreement, for the application to interests other than shares when a provision in this respect already exists in the Covered Tax Agreement or when a provision allowing taxation in the source Jurisdiction given the presence of a certain value in real property located there already exists in the Covered Tax Agreement. (74)

Belgium has made a reservation in respect of the provision of a holding period but not in respect of the extension of the provision to interests other than shares.

D. Article 10: Anti-Abuse Rule for Permanent Establishments situated in Third Jurisdictions

The rule refers to income of a State A resident company originating in a State B, *e.g.,* dividends, interest or royalties, where source State B applies its treaty with Residence State A but State A company transfers shares, debt claims or rights to property, *e.g.*, intellectual property, to a PE located in a third State C, where taxation is low. Such a triangular case has been labelled as abuse, resulting in non-taxation when State B considers that, by a sort of force of attraction of the PE, income from the assets transferred form part of the income of the PE in the third State and applies the exemption method to such income.

It was pointed out that the structure in the third State should be a real PE, with a corresponding activity.

(72) Art. 9.3 and 4.
(73) Art. 9.5.
(74) Art. 8.6.

The 2015 Action 6 Final Report [75] concluded that an anti-abuse clause should be introduced in the treaties. The MLI provides that in such a case, the Convention between A and B shall not apply if the tax in State C is lower than 60% of the tax which would be imposed in A if the PE were situated in A. The income will then remain taxable according to the domestic law of B which may levy *e.g.*, its withholding taxes. It is, therefore, B which is protected, not A. The provision shall not apply if the income is derived in connection with or is incidental to the active conduct of a business in the PE located in C, other than making, managing or holding investments for the enterprise's account. The sub-exception does not apply if the investment business is carried on by a bank, insurance or securities dealer, as the business of those entities is the management of investments.

The competent authority of State B may grant the benefit in respect of an item of income if it is justified. It will consult with the competent authority of State A before granting or denying the request. [76]

The provision applies in place of existing similar provisions or in the absence of such provisions.

As the anti-abuse rule for permanent establishments is not a minimum standard, opting out is possible. [77] A Party may reserve the right to opt out entirely in respect of all its Covered Tax Agreements, to opt out in respect of its Covered Tax Agreements which contain a clause denying or limiting benefits granted to a resident Jurisdiction enterprise deriving income originating in the source Jurisdiction from a permanent establishment located in a third country or to apply the article only to Covered Tax Agreements which already contain such clause. [78]

Indeed, the OECD Model Treaty contains a similar clause, denying the benefits of a Convention when the tax in the third jurisdiction where the permanent establishment is located is less than the lower of a rate to be determined bilaterally and 60% of the tax that would be imposed by the residence State. The domestic law of the source State will then remain applicable to the income from sources within that State. [79]

[75] No 49, p. 75.

[76] Art. 10.3.

[77] Art. 5.5.

[78] Art. 10.5.

[79] OECD Model Treaty, Art. 29, Entitlement to Benefits, sub 8.

The Multilateral Agreement has deleted the reference to a tax rate determined bilaterally in order to avoid the need for bilateral negotiations. (80)

Belgium has opted out of Article 8. As Belgium is a high tax country, this provision would apply to the detriment of its enterprises.

E. Article 11: Application of Tax Agreements to Restrict a Party's Right to Tax its own Residents

A saving clause "saves" the right of a Contracting State to tax its residents (and, in the case of the United States, its nationals) without regard to the Convention. The Residence State may, *e.g.*, tax its residents even though a distributive rule reserves exclusive taxation to the Source State. (81) The residents of the other Contracting State are the only ones to draw benefits from the treaty.

The MLI extends this rule as Action 6 of BEPS had done by adding a paragraph 3 to Article 1 of the Model Convention, applying only to residents, not to nationals. The provision aims, *e.g.*, at permitting the application of Controlled Foreign Corporation rules under which residence jurisdiction taxes its residents on income earned by a subsidiary located in the other contracting jurisdiction.

There are exceptions to the right of the Residence State to disregard the treaty vis-à-vis its residents. The most important one is Article 23 A and B which provide for an exemption or credit with respect to income which the other Contracting Jurisdiction may tax in accordance with the Covered Tax Agreement, including profits of permanent establishments. (82)

Income which may be taxed in the other jurisdiction is deemed to have its source in that jurisdiction even if under the local law of the State of residence it has its source in the latter ("re-sourcing rule").

The tax imposed on the basis of the saving clause is generally considered "secondary" to the tax imposed by the other State with the consequence that a credit or exemption must be granted in the State of residence.

[80] EM, 143.

[81] E. Reimer and A. Rust (eds), *Klaus Vogel on Double Taxation Conventions*, 5th ed., Alphen aan den Rijn, Wolters Kluwer, 2022, Art. 1/74, p. 140.

[82] Art. 11, d).

Other exceptions are listed as well in the MLI as in the OECD Commentary of Article 1.3.

The saving clause may not affect a variety of benefits: (83)

- the granting of a correlative adjustment following an initial adjustment in the source Jurisdiction on the profits of a permanent establishment or on the profits of an associated enterprise; (84)
- the taxation of an individual who performs services rendered to the source Jurisdiction or a political subdivision or local authority thereof; (85)
- the taxation of students, business apprentices or trainees or of teachers or researchers; (86)
- the protection against discriminatory taxation, (87) *e.g.*, a discrimination based on nationality;
- the provision allowing residents to request access to the competent authority or either Jurisdiction when considering a case taxation not in accordance with the Covered Tax Agreement; (88)
- the taxation of diplomats and the like; (89)
- the provision reserving the taxation of social security payments to the residence Jurisdiction; (90)
- the taxation of pensions, annuities, alimony and maintenance payments when reserved to the source Jurisdictions; (91)
- provisions otherwise limiting the right of a residence Jurisdiction to tax its residents or reserving the taxation of an item of income to the source Jurisdiction.

Belgium has adopted article 11 in spite of is previous reluctance.

The Saving Clause of the MLI applies in the absence of such clause or in its replacement. (92)

(83) References are to Art. 11.1 of the MLI and to the OECD Model Tax Treaty and its Commentary of Art. 1 at 19.

(84) Art. 11.1, a); Art. 7.2 and Art. 9.2.

(85) Art. 11.1, b); Art. 19.

(86) Art. 11.1, c); Art. 20 applying only to students or trainees.

(87) Art. 11.1, e); Art. 24.

(88) Art. 11.1, f); Art. 25

(89) Art. 11.1, g); Art. 28.

(90) Art. 11.1, h); Comm. Art. 1 at 20 when provided.

(91) Art. 11.1, i); Comm. Art. 1 at 20 for examples.

(92) Art. 11.2.

A Party may opt out of Article 11 in its entirety or in respect of Covered Tax Agreements which already include a saving clause.(93)

IV. AVOIDANCE OF PERMANENT ESTABLISHMENT STATUS

A. Article 12: Artificial Avoidance of Permanent Establishment Status through *Commissionnaire* Arrangements and Similar Strategies

Commissionnaire arrangements refer to situations where a person sells products in a State not in its own name but on behalf of a foreign – often an affiliated – company which is the owner of the products. The commissionnaire cannot be taxed on the profit derived from the sale as he is not the owner of the product which is sold. He will only be taxed on his commission, which is generally lower than the profit of a reseller. The situation was exemplified in a case where a UK company replaced the distribution agreement of its French affiliate by a commissionnaire contract, reducing substantially the profit made in France.

The OECD Model Convention stated that an agent – other than an independent one – would only constitute a PE if he had the authority to conclude contracts on behalf of the enterprise and habitually exercised it.(94)

The modified text proposed by the Action 7 Report(95) and introduced in Article 5.5 of the OECD Model and the MLI labels as a PE a person acting on behalf of an enterprise and either habitually concluding contracts or habitually playing the principal role leading to the conclusion of contracts routinely concluded without modifications by the enterprise when those contracts are:

– in the name of the enterprise;
– or for the transfer of the ownership or the granting of the right to use property owned by the enterprise or that the enterprise has the right to use;

(93) Art. 11.4.
(94) Art. 5.5.
(95) 2015 Action 7 Final Report, Preventing the Artificial Avoidance of Permanent Establishments, pp. 15-27.

– or for the provision of services by that enterprise, except if those activities would not create a fixed place of business because they are listed as exceptions to the concept of PE. (96)

Examples

A person, for example, solicits orders which are sent directly from a warehouse and are routinely approved by the enterprise. It will not be the case when the representative of a pharmaceutical enterprise promotes drugs with doctors who then prescribe them. It will be the case if employees of a local subsidiary visit large organizations, persuade them to purchase products, indicate the price according to the quantity ordered and propose a contract which is sent online to the parent.

A distributor, as opposed to an agent, does not act on behalf of the enterprise but purchases and resells in his own name.

The PE assimilation will not apply to an independent agent acting in the ordinary course of business. However, a person acting exclusively or almost exclusively on behalf of one enterprise to which it is closely related shall not be considered as an independent agent. (97)

Even if an agent provides information to his principal, he remains independent if the principal exercises no control on his activity.

A distributor acting for several firms but acting as an agent for a related company is not acting in the ordinary course of business in respect of the latter activity.

The assimilation to a permanent establishment will apply in place of the provision equating persons other than independent agents to permanent establishments if they have and habitually exercise the authority to conclude contracts on behalf of the enterprise.

The limited exception for independent agents will apply in place of the provision excluding an independent agent from permanent establishment status.

A party may opt out of Article 12 entirely.

Belgium has withdrawn its reservations to the provision.

(96) Art. 12.1.
(97) Art. 12.2.

B. Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions

Under the OECD Model Convention as it stood, specific activities are excluded from the definition of PE:

a) storage, display or delivery;

b) maintenance of a stock for storage, display or delivery;

c) maintenance of a stock of goods for processing by another enterprise;

d) purchasing or collecting information;

e) other activities of a preparatory or auxiliary character;

f) the combination of the preceding activities provided that the overall activity is of a preparatory or auxiliary character.

Some States consider that all those activities should be excepted only if they are preparatory or auxiliary.

Examples

1) A large warehouse maintained with a significant member of employees to store and deliver goods sold online does not exercise a preparatory or auxiliary activity.

2) The activity of a warehouse maintained for the delivery of spare parts to customers which have purchased machinery qualifies as auxiliary. It would not if the spare parts are also used for maintenance and repairs of the machinery.

3) A purchasing office staffed with competent employees who purchase under different types of contracts (spot of forward) various agricultural products for sale to distributors is a PE.

4) A management office exercising supervisory and coordinating functions on various subsidiaries, PEs and agents of the enterprise is a PE.

Other States consider that activities listed under a) to d) are *per se* preparatory or auxiliary and that the only worry is that a concern creates several companies to exercise related activities (“fragmentation”). [98]

[98] “Preventing the Artificial Avoidance of Permanent Establishment”, Final Report, 2015, Action 7, No 13, p. 28.

Two options are, therefore, provided for in the MLI:

Option A

The activities listed specifically in the Covered Tax Agreement and any other activity or combination of the activities listed and/or of other activities are excepted from the definition of PE only if its activity or the overall activity is of a preparatory or auxiliary character.[99]

Option B

The existing provision is maintained. Specific activities listed in a) to d) are deemed not to give rise to a permanent establishment whether or not they are preparatory or auxiliary.[100]

In both cases, an anti-fragmentation rule provides that the exception shall not apply if the enterprise or a closely-related enterprise carries on business in the same Jurisdiction and the place of business, whether it is the same or a different one, constitutes a PE and the overall activity resulting from the combination of activities is not preparatory or auxiliary, provided that the activities constitute complementary functions that are part of a cohesive business operation.[101]

A party may opt out of the clause entirely, opt out of option A if the Covered Tax Agreement provides for the exclusion of specific activities only if they are preparatory or auxiliary or of the provision in option B on the combination of complementary functions into a cohesive operation.[102]

Belgium has elected option B.

C. Article 14: Splitting-up of Contracts

Although the PPT would address this concern, the abuse consisting in splitting-up contracts between different enterprises of a same group in order to by-pass the time limit, generally 12 months, under which a project constitutes a PE is also addressed in a specific provision.[103]

[99] Art. 13.2.

[100] Art. 13.3.

[101] Art. 13.4.

[102] Art. 13.6.

[103] “Preventing the Artificial Avoidance of Permanent Establishment Status”, Final Report, 2015, Action A, p. 16.

For the computation of the 12-month period, connected activities exceeding 30 days carried out at a building site or at a construction or installation project or consisting in supervisory or consultancy activities referred to in the Covered Tax Agreement shall be added to the period of activity of the enterprise when they are carried out by the enterprise or closely-related enterprises.[104]

The provision shall apply in the absence or in place of provisions of a Covered Tax Agreement addressing the division of contracts in order to frustrate the determination of a time period or of time periods in relation to specific activities listed in Article 14.[105]

A Party may opt out entirely from the provision or opt out only for provisions relating to the exploration or exploitation of national resources, which are frequently carefully negotiated.[106]

Belgium has not adopted Article 14.

D. Article 15: Definition of a Person Closely Related to an Enterprise

For the purpose of provisions of this Part of the Multilateral Agreement relating to the artificial avoidance of permanent establishment status,[107] a person is defined as closely related to an enterprise in the event of control of one on the other or of control of both by the same person or enterprise.

In any case, the possession of 50% of the beneficial interest (or, in the case of a company more than 50% of voting power and value of shares or equity interest) will be deemed to give control.[108]

Parties may opt out of this provision if they have made reservations in respect of the operative provisions concerned.[109]

[104] Art. 14.1.
[105] Art. 14.2.
[106] Art. 14.3; EM 186.
[107] Art. 12.2, 13.4 and 14.1.
[108] Art. 15.1.
[109] Art. 15.2; EM 190.

V. IMPROVING DISPUTE RESOLUTION

A. Article 16: Mutual Agreement Procedure (MAP)

Action 14 of the BEPS Action Plan invited the drafters to address obstacles preventing countries from solving treaty-related disputes under MAP, including the absence or denial of arbitration.

The BEPS recommendations included a minimum standard, calling on countries to include Article 25 of the OECD Model Treaty relating to MAP in their tax treaties, even when the disagreement between taxpayer and tax authority bears on the conditions for the application of a treaty anti-abuse provision or on whether the application of a domestic anti-abuse provision conflicts with a treaty.[110] A timely resolution – 24 months – should be the outcome of the MAP[111]. The effectiveness of the MAP should be improved.[112] Compliance with the minimum standards should be subject to a peer review[113] in the Forum of Tax Administration (FTA) securing a monitoring process based on Terms of Reference reflecting the minimum standard and an Assessment Methodology to be developed by the OECD Committee for Fiscal Affairs.[114]

Guidelines should be published informing taxpayers about access to and use of MAP. The MAP staff should have the power to resolve MAP cases independently. It should be provided with adequate resources.[115]

The relationship between MAP and local audit settlement should be made clear to treaty partners. Audit settlement should not preclude access to MAP. If a dispute resolution process exists, independent of the audit, access to MAP may exclude matters resolved through that process.[116]

A number of changes to the OECD Model Treaty Commentary were recommended in order to secure that taxpayers meeting the requirements of a MAP process have effectively access to it. These changes were mostly inserted in the 2017 version of Article 2.5 and other articles of the Model Treaty and its Commentary.[117]

[110] "Making Dispute Resolution Mechanisms More Effective", Final Report, 2015, Action 11, p. 6.

[111] *Ibid*., 1.3, pp. 15 and 16.

[112] *Ibid*., 1.4, p. 16.

[113] *Ibid*., 1.6, p. 37.

[114] *Ibid*., 1.6, p. 38 and Annex A, p. 43.

[115] *Ibid*., 2.1 to 2.5, pp. 18-19.

[116] *Ibid*., 2.6, p. 19.

[117] *Ibid*., 3.1 to 3.3, pp. 21-27.

The request for MAP could be directed to the competent authority of either State.(118) The Report also identifies several “best practices” which are not part of the minimum standard. Where they call for amendments to the OECD Model Treaty Commentary, changes were made in 2017.

Article 16 of the MLI first reproduces paragraphs 1 to 3 of Article 25 of the OECD Model Treaty, as modified following the Action 14 BEPS Report, with some terminological changes.

MAP is available when a person considers that the actions of a Contracting State result for him in taxation not in accordance with the Convention. It is available irrespective of domestic remedies. The request may be presented to either of the two competent authorities. It must be presented within three years from the first notification of the controverted action.(119)

Those provisions shall apply in place or in the absence of similar provisions in the Covered Tax Agreements.(120)

Various compatibility clauses are inserted in Article 16.5.

The Parties to the MLI may reserve the right not to apply those provisions of paragraph 1 to their Covered Tax Agreements if they intend to meet the minimum standard by reaching the same result under each of their Covered Tax Agreements other than those permitting the taxpayer to present his case to either competent authority:(121) the taxpayer will have to present his case to the competent authority of the State of which he is a resident or a national, as the text stood before the 2017 modifications.(122)

The Parties may reserve the right to omit the time-limit language for presentation of the claim if they intend to meet the minimum standard by ensuring that the claim may be presented within at least three years of the notification of the controversial action.(123)

The competent authority shall endeavor to resolve the case by mutual agreement with its counterpart. However, it will do so only if the objection appears to it to be justified. It may also solve the case unilaterally.(124)

(118) “Making Dispute Resolution Mechanisms More Effective”, Final Report, 2015, Action 11, 3.1, p. 22.

(119) Art. 16.1.

(120) Art. 16.4.

(121) Art. 5, a).

(122) EM, No 196, p. 49.

(123) Art. 5, b).

(124) Art. 16.2, first sentence.

The agreement reached shall be implemented notwithstanding any domestic time limits(125).

The Parties may reserve the right not to apply the time limit provision in its Covered Tax Agreements if the same result is reached otherwise. (126)

They also reserve the same right if they intend to implement the minimum standard by another treaty provision under which no adjustment would be made to the profits of a permanent establishment or to profits transferred to an associated enterprise after a period mutually agreed, except in the case of fraud, gross negligence or willful default. (127)

The competent authorities shall also endeavor to resolve questions on the interpretation or application of a Covered Tax Agreement. (128)

The competent authorities may consult together for the elimination of double taxation in cases not provided for in the Covered Tax Agreement. (129)

In the event of reservations, appropriate notifications shall be made to the Depositary of the Convention. (130)

B. Article 17: Corresponding Adjustments

After a transfer pricing primary adjustment, in which one of the Contracting Jurisdictions is recognized as having the right to tax profits which have been taxed in the other one, the latter shall make an appropriate secondary adjustment of the tax charged on such profits. (131)

The provision of Article 17.1 shall apply in the absence or in place of a provision requiring appropriate adjustments after a transfer pricing taxation in the other Contracting Jurisdiction. (132)

A party may opt out entirely if such a provision is already included in the Covered Tax Agreement. (133)

(125) Art. 16.2, second sentence.
(126) Art. 16.5, c), (i).
(127) Art. 16. 5, c), (ii).
(128) Art. 16.3.
(129) Art. 16.3.
(130) Art. 16.6.
(131) Art. 17.1.
(132) Art. 17.2.
(133) Art. 17.3, a).

It may also opt out if, in the absence of such a provision, it will make the appropriate adjustment or its competent authority shall endeavor to resolve the case under MAP.(134) It would not be sufficient to provide that the competent authorities may consult together or that a Contracting Jurisdiction may make an adjustment.(135)

If parties have provided that an adjustment shall not be made on the profits of a permanent establishment or of an associated enterprise after a period to be agreed from the end of the taxable year of accrual of the profits (except if in the case of fraud, given negligence or willful default), opting out is possible.(136)

VI. ARTICLES 18 TO 26: ARBITRATION

A. Principle and time period after which mandatory binding arbitration may be requested

1) Principle

Parties to the Multilateral Convention may elect(137) to enter into Mandatory Binding Arbitration if the competent authorities acting under MAP are unable to reach an agreement within a period of two years starting on one of two dates(138) which depend on the course of the procedure (see hereunder, 4).

The unresolved issues must be submitted to arbitration if the person concerned requests it in writing.

(134) Art. 17.3, b).

(135) EM, 213.

(136) Art. 17.3, c).

(137) Art. 18 ; N. Bravo, "Mandatory Binding Arbitration in the BEPS Multilateral Instrument", *Intertax*, 2019, vol. 47, p. 693; J. Owens, "Mandatory Tax Arbitration: The Next Frontier Issue", *Intertax*, 2018, vol. 46, p. 610; H.M. Pit, "Arbitration under the OECD Multilateral Instrument Reservations, Options and Choices", *Bull. Int'l Taxation*, 2017, vol. 71, nr. 10; G. Groen, "The Nature and Scope of the Mandatory Arbitration Provision in the OECD Multilateral Convention 2016", *Bull. Int'l Taxation*, 2017, vol. 71, nr. 11; S. Govind and L. Turcan, "The Changing Contours of Dispute Resolution in the International Tax World: Comparing the OECD Multilateral Instrument and the Proposed EU Arbitration Directive", *Bull. Int'l Taxation*, 2017, vol. 71, nr. 3-4.

(138) Art. 19.1 ; N. Bravo, "Mandatory Binding Arbitration in the BEPS Multilateral Instrument", *Intertax*, 2019, vol. 47, p. 693; J. Owens, "Mandatory Tax Arbitration: The Next Frontier Issue", Intertax, 2018, vol. 46, p. 610; H.M. Pit, "Arbitration under the OECD Multilateral Instrument Reservations, Options and Choices", *Bull. Int'l Taxation*, 2017, vol. 71, nr. 10; G. Groen, "The Nature and Scope of the Mandatory Arbitration Provision in the OECD Multilateral Convention 2016", *Bull. Int'l Taxation*, 2017, vol. 71, nr. 11; S. Govind and L. Turcan, "The Changing Contours of Dispute Resolution in the International Tax World: Comparing the OECD Multilateral Instrument and the Proposed EU Arbitration Directive", *Bull. Int'l Taxation*, 2017, vol. 71, nr. 3-4.

2) Suspension and extension of the two (or more)-year period before the start of arbitration

This period of two or more years stops running if a competent authority suspends MAP because the same issue is pending before a Court or an administrative tribunal. The suspension will last until a final decision is rendered by the judicial or administrative instance or if the case has been suspended or withdrawn.

Also, if a person and the competent authority have agreed to suspend MAP, the period stops running until the suspension is lifted.[139]

If both competent authorities agree that a person affected by the case has failed to provide additional material information in a timely manner after the start of the period, the period is extended by an amount of time equal to the period elapsed between the request of the information and the date on which it is provided.[140]

3) Procedure upon start of arbitration

The competent authority which received the initial MAP request notifies it to the other competent authority within two months.[141]

Within three months of receipt of the request, a competent authority shall either notify the person and the other competent authority that it has received the information necessary or request additional information.[142]

If additional information has been requested, the competent authority shall, within three months of receipt of the information notify the person and the other competent authority that the information was received or that some is missing.[143]

4) Influence of the procedure on the start date to complete arbitration

If no competent authority has requested additional information after receiving the request for a MAP, the start date shall be the earlier of the date on which both competent authorities have notified the person who

[139] Art. 19.2.
[140] Art. 19.3.
[141] Art. 19.5.
[142] Art. 19.6.
[143] Art. 19.7.

has presented the case that they have received the information necessary or three months after the competent authority which has received the request has notified it to the other competent authority.

If additional information is requested, the start date shall be the date on which both competent authorities have notified the person that they have received the additional information or three months after both competent authorities have received all information requested by either one.

5) Settlement of the mode of application of the arbitration

The competent authorities shall then, by mutual agreement, and according to the MAP procedure, settle the mode of application of the provisions relating to arbitration, including the minimum information necessary.

Such agreement must be concluded before the date on which unresolved issues are eligible for submission to arbitration and may be modified thereafter.(144)

It is expected that a model competent authority agreement will be produced.(145)

6) Reservation on time period after which arbitration may be requested

In any event, a Party may reserve the right to replace the two-year period by a three-year period.(146)

7) Reservations as to the principle of arbitration

A Party may reserve the right not to submit an unresolved issue to arbitration if a decision on the issue has already been rendered by a court or administrative tribunal.

A reservation may also be made to the effect that, if such a decision is rendered after a request for arbitration and before the decision of the arbitration panel, the arbitration process shall terminate.(147)

(144) Art. 19.10.
(145) EM No 203, p. 58.
(146) Art. 19.11.
(147) Art. 19.12.

Indeed, in some jurisdictions, a MAP cannot override a judicial or administrative decision. This reservation avoids possible conflict.(148)

8) Implementation of the arbitration decision

The arbitration decision shall be implemented through MAP and shall be final and binding on both Contracting Jurisdictions.

However, it shall not be binding on those Jurisdictions in three cases: 1°. A person directly affected by the case does not accept the mutual agreement implementing the decision; 2°. A final court decision in one of the Contracting Jurisdictions holds the arbitration decision as invalid; 3°. A person directly affected by the case pursues litigation on the issues resolved.

The acceptance of MAP implementing the arbitration decision implies that any person directly affected by the case shall withdraw all issues resolved by MAP from consideration by a Court or administrative tribunal or otherwise terminate such proceedings.

In the second case, a new request for arbitration may be made, except if the competent authorities agree that a new request should not be permitted. The Arbitration process shall be considered not to have taken place.(149)

The third exception to the binding character of arbitration aims at avoiding that, in the case of concurrence of court and arbitration proceedings, it be asserted that the court decision binds one Contracting Jurisdiction and the arbitration decision the other one.(150)

B. Article 20: Appointment of arbitrators

The arbitration panel consists of three individual members with expertise or experience in international tax matters. They must be impartial and independent. The Chair shall not be a national or resident of either Contracting Jurisdiction.

[148] EM, No 231, p. 59.
[149] Art. 19.4.
[150] EM, 224, p. 57.

Each competent authority appoints one member within 60 days of the date of the request for arbitration. The two appointed members appoint a Chair within 60 days of the last appointment.

In the event of failure to appoint, the appointment shall be made by the highest-ranking official of the Center for Tax Policy and Administration of OECD who is not a national of either Contracting Jurisdiction. (151)

C. Article 21: Confidentiality

For purposes of the application of the arbitration part of the Multilateral Convention and of the domestic laws of the Contracting Jurisdictions, panel members and a maximum of three staff per member shall be considered as persons or authorities to whom information may be disclosed. Information received shall be considered as information exchanged pursuant to the exchange-of-information clause of the Covered Tax Agreement.

Panel members and staff have to agree to confidentiality as described in the Covered Tax Agreement. (152)

D. Article 22: Resolution of a case during the procedure

If the competent authorities reach an agreement before the decision of the arbitration panel or if the initiator of the request withdraws it, MAP and the arbitration process shall terminate. (153)

E. Article 23: Type of arbitration process

The following rules shall apply to the arbitration unless there exists another agreement.

1) Final offer procedure – Resolutions proposed by competent authorities

Each competent authority shall submit to the arbitration panel, by a date set by agreement, a proposed resolution on all unresolved issues

[151] Art. 20.
[152] Art. 21.
[153] Art. 22.

limited to specific monetary amounts or a maximum rate of tax for each adjustment.

If there is no agreement between the competent authorities on a "threshold question" regarding the conditions for application of a provision of the Covered Tax Agreement, such as residence or the existence of a permanent establishment, alternate resolutions may be proposed. (154)

The competent authorities may also submit supporting papers.

The arbitration panel shall select as its decision one of the proposed resolutions on each issue and threshold question, without any rationale or explanation. (155)

This expeditious procedure corresponds to the "final offer", "last best offer" or "baseball arbitration." (156)

2) Independent opinion procedure – reservations and application of other rules

A Party may reserve the right not to apply the "final offer" procedure. Then, except when there is another agreement, the following rules shall apply under an approach known as the "independent opinion" approach. (157)

The competent authorities shall provide all necessary information to the panel members. The panel shall decide the issues in accordance with the Covered Tax Agreement and, subject to the provisions of this Agreement, those of the domestic laws of the Contracting Jurisdictions, as well as any other sources which the competent authorities identify by mutual agreement. (158)

3) Disagreement as to procedure

If one Party has not made a reservation as to the expeditious procedure and the other one has, the competent authorities shall endeavour to reach agreement on the type of arbitration to apply.

[154] Art. 23, a) and b).

[155] Art. 23, c).

[156] EM, No 242, p. 61.

[157] EM, No 245, p. 62.

[158] Art. 23.2.

Until such agreement, Mandatory Binding Arbitration provisions shall not apply.(159)

4) Reservation on non-disclosure

A Party may choose to apply a non-disclosure rule: the competent authorities ensure that each person presenting the case and its advisors agree not to disclose information received from a competent authority or the panel. If this agreement is breached before the decision of the panel, the arbitration process terminates.(160)

F. Article 24: Reservation on agreement on a different resolution

A Party may reserve the right to elect that the arbitration decision will not be binding if the competent authorities agree on a different resolution on all unresolved issues within three months of delivery of the arbitration decision. This rule will apply only if both Contracting Jurisdictions have notified this reservation to the Depositary.(161) The reservation may be limited to the "independent opinion" type of arbitration process.(162)

G. Article 28: Reservation as to scope

A Party having chosen Arbitration may formulate reservations as to the type of cases eligible for arbitration. Such a reservation must be accepted by the other Parties. Failing acceptance, the arbitration provisions shall not apply.(163)

Belgium has accepted the arbitration provision.

[159] Art. 23.3.
[160] Art. 23.4 and 5.
[161] Art. 24.1 and 2.
[162] Art. 24.3 referring to Art. 23.2.
[163] Art. 28.2.

CONCLUSION

The MLI provides a balance between minimum standards and flexibility. It aims to achieve a large participation.

A country must decide, first, whether it will take part in the MLI – most OECD countries with the exception of the US; second, which rules of the instrument it wishes to apply – there are many options; and third, it must contact all countries with which it has a bilateral treaty to see which rules they would be willing to accept.

The European Union adopted hastily an anti-tax avoidance directive (12 July 2016) in order to avoid that the BEPS action plan be implemented in a different way in the various EU countries. The result is the adoption of several BEPS recommendations which are not compulsory, such as the limitation on deductible interest, CFC rules and a general anti-abuse clause – similar, however, to the MLI clause. It would have been wise to organize coordination between Member States as to which of the MLI options they would elect. Brexit creates a huge gap insofar as the treaties with the United Kingdom are concerned.

Much was expected by way of solutions to tax disputes, the number of which may be increased by implementation of the BEPS actions. The Multilateral Treaty brings few novel elements to the field. The MAP Procedure is patterned along traditional OECD practice. An arbitration clause was inserted in the OECD Model Treaty in 2008. A "Manual on Effective Mutual Agreement Procedures" (MCMAP) has been developed by the organization. Arbitration clauses had been inserted in several treaties [164] although a few elect the jurisdiction of an international body: the European Court of Justice in the treaty between Austria and Germany, the International Court of Justice in the treaty between Sweden and Germany. [165]

The arbitration clause included in the Multilateral Convention rests mostly on OECD precedent. It provides for arbitration between States, no role for the taxpayer, delays which correspond to it administrative traditions but not to business needs and which ignore the brevity of human life.

[164] C. del Campo, "General Report", International Fiscal Association, 2016, Madrid Congress, *Cah. dr. fisc. Intern.*, Vol. 101A, *Dispute resolution procedures in International tax matters*, p. 59.

[165] E. Reimer and A. Rust (eds), *Klaus Vogel on Double Taxation Conventions*, 4th ed., Alphen aan den Rijn, Wolters Kluwer, 2015, Art. 25, espec. p. 1819; F. Serrano Antón, "El Arbitraje Tributario en el Derecho Internacional Tributario: su Desarrollo en el Marco del Procedimiento Amistoso", in H. Taveira Torres (coord.), *Direito Tributário Internacional Aplicado*, Vol. VI, São Paulo, Quartier Latin, 2012, p. 127.

Such delays are of general concern and efforts have been made in commercial arbitration to shorten them.(166) The International Chamber of Commerce created a special commission which published a brochure on "Techniques for Controlling Time and Costs in Arbitration"(167) and addressed the concern in its modified arbitration rules, providing for the possibility given to the Arbitral Tribunal to shorten the – very reasonable – time allowed by the Rules at various steps of the procedure.(168)

[166] B. Hanotiau, "Mieux maîtriser le temps, réduire les coûts dans l'arbitrage international", in *Liber amicorum Guy Keutgen*, Brussels, Bruylant, 2008, p. 377.

[167] ICC Publication No 861-1, ENG.

[168] Art. 38.